STATE OF COMMUNITY BANKING: IS THE CURRENT REGULATORY ENVIRONMENT ADVERSELY AFFECTING COMMUNITY FINANCIAL INSTITUTIONS?

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

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Wednesday, March 20, 2013

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STATE OF COMMUNITY BANKING: IS THE CURRENT REGULATORY ENVIRONMENT ADVERSELY AFFECTING COMMUNITY FINANCIAL INSTITUTIONS?

Wednesday, March 20, 2013

U.S. House of Representatives,
Subcommittee on Financial Institutions
and Consumer Credit,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Miller, McHenry, Campbell, Pearce, Posey, Fitzpatrick, Westmoreland, Luetkemeyer, Duffy, Stutzman, Pittenger, Barr, Cotton; Meeks, Maloney, Watt, McCarthy of New York, Green, Capuano, Murphy, Delaney, and Heck.

Ex officio present: Representative Hensarling.

Chairwoman Capito. The subcommittee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time. Also, without objection, members of the full Financial Services Committee who are not members of the subcommittee will be allowed to sit on the dais and participate in today's hearing. Without objection, it is so ordered.

This morning's hearing is the first hearing for the Financial Institutions and Consumer Credit Subcommittee in this Congress. I would like to welcome our new members to the subcommittee, as well as the new ranking member, Mr. Meeks. I think we will work very well together.

As chairman, I intend to highlight the many challenges being faced by our community financial institutions and the communities they serve across the country. This should not be a partisan issue. It is my goal to work with the ranking member to identify areas of agreement for fostering a regulatory environment for community financial institutions that promote economic growth and access to a wide range of consumer credit products.

The focus of this hearing—I forgot to yield myself 3 minutes. So, the focus of this morning's hearing is on three important studies on the state of community banking. Two of the studies were products of legislation that Mr. Westmoreland of Georgia authored last Congress.

As many of my colleagues know, the State of Georgia led the Nation in the number of bank failures between 2008 and 2011. Mr. Westmoreland and Mr. Scott, also from Georgia, have been tireless advocates for the struggling financial institutions and their districts in the State of Georgia and the communities that have been adversely affected.

At the behest of Congress, the Inspectors General of the FDIC and the GAO conducted studies on the FDIC's handling of the failed community banks and lessons from community bank failures. This subcommittee first began examining these issues at a field hearing in Mr. Westmoreland's district in Newnan, Georgia, in August of 2011. And I look forward to learning more about the progress being made by the regulatory agencies to mitigate the adverse effect of community bank failures on local communities.

The third study to be discussed this morning is a study that is a thoughtful contribution to the discussion that we began in the last Congress on the importance of community financial institutions and how the current regulatory environment affects the viability of community financial institutions and their role—and their model. We heard countless anecdotal stories last Congress from community bankers expressing despair and frustration about the future prospects for a vibrant and diverse financial services system that features community banks.

The FDIC study highlights many areas that demonstrate the importance of community banks to the U.S. banking system. The study points out that in many rural areas, such as the one I represent, local community banks are the only source of banking services for members of the community.

Although larger institutions may choose to enter these markets, they will not maintain the same level of personal service and understanding that the community—the local community banks can offer. This element of relationship banking is critical in rural communities like those I represent in West Virginia. Lenders not only know their customers, but they know their extended families and the businesses they operate in these communities.

It is this level of understanding that allows the lender to sit down with the borrower and develop alternative financial strategies when economic downturns occur, or if there is a life-changing event that might impact the borrower in some way. Rural communities will not be well-served if the current regulatory environment forces lenders to move away from relationship banking and make decisions on a one-size-fits-all form of regulation and compliance.

The FDIC study also attempts to quantify the growing burden of complying with the myriad of financial regulations for community institutions. I think we found in the study it is difficult to quantify. In January of 2001, just 6 months after Dodd-Frank, we learned from a community banker in West Virginia that they have already had to hire an additional primary compliance officer.

I understand that it is a difficult figure to quantify, but we must keep up the discussion amongst policymakers, regulators, and community bankers about ways to reduce this growing burden. We need to have safely run financial institutions in our local communities. But we must ensure that any cost of compliance does not outweigh the benefits and the regulations emanating from Washington.

I would like to thank our witnesses for being here this morning to update the subcommittee on these important studies, and at this time I would like to recognize the ranking member, Mr. Meeks, for 3 minutes for the purpose of giving an opening statement.

Mr. MEEKS. Thank you, Madam Chairwoman, for holding this hearing today. And as you have indicated, this is the first hearing of the Subcommittee on Financial Institutions and Consumer Credit during the 113th Congress.

I want to express how pleased I am to be working with the chairwoman on this subcommittee. I know that we will find areas of cooperation, and I look forward to collaborating with the Chair on many areas of common interest, including regulatory relief for smaller banks and credit unions and mobile payment services, and the associated electronic payments field and many other consumer protection issues. And I know that we are going to be working very closely together.

While it is not explicitly the topic of today's hearing, but since this is our first hearing of the subcommittee, I want to state now that I am concerned about the impact that Basel III can have on community banks. Previous iterations of Basel have excluded smaller institutions from their capital requirements, which are better designed to address the risk portfolios of larger financial institutions. And of course, smaller institutions must have adequate capital for their activities. But it appears that Basel III takes a one-size-fits-all approach.

I am concerned that Basel III is too complicated and does not offer the appropriate risk ratings to different classes of assets. For example, it would apply a discount to any asset that isn't sovereign debt in the U.S. Treasuries or cash.

This means a bank that specializes in mortgages, for example, may have to hold a lot more capital against those mortgages to satisfy minimum capital requirements. However, I would think that we learn to start to make sure capital requirements don't stifle small banks in even medium-sized or regional banks institutions that don't engage in the exotic activities that some of the larger institutions do.

As we learned in the FDIC's Community Banking Study, smaller and regional institutions are the engines of economic growth in this country because they lend to their neighbors in their communities to keep their farms or their small businesses going, or to hire employees. In fact, the study noted that though community banks hold only 14 percent of the banking industry's assets, they make 46 percent of the smaller denomination loans to farms and small businesses.

Along with credit unions, they are often the sole source for mortgage financing and therefore the lifeline of the housing industry in our communities. It was not their activity that blew up the global banking system. And I think the capital requirements we place on banks should recognize that. I want to work with the chairwoman on that issue.

A concern that I often hear from my community banks is the lack of certainty. And much of this arises from the timing of rules on which the argument about uncertainty has credence. I would hope that we would make sure that we start and do not cut off funding for regulators, including the SEC, the CFTC, and the CFPB, all of which creates additional regulatory uncertainty.

A common complaint I hear from businesses when I am in New York is on the timing of rulemakings. Businesses in the market will adjust to rules and regulations, but they need to know what they are. It is time to fully fund our regulators so they can complete the process of implementing Dodd-Frank and therefore restore confidence to the marketplace.

I look forward to hearing about the other issues that are the focus of this hearing, including what I hope is a robust discussion on the good things that the FDIC is doing in protecting the Deposit Insurance Fund, and therefore taxpayers.

In reviewing the FDIC's programs in preparation for this hearing, I was pleased to learn of some of the efforts the agency has made to engage in mortgage modifications, something I hope the industry proactively addresses further. And I also hope we can explore some of the recommendations of the FDIC Inspector General and how the FDIC is implementing them.

I look forward to the testimony. Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Duffy for 1½ minutes for the purpose of an opening statement.

Mr. DUFFY. Thank you, Chairwoman Capito. I appreciate you calling this very important hearing. And I appreciate the panel for coming in and talking about our community banks and their health, and how we can make sure we have a strong community bank system throughout our country.

Many of us know that our small community banks or credit unions are the lifeblood of economic growth in our small communities across this great country. And it is those very institutions that get capital out to our small businesses which are starting up or that small business or that manufacturer which is going to expand their business and create jobs across the country. They are the institutions in rural America which get dollars out to our families who are going to buy a home or buy a car; and if our community banks are failing, so too are our small communities.

So I am pleased that the OIG and the GAO studies address some of the issues that we have known for quite some time affect our small community banks. Clearly, they face a lot of challenges in this hyper-regulatory environment. And small banks are constantly being forced to deploy resources, money, time, and personnel towards regulatory compliance instead of focusing on their traditional role of lending and serving our customers.

I look forward to your testimony and the conversation we are going to have today about the health of our small financial institutions. I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Westmoreland for 2 minutes.

Mr. WESTMORELAND. Thank you, Madam Chairwoman. I would like to ask for unanimous consent to enter into the record a statement from Representative Tom Graves, and some written questions for the witnesses.

Chairwoman CAPITO. Without objection, it is so ordered.

Mr. WESTMORELAND. I want to thank the chairwoman for having this hearing. This hearing is especially important to me because I and others worked hard to authorize it last Congress.

I read the studies with interest, but unfortunately they seemed to raise more questions than answers. I think the biggest thing to come from these studies is finally an admission that what my Georgia banks have been saying is true, that acquiring banks will maximize their expiring loss share agreements for commercial assets.

Unfortunately, the studies show the FDIC has no plan for dealing with the potential new bubble in the commercial real estate market. I am hearing from acquiring banks that they really don't know what to do with their expiring loss share agreements. I am also hearing stories from borrowers in Georgia whose acquiring bank will not negotiate reasonable modification terms.

This is a special concern since the studies also noted examiners' ongoing failure to follow the spirit of the 2009 guidance on commercial loan modifications. And as if these problems were not enough, the GAO study recognized that bank examiners negatively classify a collateral-dependent loan simply because the value of the collateral has declined.

Further, there are serious problems in the way appraisals are handled by examiners and the application of impairment accounting standards in the examination process. The IG found examiners do not properly document appraisals or evaluation for the best use of the underlying collateral. To me, this is code for examiners to be able to do what they want in terms of valuing collateral, but not having to justify it to the bank or their bosses.

The FDIC IG found examiners do not have the necessary training or background in appraisals, yet are relying on their experience in this field during bank exams. The studies make it very clear that the FDIC, the OCC, and the Federal Reserve have had trouble handling the boom-and-bust cycles over the last 25 years. They are repeating the same patterns over and over, but expecting different results.

And again, I would like to just thank the chairwoman for having this hearing. It is very important to the constituents and the bankers in Georgia.

Chairwoman CAPITO. I am glad you got that last line in.

I would like to recognize Mr. Watt for 1 minute.

Mr. WATT. Thank you, Madam Chairwoman. I want to join the other members of the subcommittee in applauding you and the ranking member for convening this hearing. This is a subject that all of us are hearing about regularly. And I especially want to applaud the composition of this panel, because we hear the community banker side, and I am sure that is an important perspective.

But it is also important to hear the perspective of the regulators and to understand whether what we are hearing from the banks is a regulatory matter or whether it is a matter of legislative significance. When it is our responsibility as legislators, we need to know that. And when we can push the regulators to be more prompt as regulators in promulgating rules, we need to push that.

So, it is especially important and I appreciate the opportunity to express that. I yield back.

Chairwoman CAPITO. Thank you. I would like to recognize Mr. Miller for 1 minute.

Mr. MILLER. Thank you, Madam Chairwoman.

The environment within which the regulators work today should basically encourage innovation and growth rather than to stifle it, but that is not what is happening. The government is acting to help banks. But what they should do is serve their customers. Instead, banks are having an onslaught of new regulations they are having to deal with. We certainly need a well-functioning regulatory system, but it should facilitate growth, not stifle it.

We are starting to see a basic turnaround in the housing market today. But what is stifling that ability to get loans? AD & C loans are just not available to many builders today, especially the smaller builders. Banks are being held back from doing what they want to do. And because of regulations placed upon them, you are seeing a certain group in the marketplace who are just avoiding getting involved.

Representative Carolyn McCarthy and I introduced the Home Construction Lending Regulatory Act today that addresses overzealous regulators. It lets you do your job, lets you make loans to well-qualified builders who have good projects but are being held back today. And it is an issue I think we need to bring up in this committee to basically turn the economy around. And it is an issue I think is important to banks and to builders. I yield back.

Chairwoman CAPITO. The gentleman yields back.

Mr. Fitzpatrick for 1 minute.

Mr. FITZPATRICK. Thank you, Madam Chairwoman. First of all, I want to say I am looking forward to being a part of this subcommittee in the 113th Congress. Among the important responsibilities of the subcommittee is to work with consumer financial institutions to find ways to provide credit for small businesses and families who inject capital into our communities.

In just the first few weeks, this Congressman made a point to meet with representatives from some of the financial institutions that serve my district in Pennsylvania. On a recent conference call with community bankers, I was reminded again about the grinding process and progress of our economy and of the housing market, and how those factors more than any others are dragging our communities down and causing high unemployment in the communities.

And of course, I heard about regulations and financial supervision, which are onerous and burdensome. We all agree that we need oversight and regulation of financial institutions. But the point is to be smart about it and not to stifle economic growth. And this is, of course, why we are here today. So I look forward to the hearing, and I yield back.

Chairwoman CAPITO. The gentleman yields back. I believe that concludes our opening statements. So, I would like to welcome our panel of distinguished witnesses.

My understanding is that Mr. Brown will give the statement from the FDIC, and then Ms. Eberley and Mr. Edwards will be here to answer questions for us. So, I appreciate that. I will introduce all three of you, and then let Mr. Brown make the statement.

Mr. Richard Brown is the Chief Economist and Associate Director of the Division of Insurance and Research for the FDIC. Ms. Eberley is the Director of the Division of Risk Management Supervision, welcome. And Mr. Bret Edwards is the Director of the Division of Resolutions and Receivership. Welcome.

Mr. Brown?

STATEMENT OF RICHARD A. BROWN, CHIEF ECONOMIST, FEDERAL DEPOSIT INSURANCE CORPORATION, ACCOMPANIED BY DOREEN R. EBERLEY, DIRECTOR, DIVISION OF RISK MANAGEMENT SUPERVISION, FEDERAL DEPOSIT INSURANCE CORPORATION, AND BRET D. EDWARDS, DIRECTOR, DIVISION OF RESOLUTIONS AND RECEIVERSHIPS, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. BROWN. Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, I appreciate the opportunity to testify on behalf of the FDIC regarding the FDIC Community Banking Study. This research effort was begun in late 2011 to better understand the changes that have taken place among the community banking sector over the past quarter century. The effort was motivated by our sense of the importance of community banks to small businesses and to local economies in every part of the country, and by our understanding that community banks face some important challenges in the post-crisis financial environment.

Our research confirms the crucial role that community banks play in our financial system. As defined by our study, community banks make up 95 percent of U.S. banking organizations. It has been mentioned that they hold 14 percent of U.S. banking assets, but make 46 percent of small loans to farms and businesses.

While their share of total deposits has declined over time, community banks still hold the majority of bank deposits in rural and other non-metropolitan counties. Without community banks, many rural areas, small towns, and urban neighborhoods would have little or no physical access to mainstream banking services. The study identified 629 counties where the only banking offices are those operated by community banks.

Our study examined the long-term trend of banking industry consolidation that has reduced the number of banks and thrifts by more than half since 1984. But the results cast doubt on the notion that future consolidation will continue at the same pace, or that the community banking model is in any way obsolete.

Since 1984, more than 2,500 institutions have failed, with most of the failures taking place during 2 crisis periods. To the extent that future crises can be avoided or mitigated, bank failures should contribute much less to future consolidation.

About 80 percent of the consolidation that has taken place has resulted from eliminating charters within bank holding companies or from voluntary mergers. And both of those trends were facilitated by the relaxation of geographic restrictions on banking that took place in the 1980s and the early 1990s. The pace of the voluntary consolidation has slowed over the past 15 years as the effects of these one-time changes were realized.

The study also showed that community banks which grew prudently and which maintained either diversified portfolios or otherwise stuck to core lending competencies exhibited relatively strong and stable performance over time, including during the recent crisis. By comparison, institutions which pursued more aggressive growth strategies underperformed.

With regard to measuring the cost of regulatory compliance, the study noted that the financial data collected by regulators does not identify regulatory costs as a distinct category of non-interest expenses. As part of our study, the FDIC conducted interviews with a group of community banks to try to learn more about regulatory costs.

Most of the participants stated that no single regulation or practice had a significant effect on their institution. Instead, most said that the strain on their organization came from the cumulative effects of a number of regulatory requirements that have built up over time.

Several of those interviewed indicated that they have increased staff over the past 10 years to support their responsibilities in the area of regulatory compliance. Still, none of the interview participants said that they actively track the various costs associated with compliance, citing the difficulties associated with breaking out those costs separately.

In summary, despite the challenges of the current operating environment, the study concludes that the community banking sector will remain a viable and vital component of the overall U.S. financial system for the foreseeable future. The FDIC's testimony today also summarizes the congressionally mandated studies by the GAO and the FDIC Office of Inspector General. These studies provided valuable information on the causes of the recent crisis and the FDIC's response.

The Inspector General also made several useful recommendations that are highly relevant to the FDIC's efforts to address the issues arising from the crisis. The FDIC concurs with all of the OIG recommendations, and is now in the process of implementing them.

I am joined today by Doreen Eberley, Director of the FDIC Division of Risk Management Supervision; and Bret Edwards, Director of the Division of Resolutions and Receiverships, who can address your questions about how the FDIC is implementing these recommendations. Thank you for the opportunity to testify, and we look forward to your questions.

[The joint prepared statement of Mr. Brown, Ms. Eberley, and Mr. Edwards can be found on page 62 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Brown.

Our next witness is the Honorable Jon T. Rymer, the Inspector General for the FDIC. Welcome.

STATEMENT OF THE HONORABLE JON T. RYMER, INSPECTOR GENERAL, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. RYMER. Thank you, Madam Chairwoman. Madam Chairwoman, Ranking Member Meeks, and members of the subcommittee, I appreciate your interest in the study conducted by my office as required by Public Law 112–88. I ask that the report entitled, "Comprehensive Study of the Impact of the Failure of Insured Depository Institutions," issued on January 3rd of this year, be made a part of the hearing's official record.

The report may be accessed at the following link:
http://www.fdicoig.gov/reports13%5C13-002EV.pdf

In the wake of the financial crisis of the 1980s, the Congress passed two laws: FIRREA, passed in 1989; and the FDIC Improvement Act, passed in 1991. These laws drove the closure and resolution processes used in the most recent crisis.

Taken together, these laws amended the FDI Act and required, among other things, that: (1) financial institutions maintain minimum capital levels; (2) regulators promptly close critically undercapitalized institutions; and the FDIC resolve banks in the least costly manner. In response, banking regulators issued rules, regulations, and policies that pertained to many of the topics discussed in our report. In my time today, I would like to highlight the two overarching conclusions we reached, and then talk about four specific observations.

The events leading to the financial crisis and the subsequent efforts to resolve it involve the dynamic interplay of laws, regulations, and agency policies and practices with the real estate and financial markets. Banks expanded lending using rapid growth in construction and real estate development.

Many of the banks that failed did so because management relaxed underwriting standards and did not implement adequate oversight and control. For their part, many borrowers did not have the capacity to repay the loan, and sometimes pursued projects without properly considering risk.

During the financial crisis, the regulators generally fulfilled their responsibilities by using risk-based supervision to react to a rapidly changing economic and financial landscape.

Chairwoman CAPITO. Excuse me. Pull the microphone just a little bit closer.

Mr. RYMER. Yes, ma'am.

Chairwoman CAPITO. Our ears are getting old up here.

Mr. RYMER. Yes, ma'am.

That said, however, most material loss reviews conducted by the three banking regulatory IGs found that regulators could have provided earlier and greater supervisory attention to troubled banks and thrifts.

The four specific observations I mentioned earlier are as follows.

First, the FDIC's resolution methods, including the shared loss agreements, were market-driven. Often, failing banks with little or no franchise value and poor asset quality did not attract sufficient interest from qualified bidders for the FDIC to sell the bank without a loss share guarantee. The FDIC used these agreements to leave failed bank assets in the banking sector, thereby supporting asset value and reducing losses to the Deposit Insurance Fund, or DIF.

Second, most community bank failures were the result of aggressive growth, asset concentrations, deficient credit administration, and declining real estate values. These factors led to write-downs and charge-offs on delinquent loans and non-performing real estate loans.

Third, we found examiners generally followed and implemented longstanding polices related to problem assets, appraisal programs, and capital adequacy. We also found that examiners did not always document the examination procedures that they performed.

And fourth, the FDIC has investment-related policies in place to protect the DIF, and to assure the character and fitness of potential investors. By their nature, such policies are going to impact FDIC decisions on proposed private equity investments.

Finally, I would like to express my appreciation to the regulators for making their staffs and the information we requested readily available to us. I would also like to thank those in my office who contributed to this study for their dedicated efforts to comply with the law.

That concludes my prepared statement. I look forward to answering your questions. Thank you.

[The prepared statement of Inspector General Rymer can be found on page 84 of the appendix.]

Chairwoman CAPITO. Thank you very much.

And our next witness is Mr. Lawrance L. Evans, the Director of Financial Markets and Community Investment at the U.S. Government Accountability Office. Welcome.

STATEMENT OF LAWRANCE L. EVANS, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. EVANS. Thank you. Chairwoman Capito, Ranking Member Meeks, and members of the subcommittee, I am pleased to be here this morning as you examine issues related to bank failures in community banking.

Between 2008 and 2011, over 400 banks in the United States failed. Almost all of these failures involved smaller banks which had less than $10 billion in assets and often specialized in providing credit to local communities. My remarks today are based on our January report, and I will briefly share some of the key findings.

First, failures of small banks were associated with high concentrations in CRE and ADC loans. These loans grew rapidly as a percentage of total risk-based capital and exceeded the regulatory thresholds for heightened scrutiny by a significant margin. Heavy ADC and CRE concentrations were often associated with aggressive growth, poor risk management, weak credit administration, and the use of riskier funding sources, namely broker deposits.

Second, we found that fair value losses related to some mortgage-related assets were a factor in a limited number of failures. But overall, fair value accounting standards were not a major driver. In fact, our analysis found that most of the assets held by failing institutions were not subject to fair value accounting. The biggest contributor to credit losses at failed institutions was non-performing loans recorded at historical costs.

However, declining collateral values related to these non-performing loans contribute to credit losses and surfaced issues between examiners and some bankers over appraisals and the classification of certain loans. Following accounting rules, regulators will require that impaired collateral dependent loans be written down to the fair value of the collateral.

State banking regulators in bank associations we spoke with said that given the significant decline in real estate values, these impaired loans resulted in significant reductions to regulatory capital. Two State banking associations maintained that the magnitude of these losses was exaggerated or exacerbated by Federal bank examiners' adverse classification of performing loans, and by their challenging of appraisals used by banks. This is at odds with regulatory guidance issued in 2006 and clarified in 2009.

Third, loan loss reserves were not adequate to absorb credit losses, in part because the current accounting model for loan loss provisioning is based on historical loss rates or incurred losses. As a result, estimated losses were based on economic conditions that understated default risk and led to insufficient reserving. This left banks vulnerable to the sustained downturn that began in 2007 as credit losses ate through reserves and depleted regulatory capital.

A more forward-looking model that focuses on expected losses could reduce the need to raise capital when it is most difficult to do so and encourage prudent risk management practices. Accounting standard-setters are taking important steps in this direction, and GAO will continue to monitor development in this area.

Fourth, driven by market conditions, FDIC resolved nearly 70% of bank failures between 2008 and 2011 using shared loss agreements to minimize the cost to the DIF. While estimated losses are expected to be roughly $43 billion, FDIC estimates that loss share agreements saved the DIF over $40 billion when compared to the estimated cost of liquidating the banks.

Lastly, we found that the impact of failures on communities may have been mitigated by the acquisitions of failed banks by healthy institutions, although significant negative effects are likely in a few areas of the country. Bank failures, by their very nature, can impact consumers who rely on local banks through their effects on the costs and availability of credit.

Our analysis of market concentration in geographic areas that experience failures found that only a few local markets raise these concerns. Some of these areas were rural counties which were serviced by one bank that was liquidated or where few banks remain.

Our econometric analysis found that failing small banks extended progressively less credit as they approached failure, but that acquiring banks generally increased credit after the acquisition, albeit more slowly. Several acquiring and peer banks we interviewed in Georgia, Michigan, and Nevada noted that conditions were generally tighter in the period following the financial crisis, making it difficult for some borrowers to access credit, particularly in CRE and ADC markets.

Econometric analysis also shows that on average, bank failures in a State were more likely to affect housing prices than unemployment or personal income. These results could be different at the local level and do not capture any changes in the patterns of lending or philanthropic activity that might be material for a community.

That concludes my opening statement. I will be happy to answer any questions that you may have.

[The prepared statement of Mr. Evans can be found on page 44 of the appendix.]

Chairwoman CAPITO. Thank you. I would like to thank the witnesses. And I will begin the questions with Mr. Brown.

We talked about relationship lending, how it defines what a community bank is, and how important it is to certain areas. I fear that as the CFPB drafts more regulations, this type of relationship lending will cease to exist. I am already concerned that the recent QM rule that the CFPB promulgated will be unworkable for many of our rural lenders. And they will get out of the mortgage business, which will cut out a lot of our constituents from being able to obtain a mortgage.

What steps are you taking as a regulator to ensure that these rules are workable for smaller institutions?

Mr. BROWN. Madam Chairwoman, your sense of the importance of relationship lending to community banks is something that was borne out in our study. They do lending on a completely different business model in terms of how credits are evaluated, and I think that will remain their niche, their specialty in the future. That is the thing that our study points out to us most clearly of all.

In terms of rules coming about through Dodd-Frank, there is concern that has been expressed by community banks in some of the roundtables that we have conducted and the interviews that we have conducted about rules in certain areas, including mortgage rules. And I think that there are some community bankers who have expressed that they might not plan to go on in those lines of business, depending on how those rules are promulgated.

So I do think that taking care to make sure that those rules do not disadvantage community banks and their particular business model, their way of doing business, is something that is very important and that the regulators are taking into account as the rules move forward.

I will allow my colleagues to chime in if they have something to add.

Chairwoman CAPITO. Did you have a comment, Ms. Eberley?

Ms. EBERLEY. Sure. We can just add that we did have the opportunity to consult with the CFPB on the rulemaking process. And we were able to share the concerns that we heard from community bankers through our Community Bank Initiatives Roundtables and other venues. And we do believe that had an impact on the final rule.

Chairwoman CAPITO. Are you presently using the FDIC's Advisory Committee on Community Banking as a liaison to the CFPB? Is this an ongoing relationship? Or is this just kind of one phone call and then back to your relative responsibilities?

There is an advisory committee on community banks within the FDIC. Are they coordinating with the CFPB and others to show the effects that these regulations are having on our smaller institutions?

Ms. EBERLEY. Our Community Bank Advisory Committee does not coordinate directly with the CFPB, but they do inform us of concerns that we share with the CFPB. So we essentially serve as the liaison with the CFPB—between community bankers and the CFPB.

Chairwoman CAPITO. Did you have a comment? Yes?

Mr. RYMER. Yes, ma'am. I would just like to add one thing. We, at the OIG, do have some concerns. I want to make sure that there is not overlap between the FDIC's Division of Consumer Protection and the CFPB. Some of the initial work we will be doing in the Division of Consumer Protection will be to try to identify overlap.

Chairwoman CAPITO. I welcome that. I think that was one of our ongoing concerns with the creation of the CFPB. At the beginning, it was supposed to rid the silos and all the prudential regulators were supposed to cede this authority. And I think in actuality that is not occurring, which bears out in your report.

Let's get to the cost of compliance. I know it is hard to quantify. That is in your reports. But anecdotally, whether it is hiring a single compliance officer in the smaller institutions, maybe your chief lending officer, your HR person, your vice president for community affairs, whatever officers you have there, and having to devote more of their time to the issue of compliance, is there anybody at the FDIC who looks at, as the regulations come forward, the cost to the community institutions?

Mr. BROWN. During the process when the regulations are considered and promulgated, the FDIC solicits input from the industry on the costs of implementing the regulations. And also about alternatives, different ways that the regulations could be devised or implemented that could mitigate those costs.

And so that is a dialogue that happens not just through our more informal processes such as our roundtables, and our Advisory Committee on Community Banking, but specifically during the rulemaking process. And we receive thousands of letters on that topic that are carefully considered during the rulemaking process.

Chairwoman CAPITO. My last question—or my last comment because I have only 12 seconds left—would be that no new bank charters were chartered in 2012, according to the FDIC. We have seen all the closures. We have talked about how important to the fabric of lending to small businesses and farmers and the agricultural community and rural areas, and that these institutions do for our constituents.

I would just launch a concern. When you see everything closing and nothing opening, that to me is a red flag which we need to monitor. And I hope that you will join us in that effort.

I will now go to Mr. Meeks for questions.

Mr. MEEKS. Thank you, Madam Chairwoman.

Let me start with, I guess, Mr. Brown.

As I stated in my opening statement, that community bank study showed that community banks hold 14 percent of the Nation's banking assets, while they offer 46 percent of small business and farming loans. So would you agree that it seems as though community banks are playing an outsized role in terms of the impact on the economy? Please give me your thoughts on that.

Mr. BROWN. Yes. I think that is our clear sense. It was our sense going into the project that obviously small businesses are very important to job creation, creating two-thirds or more of new jobs.

Small businesses were hit hard by the recession, and they depend on community banks as a source of credit.

Surveys over time have shown that small businesses prefer to do business with small banks who understand their needs, can customize their products, that sort of thing. So, that tight connection between small businesses and and community banks was borne out, I think, by the data that you are citing.

Mr. MEEKS. And so now we are trying to make sure, I think, that we get this balance right with reference to regulation in this sector. Clearly, there is some compliance cost to regulation. But what would you think the marketplace looks like for consumers without regulations such as the Equal Credit Opportunity Act, or similar fair lending bills?

Mr. BROWN. Part of the stability of the banking industry is a regulatory environment that maintains safe and sound banking and that maintains fair treatment for consumers.

The confidence that bank customers have in their institutions comes about in part because of standards that the institutions follow for fair business practices, disclosure, things that give consumers and borrowers confidence in that institution. And so, safety and soundness and consumer protection are really two sides of the same coin, and it is something that is a strength of the banking industry.

Mr. MEEKS. Let me ask Mr. Evans, one of the criticisms of the shared loss agreements, one of the shared loss agreements, really quick, is that banks are incentivized to dump assets which allegedly depress housing and commercial real estate markets. Did either the GAO study or the FDIC IG study turn up any evidence of that occurring, to your knowledge?

Mr. EVANS. I think—

Mr. MEEKS. Mr. Edwards? Okay.

Mr. EVANS. The FDIC IG's study covered those issues in much greater depth. All we can say is what we heard. We talked to some banks and they were concerned that was occurring. But we also heard from acquiring banks who said something different. But that is about the extent of what we did in that particular area, so I guess I will just—

Mr. MEEKS. Mr. Edwards?

Mr. EDWARDS. Sure. Of course we are concerned any time we hear that. We believe the way we structure the agreements incentivizes the banks not to do that, and in fact there are a lot of controls in place, including regular compliance reviews by our contractors and our staff, to ensure that kind of thing is not happening.

The premise for these shared loss agreements really was to allow the private sector, i.e., the banks that are acquiring these failed banks, to work these assets appropriately and maximize the value of the assets. And specifically, we have provisions in the agreement that if an acquiring institution wants to do a single note sale, they have to get our permission.

And certainly if they want to attempt to do any bulk sales, they have to get our permission. But our intent was for them to work these assets, and we believe, especially early on in the crisis, that we did not want these assets put out for sale because we felt they were trading below their intrinsic value.

Mr. MEEKS. Have the shared loss agreements saved the Deposit Insurance Fund any money, and ultimately the taxpayers, over the course of liquidation? And if so, what is your estimate today?

Mr. EDWARDS. The estimate is a little over $40 billion, as was noted earlier. And what that is, at the time that we do a cost test, when we bid the failed bank out, we are required under the statute to resolve the bank in the least costly manner to the DIF. So the baseline case is if we had to liquidate the bank, pay out all the deposits, and take all the assets back ourselves. That is one cost. That is generally the worst-case scenario.

Any other deal we have, i.e., a whole bank transaction where we sell the failed bank to an acquiring institution with a loss share agreement, if that saves us money then we count that as a savings. So when you added up all the savings, it was about $40 billion, because liquidating a bank and paying out the deposits and putting the assets in the government's hand is always going to be the worst-case scenario.

Chairwoman CAPITO. Thank you.

I now recognize Mr. Miller for 5 minutes for questions.

Mr. MILLER. Thank you very much.

I enjoyed your presentation today. If you look at 2008 to 2011, lenders went through a very, very tough time, especially rural banks. If you look at their AD & C loans, when the regulators were forced to apply mark-to-market and the SEC would not modify it, you put many of these loans in a poor asset quality category and they were forced to sell them off.

It is sad because most of those loans are probably worth 3 times today in value than what they had to sell them off for, and it is really sad to see. But it doesn't seem like after the economy really got to where it was starting to pick up again, and builders were starting to build again, which is going to take builders putting houses out that will help the economy return, it doesn't seem like the banks are being allowed to make the loans they should.

Mr. Brown, what is your assessment of the current state of lending for the construction industry today?

Mr. BROWN. Real estate construction lending has declined. The volume outstanding has declined quite a bit during the crisis. And the loan charge-offs in that sector have exceeded $70 billion since the end of 2007 to the present. So there have been heavy losses in that area really associated with the large declines in the market value of residential and non-residential real estate assets.

Mr. MILLER. No, I understand. That was what I said in my statement. We have gotten to the bottom. Those assets have been sold off. Those banks have taken a hit. Many of them are gone today. But the market is starting to build again. We are dealing with today. What do you see occurring today and in the future? We know it has been bad. We know it has been awful. We are past that.

Mr. BROWN. Right. We are seeing some rebound in prices in some of the formerly hard-hit markets like Phoenix, Las Vegas, and Atlanta, where we saw a double-digit increase according to the Case-

Shiller Home Price Indices last year. But those market prices, those indices remain far below their peaks from before the crisis.

Mr. MILLER. Yes. But what we are seeing out there is the regulators are basically requiring banks to go above required capital as far as lending. If you take the system that they face today, say a bank had $50 million in deposits, required reserves of $1,500,000, they are not allowed to lend about $3 million to $800,000. And that is about—that is 100 percent, and it used to be 300 percent.

Ms. Eberley, how would you say that is working today in the system?

Ms. EBERLEY. In our guidance, we encourage banks to make loans to creditworthy borrowers, including homebuilders. And there is no prohibition on making loans in the Acquisition, Development and Construction sector. The thresholds that you cite, the 100 percent and 300 percent, appear in guidance that we issued in—

Mr. MILLER. Well, 300 percent was before, but the regulators today are not allowing anybody to exceed 100 percent. And that is stifling the industry.

Ms. EBERLEY. So we don't have any rules like that.

Mr. MILLER. But the regulators are—there are no rules, but the regulators are applying this in the banks. I have talked to too many banks that keep coming back and saying the same thing. And I think the regulators are being overly restrictive because of the market situation in 2008–2011, which I am not saying wasn't bad. It was horrible. Banks lost tremendous amounts of money.

But you are seeing throughout different regions in this country that the markets coming back. People are buying new homes. When they buy new homes, the current value of existing homes is going up with them. But builders who have qualified credit and good projects can't get lenders to lend above this 100 percent because the regulators won't allow them to do that.

Ms. EBERLEY. I can just tell you that we do not have a prohibition for institutions to make acquisition development loans above 100 percent of their capital. To the extent that you have an institution that is doing that or an examiner who is telling an institution to do that, we would of course be interested in hearing the specifics on that.

Mr. MILLER. I probably have a room full of bankers who can give you specifics on that. And that is the problem we are facing. It seems like we are forcing and mandating a restriction on lenders that currently does not exist in law. And I understand the regulators are being cautious because of what many banks went through. If we would have modified mark-to-market, a lot of those banks would still be out there today.

If we would have modified mark-to-market and not forced them to take respective losses, many of those banks could have held those loans, and today, in a better marketplace, could have sold those off. I am not blaming you for that. We did nothing to modify it. I got language to the SEC to have them look at that issue and they came back and did nothing.

So I am not blaming you. We didn't do our job to allow you to do your job. But what we are facing out there to ensure that bank examiners on the ground know that they are not empowered to enforce that I think is something we need to work on internally because it is occurring.

There is no doubt that it is occurring. And there is no doubt that it is not restricted and regulated by law for them to do that. But when you look at the situation they were allowed, going to 300 percent of that and now they are forcing the 100 percent guidelines as a standard and not letting people exceed that.

It is just something that I—we introduced a bill to directly deal with that. But it would be nice if you could internally look at that and understand that system doesn't work in a recovering market. And the market is recovering.

I see my time has expired, and I thank the chairwoman for her generosity.

Chairwoman CAPITO. Thank you.

Mr. Watt for 5 minutes.

Mr. WATT. Thank you, Madam Chairwoman. I am always interested in some of the unintended consequences of the decisions we make here. I noticed that Mr. Brown, and I think Mr. Evans, talked about how the bulk of the failures that we have experienced, or a large part of them, resulted from aggressive expansion. And I think Mr. Brown testified about a change we made in the law at some point which made it easier for community banks to expand by lifting geographic restrictions.

First of all, Mr. Brown, tell me again what that change was and when we made it.

Mr. BROWN. Yes. Traditionally, there were restrictions on branching at the State levels. Some banks were in unit banking States. They really couldn't have branches. And those were relaxed at the State level in the early 1980s and early 1990s, allowing some banking organizations then to consolidate their charters and run them as branches.

Moreover, restrictions on interstate banking at the State level were essentially undone or relaxed through the Riegle-Neal Act of 1994, and after that interstate banking became much more prevalent. And both of those deregulation events facilitated the consolidation of charters within bank holding companies and also voluntary mergers across State lines.

Mr. WATT. And of course, I was here in 1994, so I am sure I supported that change. So, an unintended consequence of that is aggressive mergers, aggressive growth, and aggressive growth is what led to a number of the bank failures during the economic downturn. I want to pick up on that.

Tell us again what part of these failures and forced consolidations resulted from larger banks acquiring or other banking groups acquiring those failed banks' assets. What part of that resulted, based on your study, from aggressive growth?

Mr. BROWN. First, it was really the non-community banks, the 558 charters in 2011 that did not meet our community banking definition. They held $12 trillion in assets. They had gained $6 trillion in those assets through direct acquisitions, almost 2,500 acquisitions. So, they really grew their share of industry assets to 86 percent through acquisitions and through retail lending and consumer lending for the most part.

Community banks, on the other hand, tended to grow more organically—

Mr. WATT. And which ones of those had been community banks before that as opposed to the category that you just described?

Mr. BROWN. I am not sure if I have that information at my disposal. We probably could calculate it from the data that we collected.

Mr. WATT. Mr. Evans, you referred to something called "forward-looking" rather than retrospective accounting. How would that look? What kinds of things are the accounting standards people are talking about that would allow us to be more forward-looking in the accounting principles that are applied?

Mr. EVANS. Right. So, instead of estimated losses being based on historical losses or losses that have been incurred to date, you would consider current market conditions and other factors—

Mr. WATT. How can an accountant do that? I guess I think of accountants as being—they keep track of the numbers as they are. What would be the theory on which an accounting standard change would address that issue?

Mr. EVANS. The accountant would be doing the auditing and the attestation. This is what bankers would be doing who have knowledge of what current conditions look like and what they anticipate going forward. It would be embedded in the updated standards that will allow them to do that.

Mr. WATT. So you are talking about the audit standards as opposed to actual accounting standards then?

Mr. EVANS. That is right.

[Mr. Evans submitted the following clarification for the record: "This is an update of current accounting standards."]

Mr. WATT. My time is about to expire, so I will yield back.

Chairwoman CAPITO. Thank you.

Mr. Campbell for 5 minutes.

Mr. CAMPBELL. Thank you, Madam Chairwoman.

I want to step back and do a little 20,000-foot kind of view here. It seems to me, and I will ask you to comment on this, that there are two problems facing community banks. One is the squeeze on margins, which has to do with monetary policy, which has nothing to do with any of you at that table or any of us up at this dais.

And in recent testimony before this committee or subcommittee, other subcommittees that are a part of this overall committee, even those who advocate the current loose monetary policy would agree with it and admit that there is a tremendous pressure and squeeze on margins at the community bank level because larger banks can borrow from the Fed under the Treasury and make a spread that is completely without risk. And that is limiting margins at the community bank level.

Then on the other end, we have this increase, although unquantifiable, so it seems. But this increase in cost at the community bank level due to regulatory restrictions.

So, if you look at that, if you have declining margins and increasing costs, we see this reflected in very few new bank charters and consolidations at the community bank level.

And so from where I sit I look and I say all right, we actually have a current regulatory environment that is damaging the very sector that we are supposed to be protecting, that is causing there to be a shrinkage and, sure, maybe not failures in the classical sense of failures, but a failure of the overall sector because they just can't make it with increasing regulatory costs and shrinking margins. Would any of you like to comment on that?

Mr. BROWN. The importance of net interest income to the earnings of community banks is absolutely an accurate assessment. We have looked at changes in their efficiency ratio over time, that is, the ratio of their overhead expenses to their revenues. And it has deteriorated over the last 15 years. But more than 70 percent of that deterioration came about due to a shrinking of net interest income. And only a small portion, 20 percent, came from higher expenses. Those are expenses of regulatory and non-regulatory. We can't separate those out.

The community banks fund themselves through deposits. That is a very good funding model during periods of normal interest rates. High interest rates you can get some discounts there, but during a period of low interest rates, it is not necessarily the cheapest source of funds for them.

Mr. CAMPBELL. Other comments? Mr. Rymer?

Mr. RYMER. Yes, sir. I would just like to point out that there is some cyclicality to this. Prior to the crisis, there was an extraordinarily large number of de novo banks, new banks formed. Unfortunately, I think the crisis certainly has dissuaded potential bank investors from investing in new banks at this point in the cycle. But prior to the crisis, particularly in Georgia and California, lots of new banks were formed.

Mr. CAMPBELL. Okay. So the monetary policy as we discussed the shrinking margins is the two-thirds or three-quarters of their problem. But the regulatory costs are still part of the problem.

Do you all believe, and I only have a minute or so left, that we can—I could rattle through, they are all in here, all the different regulations that we have passed just in the last 10 or 15 years, many of which are overlapping or duplicative. Do you all believe that we can relieve this regulatory—that there is a way to pull this stuff back in order to give some relief to this sector so that the regulation isn't forcing the sector down without adding significantly to the failure risk?

Ms. EBERLEY. I might just say that what community bankers have asked us to do is to help them in understanding the regulatory environment and framework. So through our Community Bank Initiative, there were a couple of very specific requests that were made for us to help reduce burdens at community banks.

One was to increase our outreach and training. Our Director's College Program and other outreach was cited as being very valuable to bankers. They use it to help train their staff, make sure their directors understand their roles and responsibilities. And they have asked us to expand those opportunities where possible, including the ways that deliver the programs. And so, we are working on that.

The second was to give them line of sight for the regulations coming down the pike. So what is out there, what is proposed, does it apply to them, how would it apply to them. And we have developed a Web-based tool to bring all of that together and help community bankers gain an understanding.

Mr. CAMPBELL. Thank you. My time has expired.

Chairwoman CAPITO. Thank you.

Mrs. McCarthy for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you. And thank you for having this hearing. I find it fascinating.

I want to follow through a little bit with what Mr. Miller had started to talk to you about. We have been looking at the GAO report and we know that many residential builders in this are small businesses owners who rely on the community banks to finance their acquisition, development, and construction activities.

The financing options are tight and sometimes nonexistent that we have seen, and I have seen it in my own area in New York. But looking at the GAO report, commercial AD & C financing combined with weak underwriting, insufficient capital, and high concentration have proven to be risky and have led to some bank failures. If the oversight and the prudent management were in place, what, if anything, could make commercial AD & C loans risky?

Ms. EBERLEY. What makes acquisition, development, and construction loans risky is the length of time before the project comes to completion and it is the risk of economic changes during that time when the construction is taking place.

But you raised a couple of interesting points. Our Inspector General conducted an evaluation and issued a report a little bit earlier this year that covered institutions that did have concentrations that exceeded the thresholds that are included in our regulatory guidance, at which point we expect heightened attention and risk management practices by institutions.

And so, there were institutions that exceeded these thresholds, but weathered the crisis in good shape. There were other institutions that got into trouble, but managed their way back out without failing. And the principles that you outlined were the ones to which they actually adhered.

They had strong risk management practices in place. They paid attention to market fundamentals, and when their market appeared to be overheated, they pulled back. And they had strong board governance around their credit administration practices. So those were the things that made a difference for institutions that were concentrated at high levels that made it through the crisis okay.

Mrs. MCCARTHY OF NEW YORK. From what I understand, obviously with the commercial loans the banks took, which are usually higher amounts of loans and there is a certain limit on what banks would possibly put out there for what they might consider a risky loan, that kind of left our smaller residential builders with no place to go. Am I correct in interpreting it that way?

Ms. EBERLEY. I am not sure I understand your question.

Mrs. MCCARTHY OF NEW YORK. From what I understand, the bank has a—if they are going under risk management and if they are looking at how many loans they have out there and they have a lot of commercial loans, which usually are large pieces of property, more expensive to build. And if they start to go under, as we saw going back a few years ago, there wasn't any money left over for the small businesses.

That is what we are trying to look at, how we can make sure our small businesses that are residential builders, that don't need as much money as the commercial. And once they reach that limit, there was nothing left for the small businesses to get.

Ms. EBERLEY. Again, I would just say that our guidance doesn't set limits on commercial real estate lending or acquisition, development, and construction lending. It sets thresholds beyond which we expect institutions to have heightened risk management practices.

So that means our expectations about how the banks are going to manage that portfolio, we expect to see more due diligence around it. We expect to see greater levels of understanding of the marketplace fundamentals, monitoring of the marketplace fundamentals, stress testing of the portfolio to determine impacts on capital or borrowers, or changes in interest rates or changes in economic fundamentals.

So, that is our expectation. We don't place limits on the amount of lending an institution can do in a portfolio like that.

Mrs. MCCARTHY OF NEW YORK. I have a few more questions, but I don't think I can get them answered in 46 seconds, so I yield back. I will ask for written responses to my—

Ms. EBERLEY. Oh, certainly. Certainly.

Chairwoman CAPITO. Mr. McHenry for 5 minutes.

Mr. MCHENRY. Thank you. And I want to thank all of you for your service to our government and to our people.

Now look, I have met with a lot of community bankers, as most members of the committee have. And they tell me stories about an inconsistent, overly stringent examination process; that this is a hyperreaction by the FDIC to the crisis, an overreaction, in their words. Now certainly, they are regulating, but it is consistent with the FDIC study that we are talking about today.

You have also reached out to various consultants and contractors for these community banks. And I know the FDIC is in an ongoing process of doing that. But I wanted to share with you a couple highlights of criticisms of the FDIC that I have which they don't receive:

"We have received examination criticisms that were inconsistent with what prior examiners found, inconsistent with what was found in prior examinations by the same examining body, and inconsistent with guidance from our regulator. The inconsistency of the examination has made it extremely difficult for us to understand what is expected of us and to comply with expectations of our examiners."

Another one, "My financial institution has not tried to appeal a decision from our regulator. The appeals process does not appear to us to be independent. The appeals process appears to be similar to being bullied in elementary school and your only appeal is to the bully's mother."

"Typically, in the past, if the examiners found areas of concerns they would identify the area of concern and make suggestions on how to improve in these areas. Now minor infractions are met with severe criticisms and/or penalties."

Likewise another one, "Our exam this past summer was a dual exam. The exam included compliance, CRA, and fair lending. The exam lasted 4 to 5 weeks, and the number of people ranged from six to eight. We had an excellent rating prior to this exam. The compliance examiners came in with unlimited budgets and correspondingly unlimited time to search our files for errors to prove exactly what?"

I had another banker say that your agency used to be one to fix problems and to repair wounds, but that has changed to a mindset of bayoneting the wounded. Now, I understand there is a reaction to lax exams prior to the crisis. But this overreaction leads me to ask one simple question.

I will begin with you, Ms. Eberley, because exam process is certainly key to this. How are community banks expected to exist under this hostile regulatory environment?

Ms. EBERLEY. I would start by saying that we expect our examiners to examine banks in a fair and balanced manner, and to remain professional throughout all of their dealings with institutions. I take great pride in the professionalism of our examination staff and I do believe that we have a number of programs in place to ensure that we have consistency on a nationwide basis.

We have a national training program for examiners and a stringent commissioning process. We undertake internal reviews of our examination program through each of our regional offices. And we engage in extensive—

Mr. MCHENRY. So things are good?

Ms. EBERLEY. I would just tell you that we work very hard to—

Mr. MCHENRY. No, I appreciate you working very hard. I acknowledge that. And I certainly appreciate your service. But these are the criticisms I am receiving and I am hearing. Are they wrong?

Ms. EBERLEY. They have not come to me. I would ask that—

Mr. MCHENRY. Right. So they are going to come to the regulator. They are going to come to, in these words, this appeals process which they think doesn't work.

Let me just ask another question. At the November meeting of the FDIC Advisory Committee on Community Banks, there was a question on the ongoing examinations and reports and after-examinations. Have you implemented any policies or procedures to improve this process?

Ms. EBERLEY. We have undertaken a number of initiatives. We did engage in training with our entire examination workforce in 2011, I believe, about the examination approach.

In terms of communication with institutions, we issued a Supervisory Insights Journal article last year talking about the risk management examination process and what bankers should expect in terms of communication throughout the process. We issued a financial institution letter in 2011 reminding bankers about examination processes again, and the appeal programs.

We do encourage institutions to try to resolve issues while the examination is open, with the examiners. But if that can't be done, we can disagree professionally. And we encourage bankers to talk to us. We don't know that there is a problem unless there is a communication of the issue. And so they can talk to the field supervisor, regional office management, and me. I have a dedicated mailbox that is listed out in that financial institution letter.

One of the things that we are going to do through the Community Bank Initiative Project is institute an information packet, essentially, for community banks that will be mailed out to all of the community banks that we regulate, reminding them about all of these processes and encouraging them to take advantage of the process. I mean that with all sincerity that we want to communicate. We want to know if there are issues. And we want the opportunity to fix them if that is the case—

Chairwoman CAPITO. I am going to step in here, because the gentleman's time has expired.

Ms. EBERLEY. I apologize.

Chairwoman CAPITO. And we will move on to the next questioner, Mrs. Maloney.

Mrs. MALONEY. I would like to thank Ranking Member Meeks and Chairwoman Capito for calling this really important hearing on the status of community banks in our financial system and its service in our communities.

I am pleased to have joined Mr. Westmoreland in support of his two studies, and in support of really looking at ways we can help community banks. They are critical. And I would say regional banks too. They are critical to our financial system, and really unique in America.

In many of the foreign countries, they have very large banks. They don't have community banks. And my first concern was on the Basel III capital requirements.

Chairwoman Capito and I wrote a letter to the regulators, Mr. Bernanke, Mr. Curry, and others, expressing our concern that the requirements for international global banking, huge banks, were the same for the community banks. Community banks are not involved in global financing. And the requirements in Basel III, according to many community banks in the district I am privileged to represent, would force them to merge or literally go out of existence.

So I am going to be reworking this letter. I would like unanimous consent to place it into the record. Many Democrats have come to me and asked to go on it. Since we already sent it out, I think we should work on another, so that others can express their concern. And so I ask—

Chairwoman CAPITO. Without objection, it is so ordered.

Mrs. MALONEY. I also want to reference the chairwoman's mention about how important community banks are to rural areas. I would say they are just as important in urban areas. During the financial downturn, when many of our extremely important financial institutions that were larger were facing great stress, the only service that was there for the community in any type of loan and bank processing were regional and community banks.

They would continue to do the mortgages. They would continue to do the small loans. So they are absolutely critical to our banking system, and to services in many areas.

Constituents would come to me and say, "My rating is perfect, I am making zillions of dollars, but I can't refinance my home, I can't take out a mortgage. What do I do? I have been to every major bank in New York."

I would say, here is a list of community banks, regional banks, try them. And they would be able to get the services they needed. So I think that supporting them is very, very, very, very important.

And in that vein, the chairwoman and I introduced a bill last year that responded to some of the concerns that community banks brought to our attention. And we are working on reintroducing it over this break. I hope that our staffs can meet with the FDIC.

The FDIC was not supportive of the bill. I am very supportive of regulators. And I certainly want regulators to support efforts that we have. And we need to do it in a reasonable way.

But one of the areas was the appeal process where they feel that their appeals are not listened to, they are not taken into consideration. And often I feel a disconnect when I talk to regulators, whom I respect. They say, we are there, we are helping, we are doing everything.

And then you talk to community banks that because they are in the community, you know what they are doing, you know them, they know all the communities, just really know your customer. They know your customers and the customers know them. And they were saying that they did not feel that their appeals were listened to or that they were treated fairly.

I feel that this is an area where we have to work together to make it work better. We are unique in having the community banking system. It is not the same in Europe. And that is why Basel III is not sensitive to the community banks.

I personally think that community banks should be exempted from the Basel III requirements or have a different standard because they are not global competitors. They don't need to have the same standard as a global competitor. They are not global competitors. They are community banks helping communities.

I just have great respect for them because they are there for the communities I represent. And people tell me, thank God for bank such and such, a little community bank that was there to help them.

So, what my basic question is that I would like to submit to the FDIC, and I see the panel is basically all FDIC primarily, the bill that we did, and have your input on it. Because I think that we do need to have some relief for the community bankers. And my first question is on Basel III.

Chairwoman CAPITO. Your time has expired.

Mrs. MALONEY. Okay.

Anyway, I will give you a copy of it and the letter and I would love to see any comments that you have. But I think this is a very important hearing. I want to thank the ranking member; I know he pushed hard for it, and thank the chairwoman for having it.

Chairwoman CAPITO. Thank you.

Mr. Fitzpatrick?

Mr. FITZPATRICK. Thank you, Madam Chairwoman.

I will actually follow up on that question and ask Mr. Brown or Ms. Eberley, do you agree with the gentlelady's assertion or question that community banks should be exempt from Basel III?

Ms. EBERLEY. I would say that we received more than 2,500 comments from community banks about the Basel III and the standardized approach capital rulemakings that we put out for a notice of proposed rulemaking. We are in the process of considering those and take very seriously the comments and concerns that community banks have raised. It is not our intent to have an unintended consequence on the community banking—

Mr. FITZPATRICK. So what are those comments indicating? And what is your position on that question?

Ms. EBERLEY. We are in the rulemaking process, so we can't talk about our position.

But the comments that have been raised fall into three areas primarily. One has already been mentioned, and it is the implications for mortgages. It is the risk weighting for mortgages through the standardized approach. Another is the treatment of trust preferred securities. And a third would be the treatment of accumulated other comprehensive income, which is a fancy way to say depreciation or appreciation on securities.

So, those were the three primary issues that were raised. We are taking all of the comments into account. We are reading every comment letter and working with the other agencies as we go through the process to come up with a final rule.

Mr. FITZPATRICK. Mr. Brown, you indicated in your written testimony—I think you may have been quoting the FDIC community banking study—that the surveys of the community bank presidents indicated that it wasn't a cost of any single regulation that was going to break the bank, but that it was a cumulative cost of everything put together, which is exactly what I am hearing from the community banks in my district in Pennsylvania, especially around Bucks and Montgomery Counties.

They are saying that they have to hire compliance people that they didn't have a couple of years ago, they need to train their employees. They are now responsible for outside consulting fees, bringing folks in, increased costs of both internal and external auditing. And of course, all this is taking away from their ability to make the loans and their ability to have the capital to make those loans. It is a distraction.

What is your plan over the course of the next year to address those issues? And when might this subcommittee hear back on that plan?

Mr. BROWN. Our entire Community Banking Initiative is designed to learn more about these issues. Those were some of the things that we have learned thus far. And on the supervisory side, to try to address them through some of the technical assistance and other initiatives that Ms. Eberley has described thus far.

Ms. Eberley, I don't know if you want to elaborate on some of the steps in the Community Banking Initiative that we are undertaking.

Ms. EBERLEY. The ones that I mentioned were bankers who did ask us for more technical assistance. They expressed that they valued the director's colleges that we put on. These are training sessions that we offer through trade associations in each of our regions for bank directors to participate in and learn about emerging issues. We host teleconferences. We have had workshops where we will focus on a specific topic like allowance for loan and lease losses, and troubled debt restructuring.

Those have received high praise. And we have been asked for more and we have committed to do more. We are trying to look at ways to make those offerings available more broadly, like a Web-based offering so that it could be available on-demand, in order to provide that kind of training so that institutions don't have to rely on outside assistance to get that.

Mr. FITZPATRICK. Is there a specific work plan for this year, for 2013, to address the cumulative impact of all those regulations on community banks?

Ms. EBERLEY. The specific work plan that we have in place is geared toward the technical assistance offerings, and we do have a work plan, yes.

Mr. FITZPATRICK. I agree with what Mrs. Maloney indicated that during those very difficult economic times this past couple of years, it was community banks that were literally holding the communities together. They were the ones that were making the mortgage loans. They were the ones making the small business loans.

What do the statistics show during those last couple of years in a number of those small community banks, the charters have gone out of business versus new startups? Are we seeing more community banks go out of business and fewer starting up?

Ms. EBERLEY. We have seen that. And that is consistent with the economic cycle. We saw it during the last crisis as well. We are starting to hear discussions from consulting groups that are representing groups of organizers that are interested in chartering community institutions.

Mr. FITZPATRICK. What are you doing to encourage more charters?

Ms. EBERLEY. To encourage more charters? We are open to receiving applications for deposit insurance. It really is more of an economic fundamental and we are waiting for groups to come forward. We try to be supportive of the banking industry through our Community Bank Initiative and our other outreach efforts.

Chairwoman CAPITO. Thank you. The gentleman's time has expired.

Mr. Scott for 5 minutes.

Mr. SCOTT. Thank you. Let me start, first of all, because my colleague from Georgia, Congressman Lynn Westmoreland, and I put forward a very important bill that I think you all are aware of. Are you not? You are not aware of the bill we put forward? I certainly hope that you will soon become aware of it because you all are the source of this bill. I am surprised that you do not know of our work, which begs the question as to why community banks might be suffering unnecessarily.

Just to refresh your memory, Congressman Westmoreland and I represent the State of Georgia. And Georgia has unfortunately led this Nation in bank closures. Many of us feel that some of those bank closures were not necessarily caused by the external strong winds of the economy, but in many respects by not the proper type of regulation, perhaps overaggressive regulations.

In other words, we wanted to find out why these banks failed. And you all play a very important role in that. So you can see why

I am very disappointed that you all have no idea of this law and this bill that we passed.

Let me refresh your memory just for a second to explain to you what it is so you understand my very serious disappointment. We introduced Public Law 112–88 to address the concerns that our constituents in Georgia have that they are facing not only more regulations, but more aggressive enforcement, not being sensitive to those situations.

They have had increased costs unnecessarily. So we wanted to take a look at it, and we directed the Office of Inspector General of the FDIC—are you here?

Mr. RYMER. Yes, sir. I am right here.

Mr. SCOTT. All right. So this law affected you. And the GAO, are you here? Okay. To thoroughly study, which obviously you have not done, and report on a wide range of policies and procedures used by the FDIC in its supervision of troubling and failing institutions.

We specifically instructed you to address the following: the effect of loss sharing agreements; the significance of losses; the consistency of procedures used by examiners for appraising collateral values; the factors examiners consider when assessing capital adequacy; the success of FDIC field examiners in implementing the FDIC guidelines for commercial real estate workouts; the impact of cease-and-desist orders on troubled institutions; the FDIC's procedure for evaluating potential private investment in insured depository institutions; and the impact of the FDIC's policy on private investment in insured depository institutions.

This is serious. Our community banks deserve better. They only control 14 percent of the total banking assets in this country. But yet they account for 46 percent of all of the small business loans, all of the farmer's loans.

So you can see why this is serious business to us in Georgia. And we don't just sit here to pass these laws like this that are directed towards you to respond to. And so I certainly hope, with all due respect, that you will find the time to look at the legislation that my colleague, Mr. Westmoreland, and I worked so feverishly on, and to try to examine.

I yield back, Madam Chairwoman.

Chairwoman CAPITO. The gentleman yields back.

I ask unanimous consent to insert into the record a letter from the National Association of Federal Credit Unions. Without objection, it is so ordered.

Mr. Westmoreland for 5 minutes.

Mr. WESTMORELAND. Thank you, Madam Chairwoman. And I want to personally thank Mr. Edwards and his staff for the accessibility that they have given me and my office to address our constituents' questions and concerns. We haven't always agreed, but we have had some great conversations. And I want to thank him publicly for that.

Ms. Eberley, let me say that I got a call from one of my community bankers who said he had been in the banking business for 35 years. He is going through an examination. He said he had never really had an examination like this that was more nitpicking, with incompetent regulators. Yet, he did not want to come forward because of fear of retaliation.

And so, I think that is something that you need to look at. And the fact that this bank is finally making money, but it said it seemed like the regulators wanted to look in the rearview mirror rather than looking forward into what they had done to actually begin making money in saving their bank. So—

Chairwoman CAPITO. Will the gentleman yield?

Mr. WESTMORELAND. I will.

Chairwoman CAPITO. I want to underscore what he is saying because I think it is a very serious issue. And when I would talk to banks, and as I understand it we cannot appeal to you for an individual bank, we can only appeal in a policy way, that is why we wrote our letter, or rather our bill. Many of them would say they couldn't appeal because they were afraid of retaliation. They feel that if they raise something, they are going to be punished. And I think we have to get rid of that. Anyway, I yield back.

Mr. WESTMORELAND. Yes, but—

Chairwoman CAPITO. Your point is a very important one.

Mr. WESTMORELAND. Reclaiming my time, I guess this would be to Mr. Brown or anybody from the FDIC who wants to take it. Coming from the State of Georgia, and even despite the crisis that we have had, we are still one of the fastest-growing States in the Nation. And to accommodate that growth, it is important that we do have the financing in place to develop real estate.

Leading up to the downturn, the community banks, as you probably know, paid the largest amount of attention to being able to lend so we could develop. But because a lot of these real estate loans tanked, the economy tanked. They were having to write down these loans immediately, and acquire more capital, which was hard to do.

But the studies showed that the construction activity is essential to economic activity, and I think Mr. Evans will agree with this, in your community. It is certainly true in my district. And the further research—you have to establish a balance between the social benefits and the social costs of the commercial real estate.

We are beginning to see the first signs of some new construction activity in my district. And my fear is that the examiners will not allow these community banks to participate in this economic comeback that we are having in Georgia, especially in my district. So, could you describe any new guidance that you might have that you could provide to these banks to help them, and to give us the assurance that they can get back into this type of lending?

Ms. EBERLEY. I think that probably falls more in my camp. We don't have any new guidance planned, but I would say that the existing guidance that we issued throughout the crisis stands. And we have encouraged institutions to make loans to creditworthy borrowers.

We have issued a couple of different statements in that regard, in addition to encouraging institutions to work out credits with troubled borrowers. So, we keep repeating that. I can reemphasize it with the staff in the Atlanta region, and I am happy to do that, and in fact the staff nationwide. But that is our policy.

Mr. WESTMORELAND. Thank you.

The other thing I hope that you all will look at is the appraisal situation, because if you look at the loss share banks and they get an appraisal, it is far lower than what a non-loss share bank appraisal would get because that means that loss share bank would get more reimbursement from the government, which is really costing the taxpayers money.

And we have appraisal problems that go far beyond that, though, in the fact that we are now having to use appraisers from different parts of the State. As you know, real estate is location, location, location. And if these appraisers aren't familiar with the location and the benefits that it has, then they really can't do a firm appraisal. So I hope that the FDIC in total will look at the appraisal process and some of the problems that are coming from it.

With that, I know I am over my time, and I yield back.

Chairwoman CAPITO. Thank you.

Mr. Green for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman. And I thank the ranking member as well. I think this is a very timely hearing. I thank the witnesses for appearing today. We all have community banks in our districts, and sometimes we call them neighborhood banks. They are referred to as small banks. We have many names, and I am not sure that we all have the same thing in mind when we use this terminology.

So let me, if I may, bring us to a more mundane question. There are a lot of lofty ideals to be considered today, but there is something as simple as, how do you define a community bank so that I may understand that you and I are thinking of the same institution when we use the terminology?

Mr. Brown, you have said that they have created a niche for themselves. You indicated that they have a different business model. So would you kindly give us your definition of a community bank, as we have been discussing things today, please?

Mr. BROWN. Yes, Congressman. Previous studies have tended to just rely on asset size as a definition of community banks. We thought that did not quite capture their nature as relationship lenders.

Mr. GREEN. Let me quickly intercede and ask this: In terms of asset size, because that was one of the things I was going to inquire about, what is the asset size of a community bank?

Mr. BROWN. Many studies use an asset size of $1 billion and below as the definition of a community bank. But we went beyond that to look at their lending and deposit gathering activities, and the scope of their geographic footprint to try to come up with a better definition of a community bank.

Mr. GREEN. Could you give us a little bit more information on it, please?

Mr. BROWN. Yes. We excluded institutions that had no loans, no core deposits, that were specialty banks or that had foreign operations greater than 10 percent of assets. We then included institutions that had loans to assets greater than a third of the portfolio, core deposits greater than half the portfolio, had fewer than 75 offices, no more than 2 large metropolitan areas where they did business, and no more than 3 States where they did business, and no single branch more than $5 billion.

So, these tend to look at the activities of the institution, look at the geographic spread of the institution, and try to capture its local nature and its relationship nature through those attributes.

Mr. GREEN. Would anyone else like to comment on the definition of a community bank? Or have you all agreed that this is the definition that we should work from? Thank you. It is nice to see that there is agreement on something today.

I will be meeting with community bankers. And I, like other members of the subcommittee, hear quite regularly this notion that we are inundated with paperwork; and I am simplifying what they say. Permit me to ask you to tell me what I should ask them when I talk to them, given that they will surely bring this up.

I plan to have them take me through the bank, show me whatever it is that they want me to see, because I want to clearly hear and understand their side of this. When they come into my office here in Washington, D.C., we have extensive conversations. But I think it is time for me to go out and have a firsthand look at community banking. And I have asked that this be accorded me. And I have been told that this is something that I can do. So, what should I ask? What should I say to them pursuant to what the regulators think? Here is something that I would like for you to explain to me.

Mr. BROWN. In the roundtables conducted as part of the FDIC Community Banking Initiative, we talked to the bankers about their view of the future of the industry, its future viability in their mind, its connection to small business lending, how they view their niche in the financial industry, and also how they view loan demand, how their customers are doing, and how the state of their customers has changed over the course of the recession.

In addition, we talked a lot about the regulatory side, some of the concerns they had about regulation and about their perception of the cost of regulation. Those are very important issues.

Mr. GREEN. With the little time that I have left, about 29 seconds, what is the smallest bank that we have? How many employees does the smallest bank have?

Ms. EBERLEY. I believe I am aware of a $4 million institution and it has 4 employees, I believe was the number.

Mr. GREEN. Four. With four employees, is Basel III or let's just say a small number of employees, is it difficult to comprehend and work through these regulations when you have few employees? Let's not use a number, but few?

Ms. EBERLEY. That is certainly what bankers have told us, that it is the breadth of regulatory requirements and rules and regulations that is very difficult for them to absorb. And they have asked for our assistance.

Mr. GREEN. Do we have a means by which we can accord assistance to these banks such that they know that there is a space or place that they can tap into?

Ms. EBERLEY. Yes. We have established a Web tool to help institutions manage rules and regulations that are coming down the pike. And we have also committed to expanding our educational offerings for community banks to assist with training on existing rules and regulations.

Mr. GREEN. Thank you, Madam Chairwoman. I will yield back, and simply say that I will probably have more questions after I have talked to my community bankers. Thank you.

Chairwoman CAPITO. Thank you.

Mr. Duffy for 5 minutes.

Mr. DUFFY. Thank you, Madam Chairwoman.

I would join Mr. Green, Ranking Member Meeks, Mrs. Maloney, and Mr. Fitzpatrick in piling on my concern with Basel III. I, too, hear constantly from my community banks what impact this potential rule will have on them. And I guess first off, do we have a timeline of when we think the rule is going to come out?

Ms. EBERLEY. We are working diligently with the other regulators to finalize the process as soon as possible. We know what the uncertainty of delays means to institutions.

Mr. DUFFY. Do you have anything more specific than, "We are working on it?"

Ms. EBERLEY. I do not.

Mr. DUFFY. Fair enough. And I know you are not going to comment on the rule. I think it was Mr. Fitzpatrick who talked about exempting our community banks, which I think is reasonable. But if it is not an exemption, maybe a tiered structure would at least be considered for smaller community banks.

Just one other point: if you look at the conversation we are having today, the difficulty of our community banks with the burdensome regulations that are being piled upon them, and we look forward to Basel III and QM, the burden isn't getting lighter. It is getting heavier. And so hopefully, you will all take that into consideration as we try to make sure we have a structure in place that allows a healthy and vibrant community bank structure across the country. So, I didn't want to pile on, but I guess I did.

I want to quickly move over to new charters. I know it was touched on, I think by the chairwoman. But listen, we haven't had any new charters in 2012, right? In 2011, we had three, and in 2010, we had nine.

So as we move away from the financial crisis, we did have a bottom and then it started to recover. We actually have continually gone down since the crisis. Is there an explanation for why that is taking place, why we haven't bottomed out and come up since the crisis?

Ms. EBERLEY. I would say that the industry lags the economy, in terms of its overall condition and performance. And so I think that is what you are seeing is that we have hit zero. And we would anticipate that we would move up from here. As the industry is starting to improve, we would expect to see additional activity or new activity.

Mr. DUFFY. And if you look at the recession in the early 1990s, we never bottomed out—never came to zero. Maybe there is a difference between a recession and a financial crisis. Is that the answer?

Mr. BROWN. Yes. Just that the new charters have always been highly cyclical. This has been a particularly severe cycle with regard to the effect on the financial industry and their customers. And so, I think that explains some of the severity of the cycle.

There were nearly 5,000 new charters for the industry during the period of our study, and we anticipate that chartering activity will pick up with the economy and with the recovery of the industry.

Mr. DUFFY. So do you think it is more the cycle in a crisis as opposed to the new rules and regulations that have come from Dodd-Frank and others?

Mr. BROWN. Our experience through history is that it has been highly cyclical. So, we would anticipate a rebound.

Mr. DUFFY. But is it this cyclical in the sense that when we are 4 years, 3 years from the crisis we have not started to recover and come up, we are actually still going down?

Mr. BROWN. As was indicated, the performance of the industry tends to lag the recovery of the economy. The recovery of the economy itself has been somewhat muted, again, going to the severity of the financial crisis.

Mr. DUFFY. Okay. And I wanted to give a few minutes or a minute-and-a-half back to the gentleman from Georgia. So I would yield my time to him.

Mr. WESTMORELAND. Thank you for yielding. Let me say that I think Basel III would be the last nail in the coffin for a lot of our community banks. So I hope you will take that into consideration.

Mr. Evans, in your report you noticed what I have been saying for a while, that some of the acquiring banks had driven down the real estate values by selling at depressed prices. Do you see that the FDIC can handle what I am anticipating is a second wave of this, when these loss share agreements expire? If they are not extended for some point in time, there is going to be another selloff, which will depress the markets even more, which would cause even more community banks to fail.

Mr. EVANS. Thank you. We did hear from one bank who expressed those issues. We also, I should point out, heard from other acquiring banks who said the loss share agreements gave them time to work out loans. And so, I think the verdict is still out; more work needs to be done to try to figure this out. Certainly given what we have heard, it is something that you might want to consider looking into in greater depth.

Mr. WESTMORELAND. I yield back.

Chairwoman CAPITO. Thank you.

I would like to welcome to the subcommittee a new member, and recognize him for questioning, Mr. Heck from Washington.

Mr. HECK. Thank you, Madam Chairwoman, very much.

I believe this question is most appropriately directed at Mr. Edwards. Sir, could you, as succinctly and clearly as possible describe for us, help us better understand the division in decision-making responsibility and authority when it comes to the acquisition of a failing bank, between headquarters and regional offices?

As you might imagine, that question stems from circumstances in the congressional district I have the honor to represent, where the decision-making process kind of went on and on. And losses mounted. And when finally it came down and it was never clear where the decisions were being made, the evidently self-qualified local investors took a walk on the 70 stipulated new conditions. So, help us describe that division if you would please, sir.

Mr. EDWARDS. Sure. And I will ask Doreen to pipe in as well. So, when somebody is trying to be qualified to bid on a failing bank, they have to go through the Division of Risk Management Supervision and get approved to bid. I will let Doreen describe how that works.

But essentially, they have to be in good financial shape and they have to be deemed to be qualified to take that failing bank over and be successful. Otherwise, we wouldn't want that transaction to go forward.

Doreen, do you want to add to that?

Mr. HECK. And that is done at headquarters?

Ms. EBERLEY. No. The process is handled in the region. Essentially for an institution to be on the bid list for a failing bank transaction, we have to be able to know ahead of time that we can resolve the statutory factors that would be required to be considered for a merger transaction—

Mr. HECK. So the regional offices are the ones who make the decisions, not here?

Ms. EBERLEY. The regional—

Mr. HECK. Is that correct?

Ms. EBERLEY. Right. The regional office—

Mr. HECK. Including the formulation of new conditions or conditions, is that made at the general office?

Ms. EBERLEY. Yes. For an institution to become listed on the bid list and be able to participate in a failing bank transaction, that happens at the region. So, other transactions occur as well on an open bank basis. And those considerations may involve the Washington office on a parallel basis in considering things like change of control of an institution that is open and troubled before failure.

Mr. HECK. So there is a division of responsibility?

Ms. EBERLEY. For certain transactions, yes. That is an open bank transaction for a recapitalization of an institution through a change of control.

Mr. HECK. And then that decision is made here?

Ms. EBERLEY. It is not made here. There is discussion back and forth. There is consultation.

Mr. HECK. Between corporate headquarters, as it were, and the regional bank?

Ms. EBERLEY. Yes.

Mr. HECK. I see. I don't know to whom I should ask this question, but I am trying to put myself in the shoes of a community banker who is running a pretty well-run shop and is looking at admittedly the fairly low cost of money right now that he or she has to pay to depositors, and looking forward at the prospect, which seems to me to be inevitable that interest rates will rise again.

And I am wondering if you agree that, in and of itself, was an inherent impediment to aggressive loaning for what would otherwise be qualified borrowers insofar as the amount of money you lock in long-term and low-cost returns, confronts a changing interest rate environment you may be stuck. And I guess as a part of that question it makes me wonder when you evaluate bank portfolios, what is your forecast, what is your outlook for the interest rate environment?

Mr. Brown, I thought I should ask that question of you, upon reconsideration. Thank you.

Mr. BROWN. First of all, our historical experience has been that lending tends to expand somewhat during periods of rising interest rates. That is the part of the economic cycle when the economy is expanding and the monetary authority feels it is okay to raise interest rates from the recession lows.

Mr. HECK. Excuse me, sir. Do you not agree, then, that it would be an impediment to more lending? We had a lot of discussion here about not being able to get as many dollars out there circulating as possible. But if you are confronting increasing interest rates, how much today do you want to put on your books that is low return?

Mr. BROWN. Historically, lending has increased more in periods of rising interest rates. Periods of very low interest rates have been associated with less vibrant economies, slow growth like we have seen recently. And a lot of the bankers we have talked to in the roundtables and other venues have cited a lack of loan demand in the current environment, that entrepreneurs are not eager to expand their operations.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. HECK. Thank you.

Chairwoman CAPITO. Thank you.

And I would like to welcome a new member to our committee, and a new Member to Congress, Mr. Pittenger from North Carolina. Welcome.

Mr. PITTENGER. Thank you, Madam Chairwoman. Thank you for calling this important hearing. And I thank the witnesses for being here with us today and responding to our questions.

I would like to follow up on Mr. Duffy's questioning and also Mr. Westmoreland and others. I served on a community bank board for about 14 years, from the early 1990s until the mid-2000s. It was an exciting time. It was a great time for investors to invest in community banks. It was a great time of growth. And our community banks played a significant role in our region.

I live in the Charlotte, North Carolina, area. And our bank grew. We ended up selling to a regional bank. We had our typical requirements, CRA and loan loss reserve issues that we were accountable to. We had the audits that came in. We got a clean bill of health most all the time. It was a good environment. It was very positive, and frankly, it was a great learning curve for me.

But today, of course, the environment has changed, and the impediments are out there in a greater way. I met with seven of our community bank presidents a couple of weeks ago, and they expressed to me just more of an oppressive atmosphere, totally different than what I had the privilege of being involved in during those 14 years. And clearly, Basel III was a major concern, just the high regulatory effect and the cost of compliance, the attention that is given to it.

The concerns are getting capital. And the difficulty there where some banks were forced to look for private equity. And as such, the only exit for private equity is to sell a bank and consolidate more, which is worse for the market, and worse for competition.

So, all this leads us to believe that the need for relief today, to create that same environment that we had back during those positive years and to recognize that perhaps what we are doing today through the regulations is creating more difficulty and impediments than protection. And maybe the pendulum just swung way too far and maybe if we can come back.

I speak on their behalf, and frankly, on the behalf of communities all over the country that there would be very serious consideration to giving relief to these community banks, which in our region I—we probably had six community banks that grew and now they are all have consolidated or sold out. It is pretty sad. But I believe we can see this again if we have some thoughtful, prudent reevaluation of the requirements they are having to live under today.

If you would like to comment, I would be glad to hear from you.

Mr. BROWN. I think the topics that you raised obviously are of concern. They have been raised as concerns to us in our interactions with the bankers.

I would point out that in terms of the evolution of the industry, the industry's financial condition and performance is improving, and that includes small institutions. And the return on assets has increased for each of the last 3 years, and the return on equity.

Non-current loans have gone down. This repairing of the balance sheet and the earnings capacity of small banks has proceeded slower than the economic recovery, perhaps also slower than the larger banks in terms of their recovery. But it is taking place. And I think that you also mentioned access to capital.

We found that just under half of all of the additions to capital during our study period relate to retained earnings. And of course, that requires a healthy level of earnings to gain that capital. So, the restoration of that earning capacity is very important for access to capital for the industry. That is what our study—

Mr. PITTENGER. Sir, I would just say to you that I think it is a compelling statement that there are no new charters. So it is a much different climate today. And that is reflected in the absence of those who want to get back and engaged in this business as they were before.

I yield back my time. Thank you.

Chairwoman CAPITO. The gentleman yields back.

Mr. Posey for 5 minutes.

Mr. POSEY. Thank you, Madam Chairwoman.

Mr. Rymer, on Page 59 of your report you note that the historical cost was proving to be poor measurement approach in inflationary markets. Is it fair to say that the impaired accounting and fair value accounting is a poor measurement in bubble markets? As briefly as possible, please.

Mr. RYMER. Yes, sir. In terms of fair value accounting related to bank portfolios, we didn't find that fair value accounting was—

Mr. POSEY. Can you just answer my question? You agree with me or you don't agree with me?

Mr. RYMER. Sorry. If you could repeat it, sir; I have a little bit of a hearing problem.

Mr. POSEY. Is it fair to say that the impairment accounting and fair value accounting is a poor measurement in bubble markets?

Mr. RYMER. Public markets?

Mr. POSEY. In bubble, B-U-B-B-L-E markets.

Mr. RYMER. I don't think you can apply fair value accounting to bank lending. It doesn't fly.

Mr. POSEY. Very good. Thank you.

A question for each of you, just a yes or no if you would, do you think it is possible through overregulation to bankrupt or make insolvent lending institutions? Let's start with Mr. Brown.

Mr. BROWN. That has not been the experience of the study.

Mr. POSEY. Is that a "yes?"

Mr. BROWN. I think that would be a "no."

Mr. POSEY. A "no." So it is impossible to overregulate a business out of business. Okay. Thank you.

Yes, ma'am? Please speak up. I can't hear you up here.

Ms. EBERLEY. The question was, is it possible to overregulate a business out of business?

Mr. POSEY. Yes.

Ms. EBERLEY. I—

Mr. POSEY. It is a tough question. I understand that. Especially for people who work for the government. No insult intended. So, you don't know whether it is possible to overregulate anybody out of business or not. Okay.

Mr. Edwards, how about you?

Mr. EDWARDS. Is it theoretically possible? I would concede it is theoretically possible. In my experience, have I seen that? No, I have not.

Mr. POSEY. Okay.

Mr. Rymer?

Mr. RYMER. I would agree with Mr. Edwards. I think theoretically, it is certainly possible.

Mr. POSEY. Okay.

Mr. EVANS. I agree as well. Theoretically, it is possible. It is possible to overregulate a business.

Mr. POSEY. Do you think it would be possible if regulators put 55 percent of a bank's loans on nonaccrual? Let's start with you, Mr. Brown.

Mr. BROWN. If they put 55 percent of loans on nonaccrual—

Mr. POSEY. Wrongfully.

Mr. BROWN. Wrongfully?

Mr. POSEY. Yes.

Mr. BROWN. Then what is the question? I'm sorry.

Mr. POSEY. Do you think they could put a bank out of business like that?

Mr. BROWN. It is possible a bank could go out of business if it had 55 percent of loans on nonaccrual.

Mr. POSEY. Okay. But the last time you said it wasn't possible to overregulate them out of business. But you think if they did that, it would be possible.

Mr. BROWN. If they had 55 percent of loans on nonaccrual, it is possible they could be.

Mr. POSEY. Okay.

Ms. EBERLEY. I don't think regulators could inappropriately put loans on nonaccrual.

Mr. POSEY. I can't—you are going to have to speak into the microphone, please.

Ms. EBERLEY. I don't think that a regulator could inappropriately place a loan on nonaccrual. So I don't believe that would cause an institution to inappropriately go out of business. I think that if loans need to be on nonaccrual, they should be on nonaccrual, and the accounting guidance is fairly clear. It is clear that institutions—

Mr. POSEY. Okay—

Ms. EBERLEY. —nonperforming loans.

Mr. POSEY. You said, "no." That is good.

Mr. Edwards?

Mr. EDWARDS. Yes. I have to agree with Ms. Eberley that it is hard for me to understand a circumstance where the regulators would—

Mr. POSEY. Okay. That is good.

Mr. Rymer?

Mr. RYMER. First of all, it is the bank's responsibility initially to make the nonaccrual judgments. It is not the regulator's responsibility.

Mr. POSEY. All right. So is that a yes or a no?

Mr. RYMER. If—

Mr. POSEY. Just yes or no, just really simple.

Mr. RYMER. I would say from the work that we did, I did not see such a circumstance.

Mr. POSEY. Never mind. Thank you.

Yes, sir, at the end?

Mr. EVANS. Nonperforming loans would be a significant driver of bank failures. And that is what we found in our report. But the classification issue, I will pass on that.

Mr. POSEY. For Ms. Eberley's benefit, I know of an instance where regulators took a first mortgage with—on a hotel actually, about a 30 percent loan-to-value ratio, about 7 years mature, never been a day late. And the regulator said, we don't think in this market they should be able to make their payment. They have never been 1 second late in the history of the loan, a well-secured loan.

Some people think it might be entirely appropriate to put that on nonaccrual. And some people trying to use a little bit of commonsense think it would be highly inappropriate.

Mr. Rymer, let's see, Mr. Evans, from your research do you believe impairment accounting as applied in the examination process fuels the various spiral of negative balance sheet pressures, leading to more failures and write downs?

Mr. RYMER. Our study did cite some issues.

Mr. POSEY. Okay. That was a "no." That is good enough because I have a lot of ground I would like to cover, and I am running out of time.

Mr. RYMER. —regulatory issues.

Mr. POSEY. I am out of time.

Chairwoman CAPITO. You are out of time, sorry.

Mr. POSEY. Thank you, Madam Chairwoman. I would sure love a lightning round if we had 2 minutes left.

Chairwoman CAPITO. Thank you.

Mr. Barr, I would like to welcome you to the committee, and I recognize you for 5 minutes for questioning.

Mr. BARR. Thank you, Madam Chairwoman.

Ladies and gentlemen, a president of a small community bank in Central and Eastern Kentucky told me that it used to be that his bank made a business decision about whether to make a loan to a borrower and what the terms of that loan would be. Today, that same banker tells me that the government makes that decision for them. With that troubling anecdote in mind, I want to focus my questions on the costs imposed by regulations and the costs imposed by increasingly aggressive enforcement by supervisory agencies like the FDIC.

First of all, just a quick yes or no answer from Mr. Brown, Ms. Eberley, and Mr. Edwards. Do you think it is important to perform cost-benefit analysis as a predicate to promulgating rules and regulations?

Mr. BROWN. Yes, and that is our practice.

Ms. EBERLEY. I agree.

Mr. EDWARDS. Yes, I concur with that. Yes.

Mr. BARR. Okay. And Mr. Brown, you testified earlier that you solicit input from industry regarding regulatory costs through informal practices and also in the notice of comment process. Ms. Eberley, you noted that your agency was engaged in technical assistance, Web seminars, training sessions for bank directors, workshops. And I applaud the agency for taking those actions.

But the FDIC study that you all refer to in your testimony, Mr. Brown specifically, you indicated that most interview participants stated that no single regulation or practice had a significant impact on the institution, but that the cumulative effects of all regulatory requirements have built up over time.

Several other members on this panel have mentioned that earlier today, that increased staff is something that you are observing compliance staff in these community banks. But that it is so time-consuming, so costly, and so interwoven into the operations that it would be too difficult to break out these specific costs. With that testimony in mind, how can the analysis be done, the cost-benefit analysis be done properly if you acknowledge that the true costs associated with regulatory compliance cannot be captured?

Mr. BROWN. I think the difficulties in making a precise quantification of the costs and the benefits of specific regulations is something that has been noted by the GAO and other sources. We are very mindful of the balance between wanting to get information on the costs, regulatory cost, but also imposing the burden of additional regulatory reporting on the industry, which in itself can be a burden.

So we maintain that balance. That is why we rely on input from the industry, especially during the rulemaking process, to try to get better information. We think that industry is in the best position to understand their cost structure.

Mr. BARR. Given that compliance costs are increasing, and the study corroborates that and you acknowledge that increasing compliance staff is something that is happening in the industry, that the fastest growing area of banks is not in loan officers or in lending, but in compliance staff. How is the FDIC tracking, if at all, the increased compliance costs, increased costs of employing compliance officers as part of, as you acknowledge, your important cost-benefit analysis?

Mr. BROWN. I don't believe the responses indicated that compliance costs were the fastest growing cost element of those institutions. They had indicated that it had increased over a long period of time in response to a large number of regulatory changes over time. But there was no indication that it was the fastest growing area.

Mr. BARR. Okay. On top of compliance costs, I also want to just briefly explore the issue of regulatory clarity. And the example that I will cite to you is a compliance officer in a very reputable and growing community bank in Central Kentucky who tells me that her most pressing concern is the mixed signals that she receives from regulators.

Specifically, on the one hand, they are told that they need to be prudent and responsible with their loans in order to ensure safety and soundness. That comes from you all typically. Yet on the other hand, the Community Reinvestment Act wants banks to reach out to riskier, low-income borrowers who don't meet creditworthy borrowing criteria.

So the question is, is the FDIC sensitive to this concern? And what is the FDIC doing to address the contradictory mandates imposed on community banks from safety and soundness examinations on the one hand and CRA audits on the other?

Ms. EBERLEY. The consumer protection examinations are not under my purview, but I do know that we don't believe that the Community Reinvestment Act requires institutions or directs institutions to make loans that are not creditworthy. So I would disagree with the stipulation that there is—

Mr. BARR. What would you say to that particular compliance officer who doesn't understand the government's direction to the bank?

Ms. EBERLEY. We need to have a discussion with the banker. And they need to seek clarity, and I would encourage them to seek clarity from their supervisor, from their field supervisor, from their regional office. Both the consumer protection function and the safety and soundness function report up to one regional director in the field. For Kentucky, that is Anthony Lowe out of our Chicago office.

Mr. BARR. I would just—my time is up. But I would just like to encourage the FDIC to take that concern very seriously, that there is a serious lack of clarity on the part of well-meaning, well-intentioned compliance officers in these community banks. And your sensitivity to that would be appreciated.

Chairwoman CAPITO. Thank you.

Mr. Pearce for 5 minutes.

Mr. PEARCE. Thank you, Madam Chairwoman.

Just following up on Mr. Posey's statements, and then the discussion of whether it was theoretically possible for the government to regulate out of business. Now I am taking a broader view than just the banking industry. But I would direct you to my State, where we used to have 123 timber mills. And because of one regulation, all but one are shut down today, and 23,000 farmers in the San Joaquin Valley all gone because of one regulation.

The banks in the area, by the way, became unstable. Suicides rose to an all-time high for any place in the country because of one regulation. So, when you are unable to find in your own experience, come on to New Mexico. Come out to the West and we will show you a lot of areas that have been regulated out of existence.

Following up on what Mr. McHenry was talking about, I suspect that he may have been listening in on the meetings with our bankers. I hear the same complaints there, that in the past, regulators came in and they were interested in safety and soundness. And today, they come in and they are 90 percent compliance.

And so, Mr. Brown, you had said earlier in your testimony that safety and soundness, that was your charter. Do you have any idea on the budget for safety and soundness versus the budget for compliance, and the number of hours spent yearly in compliance versus safety and soundness? Does anyone on the panel have that?

Mr. BROWN. Congressman, I don't believe we have those numbers—

Mr. PEARCE. I would like to get them.

Mr. BROWN. We can certainly get back to you on that.

Mr. PEARCE. Now, keep in mind that every time I ask questions like this, we have a lower rate of getting back to me than the U.S. Postal Service. So I would really appreciate if you would follow up on that.

Now, Ms. Eberley, you were talking about how you have deep interest in making sure that there is not any hostile environment. Do you have a—last weekend, I was going to check into the Hampton for coming up, and I was able to go online and I was able to get five stars or three stars. This hotel, this one at this place rated three stars, four stars, five stars. And then, I could get comments from people who had stayed there.

Do you have anything like that for your process for your examiners so that bankers anonymously—because you heard the hostility, no they are not going to come to you. They are scared out of their minds. They are afraid that you are going to take them over and that you are going to do something. And I think that they have a valid reason, looking at the 123 mills that used to be in New Mexico and they are gone.

So, do you have a process for feedback where you can rate—or where your people get rated five stars, four stars or three stars? Do you have anything like that?

Ms. EBERLEY. We do have an examination survey process. So at the end of every examination when we mail out the report of examination, we mail a survey to the institution and ask them to complete it. I think the scale is 1 to 10—

Mr. PEARCE. And it talks about the individual regulators themselves?

Ms. EBERLEY. Yes—

Mr. PEARCE. The individual regulators.

Ms. EBERLEY. The—

Mr. PEARCE. And what percent of those do you get back?

Ms. EBERLEY. Pardon me?

Mr. PEARCE. What percent of those do you get back?

Ms. EBERLEY. I don't know the exact percentage, but we get a fairly good number, and—

Mr. PEARCE. Pretty good number?

Ms. EBERLEY. Yes. And they go to our Division of Insurance and Receivership, so they don't—I am sorry, Insurance and Research. They don't come to my division. So that division compiles the information for me and gives it to me on an aggregate basis with trends by region so that I can see what the results are.

Mr. PEARCE. Do you make that information available to the banks so that they know when someone is coming in what sort of examination that the last people received?

Ms. EBERLEY. No, it is not made available today.

Mr. PEARCE. I keep in mind that I can get that, paid $2.99 online for some program last night and I am able to get that information for $2.99. Yet you all control the banking industry of the world and they are sitting out there alarmed at what you are doing.

In New Mexico, we don't get many floods. We get 9 inches of rain a year. And yet, the flood insurance is a piece that is hammered down in New Mexico and people—the bankers express alarm about that.

Now, in a recent compliance review, one of the banks got a $15,000 fine because the names did not match exactly the IRS names. Can't you—again, on that $2.99 program I filled out last night, if I didn't fill it out correctly, it just wouldn't accept it. Can't you give a bank something where if they don't fill it out correctly—why did you stick somebody $15,000 for not—there were less than 100 of those names.

Ms. EBERLEY. So was this on their HMDA?

Mr. PEARCE. It is on the loans and—

Ms. EBERLEY. Yes. So probably the—

Mr. PEARCE. And it didn't match the IRS?

Ms. EBERLEY. Right.

Mr. PEARCE. Those used to be letters. And you sent them a letter of concern. And now, you are sticking people with fines that are very tough for small institutions, trailer houses. You are making it tough to lend money on trailer houses and on—I will be finished in just a second, Madam Chairwoman, you are very patient.

New Mexico is 47 per capita income. If you can't lend for trailer houses and if you can't lend for consumer stuff, what purpose is there in New Mexico? That is us. We are at the bottom of the heap. You guys are making it very tough for New Mexico to get access to loans.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. The gentleman yields back.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

The hearing is adjourned.

[Whereupon, at 12:11 p.m., the hearing was adjourned.]

A P P E N D I X

March 20, 2013

United States Government Accountability Office

GAO

Testimony Before the Subcommittee on Financial Institutions and Consumer Credit, House Committee on Financial Services

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FINANCIAL INSTITUTIONS

Causes and Consequences of Recent Failures of Community Banks

Statement of Lawrance L. Evans, Director
Financial Markets and Community Investment

GAO Highlights

Accountability * Integrity * Reliability

Highlights of GAO-13-476T, a testimony before the Subcommittee on Financial Institutions and Consumer Credit, House Committee on Financial Services

Why GAO Did This Study

Between January 2008 and December 2011—a period of economic downturn in the United States—414 insured U.S. banks failed. Of these, 85 percent (353) had less than $1 billion in assets. These small banks often specialize in small business lending and are associated with local community development and philanthropy. These small bank failures have raised questions about the contributing factors, including the possible role of local market conditions and the application of fair value accounting under U.S. accounting standards.

This statement is based on findings from the 2013 report on recent bank failures (GAO-13-71). This testimony discusses (1) the factors that contributed to the bank failures in states with the most failed institutions between 2008 and 2011 and what role, if any, fair value accounting played in these failures; (2) the use of shared loss agreements in resolving troubled banks; and (3) the effect of recent bank failures on local communities. To do this work, GAO relied on issued report GAO-13-71 and updated data where appropriate.

GAO did not make recommendations in the report.

View GAO-13-476T. For more information, contact Lawrance Evans, Jr. at (202) 512-4802 or evansl@gao.gov.

March 20, 2013

FINANCIAL INSTITUTIONS

Causes and Consequences of Recent Failures of Community Banks

What GAO Found

Ten states concentrated in the western, midwestern, and southeastern United States—all areas where the housing market had experienced strong growth in the prior decade—experienced 10 or more commercial bank or thrift (bank) failures between 2008 and 2011. The failures of the smaller banks (those with less than $1 billion in assets) in these states were largely driven by credit losses on commercial real estate (CRE) loans. The failed banks also had often pursued aggressive growth strategies using nontraditional, riskier funding sources and exhibited weak underwriting and credit administration practices. Fair value accounting also has been cited as a potential contributor to bank failures, but between 2007 and 2011 fair value accounting losses in general did not appear to be a major contributor, as over two-thirds of small failed banks' assets were not subject to fair value accounting. During the course of our work, some state banking associations said that the magnitude of the credit losses were exacerbated by federal bank examiners' classification of collateral-dependent loans and evaluation of appraisals used by banks to support impairment analysis of these loans. Federal banking regulators noted that regulatory guidance on CRE workouts issued in October 2009 directed examiners not to require banks to write down loans to an amount less than the loan balance solely because the value of the underlying collateral had declined, and that examiners were generally not expected to challenge the appraisals obtained by banks unless they found that underlying facts or assumptions about the appraisals were inappropriate or could support alternative assumptions.

The Federal Deposit Insurance Corporation (FDIC) used shared loss agreements to help resolve failed banks at the least cost during the recent financial crisis. Under a shared loss agreement, FDIC absorbs a portion of the loss on specified assets of a failed bank that are purchased by an acquiring bank. FDIC officials, state bank regulators, community banking associations, and acquiring banks of failed institutions GAO interviewed said that shared loss agreements helped to attract potential bidders for failed banks during the financial crisis. During 2008-2011, FDIC resolved 281 of 414 failures using shared loss agreements on assets purchased by the acquiring bank. As of December 31, 2011, Deposit Insurance Fund (DIF) receiverships are estimated to pay $42.8 billion over the duration of the shared loss agreements.

The acquisitions of failed banks by healthy banks appear to have mitigated the potentially negative effects of bank failures on communities, although the focus of local lending and philanthropy may have shifted. For example, GAO's analysis found limited rural and metropolitan areas where failures resulted in significant increases in market concentration. GAO's econometric analysis of call report data from 2006 through 2011 found that failing small banks extended progressively less net credit as they approached failure, and that acquiring banks generally increased net credit after the acquisition. However, acquiring bank and existing peer bank officials GAO interviewed noted that in the wake of the bank failures, underwriting standards had tightened and thus credit was generally more available for small business owners who had good credit histories and strong financials than those that did not. Moreover, the effects of bank failures could be significant for those limited areas that were serviced by one bank or where few banks remain.

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United States Government Accountability Office
Washington, DC 20548

Chairman Capito, Ranking Member Meeks, and Members of the Subcommittee:

I am pleased to be here today as you examine issues related to recent bank failures and community banks. Between January 2008 and December 2011, 414 insured U.S. commercial banks and thrifts (banks) failed. Of these, 85 percent (353), were small banks with less than $1 billion in assets. Banks of this size tend to be community banks with a relatively limited geographic scope of operations and often specialize in providing credit to local small businesses. Typically these banks are also associated with local community development, leadership, and philanthropy. The failures of these community banks, which were largely concentrated in certain parts of the country, occurred against the backdrop of the worst financial crisis since the Great Depression and raised a number of questions. Among these are the role played by local market conditions and related economic factors; the application of fair value accounting under generally accepted accounting principles (GAAP); and the potential effect on the communities where the banks were located, particularly in terms of credit availability, income and employment, and philanthropic activity.[1] In addition, there are questions about the impact of the Federal Deposit Insurance Corporation's (FDIC) methods for resolving failed banks on the Deposit Insurance Fund (DIF).

My remarks today are based on our January 2013 report on the impact of bank failures.[2] My statement will address (1) the factors that contributed to the failure of banks in states with 10 or more failures between 2008 and 2011, including the extent to which losses related to fair value accounting treatment affected the regulatory capital positions of failed banks; (2) market factors that affected FDIC's choice of resolution method and the costs that the DIF incurred as a result of these methods; and (3) the effect of recent small bank failures on local communities. To address

[1]Fair value accounting is a financial reporting approach that requires or permits financial institutions to measure and report on an ongoing basis certain financial assets and liabilities at the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

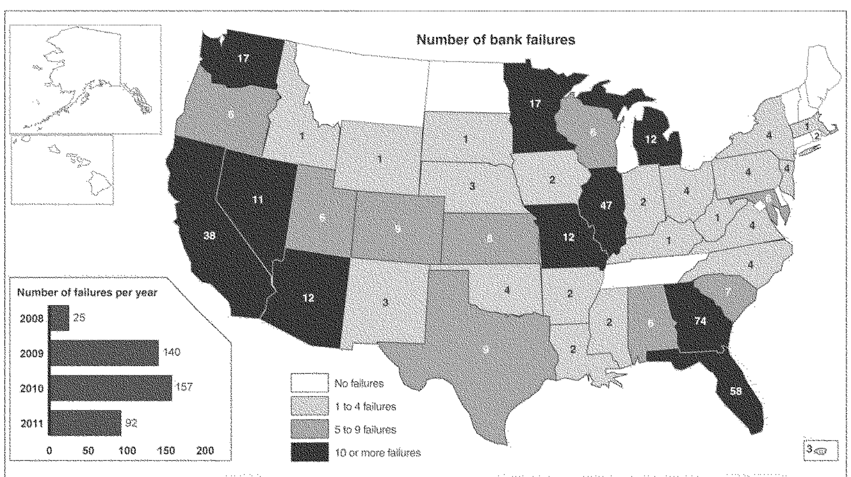
[2]GAO, *Financial Institutions: Causes and Consequences of Recent Bank Failures*, GAO-13-71 (Washington, D.C.: Jan. 3, 2013). This report was mandated by Pub. L. No. 112-88, § 3, 125 Stat. 1899, 1902 (2012). As part of this act, the FDIC Inspector General (IG) was also required to conduct a separate study on the impact of bank failures.

these issues, we analyzed call report data; reviewed inspectors general (IG) reviews of individual bank failures; conducted econometric modeling; and interviewed officials from federal and state banking regulators, banking associations, banks, and market experts. We also coordinated with the FDIC Inspector General on its study. We conducted this performance audit from February 2012 to December 2012 in accordance with generally accepted government auditing standards.

Background

Ten states concentrated in the western, midwestern, and southeastern United States—all areas where the housing market had experienced strong growth in the prior decade—experienced 10 or more bank failures between 2008 and 2011 (see fig.1). Together, failures in these 10 states comprised 72 percent (298), of the 414 bank failures across all states during this time period.

Figure 1: Number of Bank Failures by State, 2008-2011



Source: GAO analysis of FDIC data; Map Resources (map).

Within these 10 states, 86 percent (257) of the failed banks were small institutions with assets of less than $1 billion at the time of failure, and 52 percent (155), had assets of less than $250 million. Twelve percent (36) were of medium-size banks with more than $1 billion but less than $10 billion in assets, and 2 percent (5) were large banks with assets of more than $10 billion at the time of failure.

Bank Failures Were Largely Related to Nonperforming Real Estate Loans, but Also Highlighted the Impact of Impairment Accounting and Loan Loss Provisioning

In the 10 states with 10 or more failures between 2008 and 2011, failures of small and medium-size banks were largely associated with high concentrations of commercial real estate (CRE) loans, in particular the subset of acquisition, development, and construction (ADC) loans, and with inadequate management of the risks associated with these high concentrations.[3] Our analysis of call report data found that CRE (including ADC) lending increased significantly in the years prior to the housing market downturn at the 258 small banks that failed between 2008 and 2011. This rapid growth of failed banks' CRE portfolios resulted in concentrations—that is, the ratio of total CRE loans to total risk-based capital—that exceeded regulatory thresholds for heightened scrutiny established in 2006 and increased the banks' exposure to the sustained downturn that began in 2007.[4] Specifically, we found CRE concentrations grew from 333 percent in December 2001 to 535 percent in June 2008. At the same time, ADC concentrations grew from 104 percent to 259 percent. The trends for the 36 failed medium-size banks were similar over this time period. In contrast, small and medium-sized banks that did not fail exhibited substantially lower levels and markedly slower growth rates

[3]Regulators define CRE loans to include ADC loans that are secured by real estate to finance land development and construction, including new construction, upgrades, and rehabilitation. CRE loans also include unsecured loans to finance commercial real estate, loans secured by multifamily properties, and loans secured by nonfarm nonresidential property. ADC loans generally are considered to be the riskiest class of CRE loans because of their long development times and because they can include properties (such as housing developments or retail space in a shopping mall) that are built without firm commitments from buyers or lessees. By the time the construction phase is completed, market demand may have fallen, putting downward pressure on sales prices or rents, making ADC loans more volatile.

[4]Guidelines issued by federal banking regulators in 2006 described characteristics that would subject banks to greater regulatory scrutiny. These included an ADC concentration of more than 100 percent or a CRE concentration of more than 300 percent when there is an increase in the outstanding balance of the CRE portfolio of 50 percent or more during the prior 36 months. *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices* 71 Fed. Reg. 74,580 (Dec. 12, 2006).

of CRE loans and as a result had significantly lower concentrations of them, reducing the banks' exposure.

With the onset of the financial crisis, the level of nonperforming loans began to rise, as did the level of subsequent charge-offs, leading to a decline in net interest income and regulatory capital.[5] The rising level of nonperforming loans, particularly ADC loans, appears to have been the key factor in the failures of small and medium banks in the 10 states between 2008 and 2011. For example, in December 2001, 2 percent of ADC loans at the small failed banks were classified as nonperforming. With the onset of the financial crisis, the level of nonperforming ADC loans increased quickly to 11 percent by June 2008 and 46 percent by June 2011.[6] As banks began to designate nonperforming loans or portions of these loans as uncollectible, the level of net charge-offs also began to rise.[7] In December 2001, net charge-offs of ADC loans at small failed banks were less than 1 percent. By June 2008, they had risen to 2 percent and by June 2011 to 12 percent.

CRE and especially ADC concentrations in small and medium-size failed banks in the 10 states were often correlated with poor risk management and risky funding sources. Our analysis showed that small failed banks in the 10 states had often pursued aggressive growth strategies using nontraditional and riskier funding sources such as brokered deposits.[8]

[5]Net interest income is the difference between the interest income recognized on earning assets and the interest expense on deposits and other borrowed funds. Increases in the loan loss allowance for credit losses on nonperforming loans are charged to the bank's expenses on the income statement, thus reducing its net interest income. Reductions in a bank's income are reflected in its earnings, which are included in retained earnings, a component of regulatory capital.

[6]Nonperforming loans are defined as loans that are 90 days or more past due and loans on which the bank is no longer accruing interest. Institutions must estimate the credit losses on nonperforming loans and increase the loan loss allowance accordingly.

[7]Net charge-offs are the total amount of loans that are removed from the balance sheet because of uncollectibility, less amounts recovered on loans previously charged off.

[8]A "brokered deposit" is defined as a deposit obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker. The broker pools large-denomination deposits from many small investors and markets the pooled deposits to financial institutions, usually in blocks nearing $100,000, and negotiates a higher rate for the pooled certificates of deposit. In contrast, core deposits are largely derived from a bank's regular customer base, and are typically the most stable and least costly source of funding with the lowest interest rates.

The IG reviews noted that in the majority of failures, management exercised poor oversight of the risks associated with high CRE and ADC concentrations and engaged in weak underwriting and credit administration practices. Further, 28 percent (84) of the failed banks had been chartered for less than 10 years at the time of failure and according to FDIC, appeared in many cases to have deviated from their approved business plans. Large bank failures in the 10 states were associated with some of the same factors as small banks—high-risk growth strategies, weak underwriting and risk controls, and excessive concentrations that increased these banks' exposure to the real estate market downturn.The primary difference was that the large banks' strategies generally relied on risky nontraditional residential mortgage products as opposed to commercial real estate.

To further investigate factors associated with bank failures across the United States, we analyzed data on FDIC-insured commercial banks and state-chartered savings banks from 2006 to 2011. Our econometric analysis suggests that across the country, riskier lending and funding sources were associated with an increased likelihood of bank failures. Specifically, we found that banks with high concentrations of ADC loans and an increased use of brokered deposits were more likely to fail from 2008 to 2011, while banks with better asset quality and greater capital adequacy were less likely to fail.[9] An FDIC IG study issued in October 2012 found that some banks with high ADC concentrations were able to weather the recent financial crisis without experiencing a corresponding decline in their overall financial condition. Among other things, the IG found that these banks exhibited strong management, sound credit administration and underwriting practices, and adequate capital.[10]

[9]We excluded savings associations and insured branches of foreign banks from our analysis, because these institutions did not report data on key variables for the time period we analyzed. We collected data on characteristics that described a bank's capital adequacy; asset quality; earnings; liquidity; ADC lending; multifamily real estate lending; nonfarm, nonresidential real estate lending; commercial real estate lending not secured by real estate; brokered deposits funding; and size. We then estimated the likelihood of failure as a function of these characteristics, controlling for factors that affected the likelihood of failure of all banks, such as the market for the banks' products and services and overall economic conditions.

[10]FDIC Office of the Inspector General, Office of Audits and Evaluations, *Acquisition Development, and Construction Loan Concentration Study*, no. EVAL-13-001 (October 2012).

Credit Losses and Charge-offs from Nonperforming Loans Contributed Significantly to Bank Failures Nationwide, but Losses Due to Fair Value Accounting Did Not

We found that losses related to bank assets and liabilities that were subject to fair value accounting contributed little to bank failures overall, largely because most banks' assets and liabilities were not recorded at fair value. Based on our analysis, fair value losses related to certain types of mortgage-related investment securities contributed to some bank failures. But in general fair value-related losses contributed little to the decline in net interest income and regulatory capital that failed banks experienced overall once the financial crisis began.

We analyzed the assets and liabilities on the balance sheets of failed banks nationwide that were subject to fair value accounting between 2007 and 2011. We found that generally over two-thirds of the assets of all failed commercial banks (small, medium-size, and large) were classified as held-for-investment (HFI) loans, which were not subject to fair value accounting.[11] For example, small failed commercial banks held an average of 77 percent of their assets as HFI loans in 2008. At the same time, small surviving (open) commercial banks held an average of 69 percent in such loans. Failed and open small thrifts, as well as medium-size and large commercial banks, had similar percentages.

Investment securities classified as available for sale (AFS) represented the second-largest percentage of assets for all failed and open banks over the 5-year period we reviewed. For example, in 2008, small failed commercial banks held an average of 10 percent of their assets as AFS securities, while small open banks averaged 16 percent. Generally, AFS securities are recorded at fair value, but the changes in fair value only impacts earnings or regulatory capital under certain circumstances.[12] While several other asset and liability categories are recorded at fair

[11]Generally, HFI loans are recorded at amortized cost, net of an impairment allowance for estimated credit losses. Essentially, amortized cost is outstanding principal adjusted for any charge-offs, deferred fees or costs, and unamortized discounts or premiums.

[12]Some assets and liabilities, such as securities designated for trading, are measured at fair value on a recurring basis (at each reporting period), where unrealized gains or losses flow through the bank's earnings in the income statement and affect regulatory capital. However, for certain other assets and liabilities that are measured at fair value on a recurring basis, such as AFS securities, unrealized fair value gains and losses generally do not impact earnings and thus generally are not included in regulatory capital calculations. Instead, these gains or losses are recorded through other comprehensive income, unless the institution determines that a decline in fair value below amortized cost constitutes an other than temporary impairment, in which case the instrument is written down to its fair value, with credit losses reflected in earnings.

value and impact regulatory capital, together these categories did not account for a significant percentage of total assets at either failed or open commercial banks or thrifts. For example, in 2008, trading assets, nontrading assets such as nontrading derivative contracts, and trading liabilities at small failed banks ranged from 0.00 to 0.03 percent of total assets.

As discussed earlier, declines in regulatory capital at failed banks were driven by rising levels of credit losses related to nonperforming loans and charge-offs of these loans. For failed commercial banks and thrifts of all sizes nationwide, credit losses, which resulted from nonperforming HFI loans, were the largest contributors to the institutions' overall losses when compared to any other asset class. These losses had a greater negative impact on institutions' earnings and regulatory capital levels than those recorded at fair value.

During the course of our work, several state regulators and community banking association officials told us that at some small failed banks, declining collateral values of impaired collateral-dependent loans—particularly CRE and ADC loans in those areas where real estate assets prices declined severely—drove both credit losses and charge-offs and resulted in reductions to regulatory capital. Data are not publicly available to analyze the extent to which credit losses or charge-offs at the failed banks were driven by declines in the collateral values of impaired collateral-dependent CRE or ADC loans. However, state banking associations said that the magnitude of the losses was exacerbated by federal bank examiners' classification of collateral-dependent loans and evaluation of appraisals used by banks to support impairment analysis of these loans. Federal banking regulators noted that regulatory guidance in 2009 directed examiners not to require banks to write down loans to an amount less than the loan balance solely because the value of the underlying collateral had declined and that examiners were generally not expected to challenge the appraisals obtained by banks unless they found that any underlying facts or assumptions about the appraisal were inappropriate or could support alternative assumptions.[13]

[13]FDIC, Federal Reserve, OCC, OTS, the National Credit Union Administration (NCUA), and the Federal Financial Institutions Examination Council (FFIEC) State Liaison Committee, *Policy Statement on Prudent Commercial Real Estate Loan Workouts* (Oct. 30, 2009) (see for example, Federal Reserve SR 09–07 and FDIC FIL-61-2009). We reported in 2011 that interviews with officials from 43 banks in different parts of the

Current Accounting Practices for Loss Provisioning May Have Delayed Reporting of Credit Losses during the Recent Crisis

A loan loss provision is the money a bank sets aside to cover potential credit losses on loans.[14] The Department of the Treasury (Treasury) and the Financial Stability Forum's Working Group on Loss Provisioning (Working Group) observed that the current accounting model for estimating credit losses is based on historical loss rates, which were low in the years before the financial crisis. Under GAAP, the accounting model for estimating credit losses is commonly referred to as an "incurred loss model" because the timing and measurement of losses are based on estimates of losses incurred as of the balance sheet date. In a 2009 speech, the Comptroller of the Currency, who was a co-chair of the Working Group, noted that in a long period of benign economic conditions, such as the years prior to the most recent downturn, historical loan loss rates would typically be low. As a result, justifying significant loan loss provisioning to increase the loan loss allowance can be difficult under the incurred loss model.

Treasury and the Working Group noted that earlier recognition of loan losses could have reduced the need for banks having to recognize increases in their incurred credit losses through a sudden series of loan loss provisions that reduced earnings and regulatory capital. Federal banking regulators have also noted that requiring management at the failed banks to recognize loan losses earlier could have helped stem losses. Specifically, such a requirement might have provided an incentive not to concentrate so heavily in the loans that later resulted in significant losses. To address this issue, the Financial Accounting Standards Board has issued a proposal for public comment for a loan loss provisioning model that is more forward-looking and focuses on expected losses. This proposal would allow banks to establish a means of recognizing potential

country had identified multiple concerns with examiner treatment of CRE loans and related issues. GAO, *Banking Regulation: Enhanced Guidance on Commercial Real Estate Risks Needed*, GAO-11-489 (Washington, D.C.: May 19, 2011).

[14]GAAP requires financial institutions to maintain an allowance for loan losses (loan loss allowance) at a level that is appropriate to cover estimated credit losses incurred as of the balance sheet date for their entire portfolio of HFI loans. Under GAAP, institutions must recognize impairment on HFI loans when credit losses are determined to be probable and reasonably estimable. That is, when, based on current information and events, it is probable that an institution will be unable to collect all amounts due (i.e., both principal and interest) according to the contractual terms of the original loan agreement. An increase in the loan loss allowance results in a charge to expenses, termed a provision for loan losses (loan loss provision), except in the case where there are recoveries of amounts previously charged off. Loan loss provisions reduce the net interest income earned as part of a bank's earnings, and regulatory capital declines.

losses earlier on the loans they underwrite and could incentivize prudent risk management practices. Moreover, it is designed to help address the cycle of losses and failures that emerged in the recent crisis as banks were forced to increase loan loss allowances and raise capital when they were least able to do so (procyclicality). We plan to continue to monitor the progress of the ongoing activities of the standard setters to address concerns with the loan loss provisioning model.

FDIC Used Shared Loss Agreements to Attract Bidders at Least Cost to the Deposit Insurance Fund

FDIC is required to resolve a bank failure in a manner that results in the least cost to the Deposit Insurance Fund (DIF). FDIC's preferred resolution method is to sell the failed bank to another, healthier, bank. During the most recent financial crisis, FDIC facilitated these sales by including a loss share agreement, under which FDIC absorbed a portion of the loss on specified assets purchased by the acquiring bank. From January 2008 through December 31, 2011, FDIC was appointed as receiver for the 414 failed banks, with $662 billion in book value of failed bank assets. FDIC used purchase and assumption agreements (the direct sale of a failed bank to another, healthier bank) to resolve 394 failed institutions with approximately $652 billion in assets. As such, during the period 2008 through 2011, FDIC sold 98 percent of failed bank assets using purchase and assumption agreements. However, FDIC only was able to resolve so many of these banks with purchase and assumption agreements because it offered to share in the losses incurred by the acquiring institution. According to FDIC officials, at the height of the financial crisis in 2008, FDIC sought bids for whole bank purchase and assumption agreements (where the acquiring bank assumes essentially all of the failed bank's assets and liabilities) with little success. Potential acquiring banks we interviewed told us that they did not have sufficient capital to take on the additional risks that the failed institutions' assets represented. Acquiring bank officials that we spoke to said that, because of uncertainties in the market and the value of the assets, they would not have purchased the failed banks without FDIC's shared loss agreements.

Because shared loss agreements had worked well during the savings and loan crisis of the 1980s and early 1990s, FDIC decided to offer the option of having such agreements as part of the purchase and assumption of the failed bank. Shared loss agreements provide potential buyers with some protection on the purchase of failed bank assets, reduce immediate cash needs, keep assets in the private sector, and minimize disruptions to banking customers. Under the agreements, FDIC generally agrees to pay 80 percent for covered losses, and the acquiring bank covers the remaining 20 percent. From 2008 to the end of 2011, FDIC resolved 281 of the 414 failures (68 percent) by providing a shared loss agreement as part of the purchase and assumption. The need to offer shared loss agreements diminished as the market improved. For example, in 2012 FDIC had been able to resolve more than half of all failed institutions without having to offer to share in the losses. Specifically, between January and September 30, 2012, FDIC had to agree to share losses on 18 of 43 bank failures (42 percent). Additionally, some potential bidders were willing to accept shared loss agreements with lower than 80 percent coverage.

As of December 31, 2011, DIF receiverships had made shared loss payments totaling $16.2 billion. In addition, future payments under DIF receiverships are estimated at an additional $26.6 billion over the duration of the shared loss agreements, resulting in total estimated lifetime losses of $42.8 billion (see fig. 2).[15]

Figure 2: Shared Loss Agreements Entered into by Year, 2008-2011

Year	Number of shared loss agreements	Estimated lifetime losses (dollars in billions)
2008	3	$3.29
2009	90	19.92
2010	130	15.98
2011	58	3.65
	Total 281	Total $42.84

Source: GAO analysis of FDIC data.

By comparing the estimated cost of the shared loss agreements with the estimated cost of directly liquidating the failed banks' assets, FDIC has estimated that using shared loss agreements has saved the DIF over $40 billion. However, while the total estimated lifetime losses of the shared loss agreements may not change, the timing of the losses may, and payments from shared loss agreements may increase as the terms of the agreements mature. FDIC officials stated that the acquiring banks were

[15]FDIC reported that, as of December 31, 2012, DIF receiverships made shared-loss payments totaling $23.3 billion and are estimated to pay an additional $18.1 billion over the duration of the shared loss agreements, resulting in total lifetime losses of $41.4 billion. These data included shared-loss agreements associated with both the bank failures that occurred between 2008 and 2011 as well as the additional banks that failed in 2012.

being monitored for compliance with the terms and conditions of the shared loss agreements. FDIC is in the process of issuing guidance to the acquiring banks reminding them of these terms to prevent increased shared loss payments as these agreements approach maturity.

Impact of Bank Failures on Local Communities Was Mixed

The acquisitions of failed banks by healthy banks appear to have mitigated the potentially negative effects of bank failures on communities, although the focus of local lending and philanthropy may have shifted. First, while bank failures and failed bank acquisitions can have an impact on market concentration—an indicator of the extent to which banks in the market can exercise market power, such as raising prices or reducing the availability of some products and services—we found that a limited number of metropolitan areas and rural counties were likely to have become significantly more concentrated.

We analyzed the impact of bank failures and failed bank acquisitions on local credit markets using data for the period from June 2007 to June 2012. We calculated the Herfindahl-Hirschman Index (HHI), a key statistical measure used to assess market concentration and the potential for firms to exercise their ability to influence market prices. The HHI is measured on a scale of 0 to 10,000, with values over 1,500 considered indicative of concentration.[16] Our results suggest that a small number of the markets affected by bank failures and failed bank acquisitions were likely to have become significantly more concentrated. For example, 8 of the 188 metropolitan areas affected by bank failures and failed bank acquisitions between June 30, 2009, and June 29, 2010, met the criteria for raising significant competitive concerns. Similarly, 5 of the 68 rural counties affected by bank failures during the same time period met the criteria. The relatively limited number of areas where concentration increased was generally the result of acquisitions by institutions that were not already established in the locales that the failed banks served.

[16]The HHI reflects the number of firms in the industry and each firm's market share. It is calculated by summing the squares of the market shares of each firm competing in the market. The HHI also reflects the distribution of market shares of the top firms and the composition of the market outside the top firms. According to the Department of Justice and the Federal Trade Commission, markets in which the value of the HHI is between 1,500 and 2,500 points are considered to be moderately concentrated, and those in which the value of the HHI is in excess of 2,500 points are considered to be highly concentrated, although other factors also play a role.

However, the effects could be significant for those limited areas that were serviced by one bank or where few banks remain.

Second, our econometric analysis of call report data from 2006 through 2011 found that failing small banks extended progressively less net credit as they approached failure, but that acquiring banks generally increased net credit after the acquisition, albeit more slowly.[17] Acquiring and peer banks we interviewed in Georgia, Michigan, and Nevada agreed.[18] However general credit conditions were generally tighter in the period following the financial crisis. For example, several noted that in the wake of the bank failures, underwriting standards had tightened, making it harder for some borrowers who might have been able to obtain loans prior to the bank failures to obtain them afterward. Several banks officials we interviewed also said that new lending for certain types of loans could be restricted in certain areas. For example, they noted that the CRE market, and in particular the ADC market, had contracted and that new lending in this area had declined significantly.

Officials from regulators, banking associations, and banks we spoke with also said that involvement in local philanthropy declined as small banks approached failure but generally increased after acquisition. State banking regulators and national and state community banking associations we interviewed told us that community banks tended to be highly involved in local philanthropic activities before the recession—for example, by designating portions of their earnings for community development or other charitable activities. However, these philanthropic activities decreased as the banks approached failure and struggled to

[17]We used an econometric model to estimate net credit extended by banks during a quarter as a function of the capital adequacy; asset quality; earnings; liquidity; ADC lending; nonfarm, nonresidential real estate lending; multifamily real estate lending; commercial real estate lending not secured by real estate; brokered deposits; size; and other factors. We also included indicators for each quarter to control for factors affecting net credit extension that are common to all banks at the same time, such as the regulatory environment, the state of the market for bank products and services, and the condition of the overall economy. We then used the results of our model to predict net credit extended by failing banks in the quarters leading up to their failure and by acquiring banks in the quarters following acquisition of a failed bank.

[18]We chose to focus on these three states because they reflect the three major areas where the bank failures were concentrated—the southeast, southwest, and midwest. They reflect states with either highest numbers of bank failures or highest failure rates. They also reflect the economic conditions that contributed to the bank failures—high unemployment rates, and for two states, high declines in house prices.

conserve capital. Acquiring bank officials we interviewed told us that they had generally increased philanthropic activities compared with the failed community banks during the economic downturn and in the months before failure. However, acquiring banks may or may not focus on the same philanthropic activities as the failed banks. For example, one large acquiring bank official told us that it made major charitable contributions to large national or statewide philanthropic organizations and causes and focused less on the local community charities to which the failed bank had contributed.

Finally, we econometrically analyzed the relationships among bank failures, income, unemployment, and real estate prices for all states and the District of Columbia (states) for 1994 through 2011. Our analysis showed that bank failures in a state were more likely to affect its real estate sector than its labor market or broader economy. In particular, this analysis did not suggest that bank failures in a state—as measured by failed banks' share of deposits—were associated with a decline in personal income in that state. To the extent that there is a relationship between the unemployment rate and bank failures, the unemployment rate appears to have more bearing on failed banks' share of deposits than vice versa. In contrast, our analysis found that failed banks' share of deposits and the house price index in a state appear to be significantly related to each other. Altogether, these results suggest that the impact of bank failures on a state's economy is most likely to appear in the real estate sector and less likely to appear in the overall labor market or in the broader economy.[19] However, we note that these results could be different at the city or county level.

[19]We measured bank failures in a state as the fraction of deposits in a state that were in banks that failed during the past year. This measure captures both the size of the failing banks and their share of the deposits (a proxy for their weight in a state), whereas the absolute number of failures or the simple failure rate does not. We measured income in a state using state personal income, adjusted for inflation. We measured unemployment in a state using the unemployment rate. We measured real estate prices using house price indices for single-family detached properties with conventional conforming mortgages. For each variable, we estimated the relationship between the variable, its past values, and past values of the other three variables. We used a technique that controls for time-invariant characteristics of states and features of the national economy that affect all states at the same time and that allows for the possibility that all four variables are jointly determined and affected by each other. We then used Granger causality tests to estimate the likelihood that the past values of each variable helped explain the current values of the other variables.

Chairman Capito, Ranking Member Meeks, and Members of the Subcommittee, this concludes my prepared statement. I would be happy to answer any questions that you may have at this time.

Contacts and Acknowledgments

If you or your staff have any questions about this testimony, please contact Lawrance Evans, Jr. at (202) 512-4802 or evansl@gao.gov. Contact points for our Offices of Public Affairs and Congressional Relations may be found on the last page of this report. GAO staff who made key contributions to this testimony include Karen Tremba, Assistant Director; William Cordrey, Assistant Director; Gary Chupka, Assistant Director; William Chatlos; Emily Chalmers, Robert Dacey; Rachel DeMarcus; M'Baye Diagne; Courtney LaFountain; Marc Molino, Patricia Moye; Lauren Nunnally; Angela Pun, Stefanie Jonkman; Akiko Ohnuma; Michael Osman; and Jay Thomas.

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STATEMENT OF

THE FEDERAL DEPOSIT INSURANCE CORPORATION
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on

STATE OF COMMUNITY BANKING: IS THE CURRENT REGULATORY ENVIRONMENT ADVERSELY AFFECTING COMMUNITY FINANCIAL INSTITUTIONS?

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES

U.S. House of Representatives

March 20, 2013
2128 Rayburn House Office Building

Chairwoman Capito, Ranking Member Meeks, and members of the Subcommittee, we appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the state of community banking and to describe the findings of the *FDIC Community Banking Study*, a comprehensive review based on 27 years of data on community banks.[1] We also welcome the opportunity to discuss the reviews by the Government Accountability Office (GAO) and the FDIC Office of Inspector General (OIG) of the causes of the recent financial crisis and the FDIC's supervision and resolution-related responses.

As the Subcommittee is well aware, the recent financial crisis has proved challenging for all financial institutions. The FDIC's problem bank list peaked at 888 institutions in 2011. Since January 2008, 469 insured depository institutions have failed, with banks under $1 billion making up 407 of those failures. Fortunately, the pace of failures has declined significantly since 2010, a trend we expect to continue.

The failure of a bank has the potential to be a highly disruptive event. While the FDIC protects insured depositors and resolves each institution in the least costly and least disruptive manner possible, the customers of a failed bank may still face the need to establish a new banking relationship that meets their financial needs. A bank failure also may be disruptive to a local community if the failure results in an adverse impact on the availability of credit or if distress sales of the failed bank's assets adversely affect local real estate prices.

[1] *FDIC Community Banking Study*, December 2012, http://www.fdic.gov/regulations/resources/cbi/study.html

Given the challenges that community banks, in particular, have faced in recent years, the FDIC last year launched a "Community Banking Initiative" to refocus our efforts to communicate with community banks and to better understand their concerns. The knowledge gathered through this Initiative will help to ensure that our supervisory actions are grounded in the recognition of the important role that community banks play in our economy. A key product of the Initiative was the recently published *FDIC Community Banking Study*, which is discussed in more detail below.

Congress also enacted P.L. 112-88, which mandates comprehensive reviews by the GAO and by the FDIC OIG of the causes of the recent crisis, the supervisory response, and the resolution of failed institutions. Consistent with the *FDIC Community Banking Study*, the GAO and OIG reviews identify three primary factors that contributed to bank failures in the recent crisis, namely: 1) rapid growth; 2) excessive concentrations in commercial real estate lending (especially acquisition and development lending); and 3) funding through highly volatile deposits. By contrast, community banks that followed a traditional business plan of prudent growth, careful underwriting and stable deposit funding were much more likely to survive the recent crisis.

Our testimony discusses the findings of the *FDIC Community Banking Study*, as well as our assessment and response to the reviews by the FDIC OIG and the GAO.

FDIC Community Banking Study

In December 2012, the FDIC released the *FDIC Community Banking Study*, our comprehensive review of the U.S. community banking sector covering 27 years of data. The Study set out to explore some of the important trends that have shaped the operating environment for community banks over this period, including: long-term industry consolidation; the geographic footprint of community banks; their comparative financial performance overall and by lending specialty group; efficiency and economies of scale; and access to capital. This research was based on a new definition of community bank that goes beyond size to also account for the types of lending and deposit gathering activities and limited geographic scope that are characteristic of community banks.

Specifically, where most previous studies have defined community banks strictly in terms of asset size (typically including banks with assets less than $1 billion), our study introduced a definition that takes into account a focus on lending, reliance on core deposit funding, and a limited geographic scope of operations. Applying these criteria for the baseline year of 2010 has the effect of excluding 92 banking organizations with assets less than $1 billion while including 330 banking organizations with assets greater than $1 billion. Importantly, the 330 community banks over $1 billion in size held $623 billion in total assets – approximately one-third of the community bank total. While these institutions would have been excluded under many size-based definitions, we found that they operated in a similar fashion to smaller community banks. It is important to note that the purpose of this definition is research and analysis; it is not intended to substitute for size-based thresholds that are currently embedded in statute, regulation, and supervisory practice.

Our research confirms the crucial role that community banks play in the American financial system. As defined by the Study, community banks represented 95 percent of all U.S. banking organizations in 2011. These institutions accounted for just 14 percent of the U.S. banking assets in our nation, but held 46 percent of all the small loans to businesses and farms made by FDIC-insured institutions. While their share of total deposits has declined over time, community banks still hold the majority of bank deposits in rural and micropolitan counties.[2] The Study showed that in 629 U.S. counties (or almost one-fifth of all U.S. counties), the only banking offices operated by FDIC-insured institutions at year-end 2011 were those operated by community banks. Without community banks, many rural areas, small towns and urban neighborhoods would have little or no physical access to mainstream banking services.

Our Study took an in-depth look at the long-term trend of banking industry consolidation that has reduced the number of federally insured banks and thrifts from 17,901 in 1984 to 7,357 in 2011. All of this net consolidation can be accounted for by an even larger decline in the number of institutions with assets less than $100 million. But a closer look casts significant doubt on the notion that future consolidation will continue at this same pace, or that the community banking model is in any way obsolete.

More than 2,500 institutions have failed since 1984, with the vast majority failing in the crisis periods of the 1980s, early 1990s, and the period since 2007. To the extent that future crises can be avoided or mitigated, bank failures should contribute much less to future

[2] The 3,238 U.S. counties in 2010 included 694 micropolitan counties centered on an urban core with population between 10,000 and 50,000 people, and 1,376 rural counties with populations less than 10,000 people.

consolidation. In addition, about one third of the consolidation that has taken place since 1984 is the result of charter consolidation within bank holding companies, while just under half is the result of voluntary mergers. But both of these trends were greatly facilitated by the gradual relaxation of restrictions on intrastate branching at the state level in the 1980s and early 1990s, as well as the rising trend of interstate branching that followed enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. The pace of voluntary consolidation has indeed slowed over the past 15 years as the effects of these one-time changes were realized. Finally, the Study questions whether the rapid pre-crisis growth of some of the nation's largest banks, which occurred largely as a result of mergers and acquisitions and growth in retail lending, can continue at the same pace going forward. Some of the pre-crisis cost savings realized by large banks have proven to be unsustainable in the post-crisis period, and a return to pre-crisis rates of growth in consumer and mortgage lending appears, for now anyway, to be a questionable assumption.

The Study finds that community banks that grew prudently and that maintained diversified portfolios or otherwise stuck to their core lending competencies during the study period exhibited relatively strong and stable performance over time. Other institutions that pursued higher-growth strategies – frequently through commercial real estate or construction and development lending – encountered severe problems during real estate downturns and generally underperformed over the long run. Moreover, the Study finds that economies of scale play a limited role in the viability of community banks. While average costs are found to be higher for very small community banks, most economies of scale are largely realized by the time an institution reaches $100 million to $300 million in size, depending on the lending specialty.

These results comport well with the experience of banking industry consolidation since 1984, in which the number of bank and thrift charters with assets less than $25 million has declined by 96 percent, while the number of charters with assets between $100 million and $1 billion has grown by 19 percent.

With regard to measuring the costs associated with regulatory compliance, the Study noted that the financial data collected by regulators does not identify regulatory costs as a distinct category of noninterest expenses. In light of the limitations of the data and the importance of this topic in our discussions with community bankers, the FDIC conducted interviews with a group of community banks as part of our Study to try to learn more about regulatory costs. As described in Appendix B of the Study, most interview participants stated that no single regulation or practice had a significant effect on their institution. Instead, most stated that the strain on their organization came from the cumulative effects of all the regulatory requirements that have built up over time. Many of the interview participants indicated that they have increased staff over the past ten years to support the enhanced responsibility associated with regulatory compliance. Still, none of the interview participants indicated that they actively track the various costs associated with regulatory compliance, because it is too time-consuming, too costly, and so interwoven into their operations that it would be difficult to break out these specific costs. These responses point to the challenges of achieving a greater degree of quantification in studying this important topic.

In summary, the Study finds that, despite the challenges of the current operating environment, the community banking sector remains a viable and vital component of the overall

U.S. financial system. It identifies a number of issues for future research, including the role of commercial real estate lending at community banks, their use of new technologies, and how additional information might be obtained on regulatory compliance costs.

Examination and Rulemaking Review

In addition to the comprehensive study on community banks, the FDIC also reviewed its examination, rulemaking, and guidance processes during 2012 with a goal of identifying ways to make the supervisory process more efficient, consistent, and transparent – while maintaining safe and sound banking practices. This review was informed by a February 2012 FDIC conference on the challenges and opportunities facing community banks, a series of six roundtable discussions with community bankers around the nation, and ongoing discussions with the FDIC's Advisory Committee on Community Banking.

Based on concerns raised in these discussions, the FDIC has implemented a number of enhancements to our supervisory and rulemaking processes. First, the FDIC has restructured the pre-exam process to better scope examinations, define expectations and improve efficiency. Second, the FDIC is taking steps to improve communication with banks under our supervision by using web-based tools to provide critical information about changes in regulations, including deadlines for submitting comments on proposed new rules. Finally, the FDIC has instituted a number of outreach and technical assistance efforts, including increased direct communication between examinations, increased opportunities to attend training workshops and symposiums, and conference calls and training videos on complex topics of interest to community bankers.

The FDIC plans to continue its review of examination and rulemaking processes, and is developing new initiatives to provide technical assistance to community banks, which we expect to introduce later this year.

Reviews Required by P.L. 112-88

Under P.L. 112-88, the GAO was tasked with analyzing the causes and impact of a number of elements of the crisis, including: 1) the causes of high levels of bank failures in states with 10 or more failures since 2008; 2) the procyclical impact of fair value accounting standards; 3) the causes and potential solutions for the "vicious cycle" of loan write downs, raising capital, and failures; 4) an analysis of the community impact of bank failures; and 5) the feasibility and overall impact of loss share agreements.

P.L. 112-88 also tasked the FDIC's OIG with reviewing eight specific issue areas: 1) loss share agreements, otherwise known as shared-loss agreements (SLAs); 2) losses at failed banks; 3) examiner implementation of appraisal guidelines; 4) examiner assessment of capital adequacy and private capital investment in failing institutions; 5) examiner implementation of loan workout guidance; 6) the application and impact of formal enforcement orders; 7) the impact of FDIC policies on investments in institutions; and 8) the FDIC's handling of private equity company investments in institutions. The OIG subsequently reviewed and described FDIC compliance with applicable regulatory and supervisory standards in each of the eight areas.

The resulting GAO and OIG reviews were detailed and comprehensive, providing a wealth of information and data regarding the causes of the recent crisis and the FDIC's response. Although the GAO review did not include any recommendations, the OIG made several useful recommendations that are highly relevant to the FDIC's efforts to address the many issues arising from the crisis. The FDIC concurs with all of the OIG's recommendations and is now in the process of implementing them. Detailed descriptions of the FDIC's assessment of the issues identified by P.L. 112-88, the OIG's recommendations and the FDIC's implementation efforts are provided as an Appendix to this testimony.

Conclusion

The recent financial crisis has proved challenging for financial institutions in general and for community banks in particular. Analyses of bank failures during the crisis by the FDIC, its OIG and the GAO point to some common risk factors, including rapid growth, concentrations in high-risk loans, and funding through volatile deposits. In contrast, community banks that followed more conservative business models were much more likely to survive the crisis. The FDIC's extensive study of community banking over a 27-year period shows that while these institutions face a number of challenges, they will remain a viable and vital component of the overall U.S. financial system in the years ahead.

As mandated by statute, the GAO and the FDIC OIG conducted reviews that provided valuable information regarding the causes of the recent crisis and the FDIC's response. The FDIC welcomes the insights provided by the GAO and the OIG regarding the causes of the recent crisis. As described in the Appendix to this testimony, the review by the FDIC OIG also made a number of useful recommendations that the FDIC is now in the process of implementing. We believe that this type of analysis and policy review is an important element of our long-term efforts to maintain a safe and sound financial system and to effectively and appropriately respond when FDIC-insured institutions encounter financial distress.

Appendix

The discussions below correspond to the eight issue areas identified in P.L. 112-88 for review by the FDIC's Office of Inspector General (OIG). Each section includes a discussion of the key policy issues, any recommendations by the OIG and actions being undertaken by the FDIC to implement the recommendations.

Issue 1 -- Shared-Loss Agreements

When the Office of the Comptroller of the Currency (OCC) or a state banking regulator closes an FDIC-insured institution, federal law requires the FDIC to use the least costly method to resolve the failing institution. During the savings and loan and banking crisis of the late 1980s and early 1990s, the FDIC in most cases took control of the troubled assets of failed banks and managed them for eventual liquidation. Although the management of troubled assets in receivership met our statutory responsibilities in resolving failed banks, this strategy was found to have some serious shortcomings. Liquidating assets in receivership can result in significant disruptions for borrowers and surrounding communities, a diminution in the value of assets held under government control, and high losses to the insurance fund. In addition, the FDIC and the Resolution Trust Corporation had to employ over 20,000 people to manage and sell the assets from those bank failures.

An innovation introduced in the early 1990s was the shared loss agreement (SLA), in which the acquiring institution would assume all of the assets of the failed bank in exchange for a partial indemnification against future losses on troubled assets. Under a typical SLA structure, the FDIC would assume 80 percent of future losses on troubled assets, with the acquiring institution assuming the remaining 20 percent. While this partial indemnification against loss would induce risk averse acquirers to take on these troubled assets under private management, and thus keep them out of a government-controlled receivership, it also provided an incentive for the acquirer to maximize net recoveries on those assets – consistent with the fiduciary responsibility of the FDIC.

In the recent financial crisis, the FDIC has made much more extensive use of SLAs to facilitate the prompt transfer of failed bank assets to private management. SLAs were an essential tool to overcome the extreme uncertainty and risk aversion with regard to future loan performance and collateral values, especially early in the crisis. Almost 65 percent of the bank failures since the beginning of 2008 through 2012 were resolved through whole-bank purchase and assumption transactions with SLAs. As of December 31, 2012, the cost savings obtained through using whole-bank purchase and assumption transactions with SLAs, as opposed to more costly resolution alternatives, were projected to be approximately $41.1 billion

The goals of SLAs are to allow as many assets as possible to be kept in the private sector with a lending institution and to have the acquiring institution manage those assets under incentives that closely align the interests of the bank with the interests of the FDIC. Because an acquiring institution has financial exposure to the losses on assets purchased under this arrangement, it has an incentive to utilize a "least loss" strategy in managing and disposing of these assets.

SLAs also address the effect of bank failures on the local market by keeping more of the failed bank's borrowers in a banking environment. The acquiring institution can more easily work with the borrowers to restructure problem loans or to advance additional funding when prudent, helping to avoid a further decline in collateral values in the failed bank's market. Most importantly for the borrowers, the provisions of the SLAs entered into by the FDIC during this crisis require the acquiring institution to consider modifications for nonperforming loans in order to minimize unnecessary foreclosures.

Prospective bidders for failed institutions have the option to bid with or without an SLA. As expected, the number of failing bank resolution transactions conducted with SLAs has begun to decrease as the economy has recovered and as real estate markets have stabilized. In 2010, 130 of 157 bank failures, or 83 percent, were resolved using SLAs. Since then, both the number and percent of failed bank resolutions involving SLAs has declined steadily. In 2011, 58 out of 92 failed bank resolutions, or 63 percent, involved an SLA, as did 20 of 51 resolutions, or 39 percent, in 2012. None of the four failures so far this year was resolved using an SLA.

Term of shared-loss agreements

There are two primary types of SLAs, those applied to single family mortgage loans and those applied to non-single family loans. Single family SLAs have a term of ten years. Non-single family loan SLAs have a term of eight years, consisting of five years of shared-loss coverage followed by three years to allow for recovery payments to the FDIC on the assets for which a shared-loss claim was paid. The long term nature of the agreements is intended to allow for the acquiring institution to maximize the value of the failed bank's assets. As part of that process, banks work with distressed borrowers, attempting to reach a mutually beneficial resolution. The expiration of these agreements does not change the underlying incentives for the acquiring institution to develop new customer relationships and maximize net recoveries.

Management of acquired assets

The SLA requires the acquiring institution's best efforts to maximize recoveries. In satisfying this requirement, the acquiring institution is expected to consider every resolution alternative, including loan modifications. As such, acquiring institutions must undertake loss mitigation efforts prior to taking any foreclosure action. Additionally, the acquiring institution is required to manage and administer each loan covered under an SLA in accordance with prudent business and banking practices and in accordance with the acquiring institution's written internal credit policies and established practices.

The requirement for acquiring institutions to undertake loan modifications is subject to a financial analysis designed to ensure that qualifying borrowers are approved for modification and that such a strategy will maximize long-term recoveries. Because acquiring institutions generally share a portion of any losses, they share the FDIC's interest in pursuing modification in cases where it can be shown to maximize recoveries. Loss mitigation alternatives that increase the value of the loans will likely improve the affordability of the loan to the borrower and thereby lower the probability of default. Loan modifications can help borrowers preserve their stake in their homes and businesses. Collectively, these efforts to avoid foreclosures can help to preserve the viability of the community as a whole, which is also clearly in the best interest of an acquiring bank doing business in that community. All of these considerations point to a strong incentive on the part of the acquiring bank to avoid foreclosure or short sale and pursue a loan modification or restructuring whenever that alternative proves feasible.

Commercial real estate loan restructuring requirements

On December 17, 2010, the FDIC issued *Commercial Loss Mitigation Guidance on Commercial Real Estate (CRE) Loans,* requiring acquiring institutions to pursue a disposition strategy other than foreclosure on a covered asset when an alternative strategy is projected to result in the least loss. For commercial loans that are restructured by an acquiring institution, the loss share reimbursement is based on the portion of a restructured loan that is categorized as a loss. Therefore, an acquiring institution may file a shared-loss claim on a commercial loan based on the market value of the underlying collateral without the need to foreclose.

Residential mortgage modification requirements

SLAs also require the acquiring institution to implement a comprehensive loan modification program, such as HAMP or the FDIC Loan Modification Program, for single-family mortgages covered under the agreement. Modifications improve borrower affordability, increase the probability of performance, and allow borrowers to remain in their homes. Prior to any foreclosure action, the acquiring institution is required to perform and document a simple financial analysis to assess the feasibility of modifying a single family mortgage loan. If a qualified borrower accepts the modification offer, the bank can submit a shared-loss claim to the FDIC. One clear advantage for acquiring institutions to pursue modification is the ability to be paid sooner than might be the case in a foreclosure. Not only must the institution exhaust all loss mitigation options before foreclosure can proceed, but foreclosure and the sale of foreclosed property is a process that can take up to two years or more, depending on the state in which the property is located. Hence, the acquiring institution has a strong incentive to consider and engage in single family mortgage loan modifications where viable.

Monitoring of shared-loss agreements

The FDIC monitors compliance with the SLAs through quarterly reporting by the acquiring institution and through periodic reviews of the acquiring institution's adherence to the agreement terms. If the FDIC determines that an acquiring institution has not complied with the terms of the SLA, including the requirement to consider and engage in loan modifications, the FDIC will delay payment of shared-loss claims until compliance problems are corrected. The FDIC can deny payment of a claim altogether or indefinitely suspend payments for as long as the acquiring institution remains out of compliance with the agreement. The periodic reviews of the acquiring institution are completed onsite, and include: verifying the accuracy of shared-loss claims; ensuring compliance with loss mitigation efforts; testing the acquiring institution's policies and procedures to ensure uniform criteria are being applied to both shared-loss assets and the bank's own legacy assets; reviewing internal audit reports and the external independent public accountant reports to ensure that internal controls are in place; and verifying that adequate accounting, reporting, and recordkeeping systems are in place. Thus far, we have found that the overwhelming majority of acquiring institutions are diligent in their efforts to comply with all the terms of the SLAs.

OIG Recommendation

The OIG recommended that the FDIC develop a strategy for mitigating the impact of impending portfolio sales and SLA terminations on the Deposit Insurance Fund, and that it ensure that procedures, processes, and resources are sufficient to address the volume of terminations and potential requests for asset sales.

The FDIC agrees with this recommendation, and steps are being taken to meet its stated goals. At the same time, we believe that a number of factors, including the provisions of the SLAs themselves, will help to avoid the unnecessary sale of distressed assets and mitigate the market impact once the SLAs are terminated.

For example, the FDIC policy for portfolio note sales provides that: 1) the acquiring institution's right to conduct a portfolio sale is conditional and requires FDIC consent; 2) the evaluation of portfolio sales by the FDIC will include an analysis of alternative collection and modification strategies and a review to determine whether collections would be maximized on an asset-by-asset basis; 3) the FDIC's Loan Sale Advisory Review Committee will review all request for portfolio sales and large individual loan sales to ensure a consistent approach to the approval process; and 4) an acquiring institution is not to rely on portfolio sales as a primary resolution strategy for shared-loss assets.[3]

The FDIC has closely monitored and diligently enforced compliance with the SLAs. We believe that, as a result of our efforts in this regard combined with the aging of the portfolios, a relatively small portion of the original principal balance of non-single family assets covered under SLAs will remain outstanding when the shared-loss coverage periods on those agreements terminate. Since the inception of the program in 2008 through year-end 2012, the total covered principal balance for non-single family assets has already shrunk by over 60 percent, from approximately $139 billion to $54 billion. We project the total covered principal balance to shrink further to approximately $25 billion by the time the shared-loss coverage periods for the remaining non-single family SLAs expire. Furthermore, the majority of the shared-loss coverage periods on the outstanding non-single family SLAs are scheduled to expire over a four-year period (from 2014 to 2017) and over a wide geographic area. To the extent that the balances of covered assets have already declined, and that the expiration of the non-single family SLAs that cover these remaining balances will be spread out over a period of years and across different

[3] The FDIC has repeatedly communicated its expectations regarding the requirements and approval of portfolio note sales to the acquiring institutions in a variety of settings, including the Annual Risk Sharing Conference held in October 2012 and the Georgia Bankers Roundtable Conference held in November 2012. Formal guidance also was issued to all acquiring institutions in a letter dated October 9, 2012.

geographical regions, we do not expect the scheduled expiration of non-single family SLAs to have severe effects on local asset markets.

Some also have expressed the concern that, after the shared-loss coverage periods end, acquiring institutions will sell or otherwise dispose of non-single family assets at distressed prices. However, SLAs do not provide incentives for the acquiring institutions to engage in the "fire sale" of covered assets at the end of the shared-loss coverage period. As these agreements expire, the acquiring institutions will absorb 100 percent of all losses from below market sales or other dispositions, resulting in a hit to capital for these institutions. Further, the FDIC retains rights to recoveries on assets during the recovery period and, as a result, the acquiring institutions remain bound by the requirements of the SLA, including the requirement to maximize recoveries.

The FDIC has committed to conducting a full assessment of the sufficiency of its procedures, processes, and resources for the anticipated volume of portfolio sales and SLA terminations. The FDIC will complete the assessment and deliver its conclusions to the OIG by September 30, 2013.

OIG Recommendation

The second OIG recommendation was that the FDIC research the risks presented by commercial loan extension decisions and determine whether additional controls should be introduced to monitor the efforts of acquiring institutions to extend the terms of commercial loans. We agree with this recommendation.

The FDIC has established an internal national task force that is composed of staff from the Division of Resolutions and Receiverships and the Division of Risk Management Supervision to share information and proactively collaborate on topics such as concerns about shared-loss agreements. In addition, regular collaboration with regulators at the Federal Reserve Board (FRB), the OCC, and the Canadian Office of Superintendent of Financial Institutions has been established to ensure consistency and to facilitate open communication and information sharing throughout the term of the SLAs.

The FDIC is in the process of enhancing its Compliance Review Program to require the evaluation of loan amendments, including maturity date extensions, to ensure that they comply with the SLA provisions governing loan modifications. The goal of this effort is to ensure that any loan modification or refusal to modify a loan is consistent with maximizing recoveries and with the acquiring institution's policies and procedures with regard to legacy loans. Violations of the SLA will not be tolerated. If found, such violations could result in loans being removed from loss sharing and, when appropriate, the clawback of any claims paid by the FDIC. In addition, the Compliance Review Program will target high risk areas, such as sales of real estate owned, where assets could be liquidated in a manner that is inconsistent with prudent management standards and that fails to maximize collections.

The FDIC conducts targeted Loss Mitigation Reviews, which are undertaken in addition to our regularly scheduled compliance monitoring reviews and serve as a mechanism to directly communicate with acquiring institutions as to the requirements of the program. The acquiring institutions are reminded of the contractual obligations of the agreements and expectations for loan modification efforts, as well as the potential penalties for violations of the terms of the SLA. The reviews include, but are not limited to, inconsistent policies on commercial loan term extensions, violations of management standards and permitted amendment provisions, violations of internal bank policy and procedures, and actions that are inconsistent with maximizing collections.

In response to the OIG report, the FDIC has committed to reinforcing previous communications, requiring FDIC compliance monitoring contractors to review a sample of loan modification decisions for maturing loans, and analyzing the costs and benefits of collecting and monitoring trend information on commercial loan modifications. The FDIC will complete these actions and deliver its conclusions to the OIG by September 30, 2013.

Finally, the FDIC will continue to reach out to banks and other members of the public that may have concerns about the impact of the SLAs and their impending terminations. This type of communication will provide us with additional information on the potential issues that could arise as the shared-loss coverage period on the SLAs terminate, and enhance our ability to address these concerns in a timely fashion.

Issue 2 -- Losses at Institutions

According to Material Loss Reviews conducted by the OIG in the aftermath of bank failures, losses at community banks during the crisis were most often caused by management strategies of aggressive growth and concentrations in commercial real estate (CRE) loans, including notably, concentrations in acquisition, development and construction loans, coupled with inadequate risk management practices in an environment of falling real estate values that led to impairment losses on delinquent and nonperforming loans. Another common characteristic of failed banks was reliance on volatile brokered deposits as a funding source.

We are not aware of, and the OIG did not identify, any instances where a bank failed due to supervisor required write-downs of current loans – so-called "paper losses." When examiners classified loans considered current by bank management, the examiners did so for safety and soundness reasons in accordance with regulatory guidance on classification of loans.

In addition, the application of fair value accounting was not found to have had a significant effect on most community bank failures. Fair value accounting is most often applied to valuations of securities, and since most community banks classify debt securities as available for sale (AFS), the unrealized gains and losses on AFS securities do not impact regulatory capital under current rules.

OIG Recommendation

The OIG study of the losses that led to the failure of community banks during the financial crisis included no recommendations for the FDIC.

Issue 3 -- Appraisals

Interagency supervisory policy establishes that repayment capacity is the primary driver of examination classification decisions.[4] However, as the crisis unfolded, it became clear that the failure to follow prudent underwriting criteria had contributed to the inability of many borrowers to service their loans. For example, many residential borrowers experienced difficulty in making their payments when their monthly loan payment reset to a higher amount, and many commercial borrowers experienced similar financial difficulties due to diminished cash flows from lower sales or reduced operating income. As primary sources of loan repayment declined, lenders were increasingly forced to rely on the value of real estate collateral as a secondary source of repayment. Amid the real estate market distress triggered by the housing bust and resulting financial crisis, rising levels of nonperforming loans and subsequent foreclosures and distressed sales placed additional downward pressure on real estate prices. As the market value of many commercial and residential properties declined to levels below their original estimated value, the proper valuation of real estate collateral became a critical component of evaluating the condition of troubled banks.

Then, as now, the FDIC reviews the appraisal programs of supervised institutions through the analysis of individual appraisals during loan reviews and through the assessment of a bank's appraisal policies and procedures. Examiners use a risk-focused approach tailored to a lender's real estate lending activities and expand the depth of their review when the examination process identifies any areas of concern. The FDIC uses an exception-based process to document noncompliance with appraisal guidance, regulations, and the institutions' valuation program requirements. When no deficiencies are noted relative to the FDIC's appraisal regulations, current guidance requires that a statement to that effect be included in the examination documentation.[5] While the OIG's report found that examiners documented instances of noncompliance consistent with the FDIC's exception-based process, it also noted that examination documentation did not always include the required positive assurance statement.

OIG Recommendation

The OIG report recommended that the FDIC clarify and remind examiners of the supervisory expectations relative to documenting their review of a bank's appraisal program, including the need to include a positive assurance statement when examiners determine that appraisal practices are satisfactory. The FDIC concurs with these recommendations. In response, the FDIC has clarified its examination expectations relative to examiner review of valuations programs, reminded examiners of the requirement to include a positive assurance statement when appropriate, and compliance with this requirement will be monitored within the FDIC's existing internal review control process.

The OIG also recommended to the FDIC, OCC, and FRB that the agencies strengthen requirements for examiner documentation related to the review of appraisal programs. On

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[4] See *Interagency Appraisal and Evaluation Guidelines*, December 2, 2010, at http://www.fdic.gov/news/news/financial/2010/fil10082.html

[5] See Part 323 of the FDIC Rules and Regulations at http://www.fdic.gov/regulations/laws/rules/2000-4300.html.

February 19, 2013, the FDIC discussed with the OCC and the FRB its strategy to improve documentation by reminding examiners of existing guidance and to monitor compliance as part of our internal control function. The agencies agreed to continue to evaluate whether additional guidance on appraisal review documentation might be warranted going forward.

Supervisory guidance also requires examiners to assess the appropriateness of an institution's Allowance for Loan and Lease Losses (ALLL) within the framework of U.S. generally accepted accounting principles (GAAP). GAAP requires that the ALLL reflect losses which are "probable and estimable;" therefore, bank management must determine an appropriate ALLL level that is supported by reasonable assumptions and objective data. Furthermore, GAAP requires that all credit losses associated with a loan be deducted from the allowance, and that the loss portion of the loan balance be charged off in the period in which the loan is deemed uncollectible. If the ALLL is found to be insufficient during an FDIC examination, we may recommend that management increase the allowance or improve its ALLL calculation methodology to ensure that financial reporting is accurate under GAAP.

The OIG made no recommendations with respect to how examiners follow examination procedures in evaluating an institution's ALLL.

Issue 4 -- Capital

Examiners assess an institution's capital adequacy by considering a number of factors, including: the institution's financial condition; the nature, trend, and volume of problem assets, the adequacy of ALLL; earnings and dividends; management's access to additional capital; prospects and the plans for growth, and past experience in managing growth; access to capital markets and other sources of capital; balance sheet composition and risks associated with nontraditional activities; and risk exposure associated with off-balance-sheet activities. During the crisis, examiners evaluated capital adequacy in accordance with the criteria outlined in the Uniform Financial Institution Ratings System (UFIRS) and applicable standards under the provisions of Prompt Corrective Action. When an institution was successful in raising external capital, examiners incorporated those capital raises into the analysis of capital adequacy and the overall rating of the institution.

OIG Recommendation

The OIG review made no recommendations with respect to the capital issues identified in the statute.

Issue 5 -- Loan Workouts

During the crisis, diminished cash flows associated with commercial properties contributed to sharp declines in real estate prices and made it difficult for many borrowers to make their payments. In such situations, prudent workout arrangements are often in the best interest of the financial institution and the borrower. In response, the FDIC, working with the other Federal financial institution regulators, issued guidance encouraging lenders to work with borrowers experiencing financial difficulty repaying their real estate loans.[6] The guidance states that renewed or restructured loans to borrowers who have the ability to repay their debts according to reasonable, modified terms will not be subject to adverse classification solely because the value of the underlying collateral has fallen below the loan balance. Financial institutions that implement prudent commercial real estate loan workout arrangements after performing a comprehensive review of a borrower's financial condition are not subject to criticism for engaging in these efforts even if the restructured loans have weaknesses that result in adverse credit classification.

OIG Recommendation

While the OIG determined that examiners had successfully implemented three of the four elements of the interagency guidance – those related to loan-specific workout arrangements, classification of loans, and regulatory reporting and accounting considerations -- the review did note a lack of documentation that examiners had reviewed the institution's implementation of the risk management requirements in cases where no exceptions were noted. The OIG recommended that the FDIC remind examiners of documentation requirements related to the review of loan workout programs.

The FDIC concurs with the OIG recommendations. On February 27, 2013, the FDIC reminded risk management examiners of its examination expectations relative to their review of the risk management elements of loan workout programs at supervised institutions.

Issue 6 -- Supervisory Orders

To promote uniformity of practice and to ensure that banks most in need of corrective action receive the appropriate supervisory attention, the FDIC has adopted a policy that presumes that banks with composite UFIRs ratings of 3, 4, or 5 will be the subject of either a formal or informal enforcement action unless there are specific circumstances that would excuse the institutions from such an action.[7] By definition, banks with composite ratings of 4 or 5 have significant problems that warrant formal action, and banks rated composite 3 have weaknesses that, if not corrected, could worsen to a more severe situation. Accordingly, FDIC policy indicates that at least an informal action, such as a memorandum of understanding, be taken against composite 3 rated institutions.

OIG Recommendation

The OIG determined that the FDIC, OCC, and FRB are each following their respective agency's policy with respect to issuing enforcement actions, but noted that those policies differ

[6] See *Policy Statement on Prudent Commercial Real Estate Workouts*, October 2009, at http://www.fdic.gov/news/news/financial/2009/fil09061a1.pdf and *Statement on Working with Mortgage Borrowers*, April 2007 at http://www.fdic.gov/news/news/press/2007/pr07032a.html.

[7] See *FDIC Risk Management Manual of Examination* Policies at http://www.fdic.gov/regulations/safety/manual/

somewhat across the agencies. Accordingly, the OIG recommended that the agencies study these differences to determine whether there are certain approaches that have been more successful. The FDIC agrees with this recommendation, and is currently undertaking an internal review of enforcement action trends. We will share the results with the other agencies as part of a joint project to review the effectiveness of enforcement actions the agencies agreed to launch under the Task Force on Supervision, a group of senior supervision officials under the Federal Financial Institutions Examination Council.

The OIG also reviewed whether enforcement actions may have limited credit availability and determined that some enforcement order provisions may have indirectly limited lending. However, the OIG also found that there were important safety and soundness reasons for those provisions and that other factors – such as the weakness in the economy, competition, and a lack of loan demand – impacted lending more. Similarly, the review of whether orders affected the ability to raise capital showed that a bank's ability to raise capital is related more to its condition, earnings, asset quality, and growth prospects than the existence of an enforcement order.

Issue 7 -- Impact of FDIC Policies on Investment

Through various statutes, rules, and policies, and in order to protect the Deposit Insurance Fund, the FDIC is required to consider a number of factors when evaluating applications for entry into banking or expansion of banking activities. The FDIC approved the majority of applications and notices over the review period. In cases where applications were not approved, the FDIC documented its concerns about various aspects of the proposals.

OIG Recommendation

The OIG did not identify instances of the FDIC "steering" potential investors away from failing banks, and made no recommendations for the FDIC with respect to its treatment of potential bank investors.

Issue 8 -- Private Capital Investors

As the financial crisis intensified, the number of problem and failing banks rose rapidly, and these institutions found it increasingly difficult to attract external capital. At the same time, the FDIC found it increasingly difficult to attract bidders to acquire failed institutions. In August 2009, the FDIC Board of Directors adopted the *Final Statement of Policy on Qualifications for Failed Bank Acquisitions*, a policy statement providing guidance to private capital investors wishing to invest in bank holding companies or insured depository institutions formed for the purpose of acquiring failed institutions.[8] Among other things, the policy requires higher levels of capital – namely, a commitment of Tier 1 common equity to total assets of at least 10 percent for a period of 3 years from the time of acquisition of a failed institution – as well as a commitment

[8] *Final Statement of Policy on Qualifications for Failed Bank Acquisitions*
http://www.fdic.gov/news/board/Aug26no2.pdf

for cross-support on the part of institutions making multiple acquisitions, limits on affiliate transactions, and prohibitions on complex, functionally opaque ownership structures.

Overall, private capital investors subject to the statement of policy have played a positive, but relatively small, part in the resolution of failed institutions. As of the date of the OIG's review, a total of 13 private capital investor groups had purchased 36 failed institutions. The FDIC's experience thus far indicates that private capital investors have complied with the statement of policy and have not presented significant supervisory issues.

OIG Recommendation

The OIG had no recommendations with respect to the private capital investment policy.

Office of Inspector General

Testimony

Before the Committee on Financial Services
Subcommittee on Financial Institutions and
Consumer Credit
U.S. House of Representatives

Overview of FDIC OIG Report: *Comprehensive Study on the Impact of the Failure of Insured Depository Institutions*

Statement of Jon T. Rymer
Inspector General
Federal Deposit Insurance Corporation

Statement of Jon T. Rymer
Inspector General, Federal Deposit Insurance Corporation
March 20, 2013

House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit

Chairman Capito, Ranking Member Meeks, and Members of the Subcommittee:

Thank you for your interest in the year-long study that the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) conducted on the impact of the failure of insured depository institutions during the recent financial crisis. The OIG is an independent office within the FDIC, established to conduct audits, investigations, and other reviews to prevent and detect waste, fraud, and abuse relating to the programs and operations of the FDIC, and to improve the efficiency and effectiveness of those programs and operations. I was appointed as the Inspector General of the FDIC by President Bush, and confirmed by the Senate in June 2006.

Through its audits, evaluations, and other reviews, the OIG provides oversight of FDIC programs and operations. Our work is either required by law or self-initiated based on our assessment of various risks confronting the FDIC. Our audits, evaluations, and other reviews assess such areas as program effectiveness, adequacy of internal controls, and compliance with statutory requirements and corporate policies and procedures. We perform our work using internally available resources, supplemented by contracts with independent public accounting firms when expertise in a particular area is needed or when internal resources are not available. Our work, as well as that of our contractors, is performed in accordance with standards applicable to federal audit, evaluation, and investigative entities.

As requested in your invitation to appear today, I will be providing an overview of the broad and comprehensive study required by Public Law 112-88. My office spent over 3,400 staff days to complete this study. The professionals conducting this study produced a 200-page report, containing general observations and detailed explanations of our findings and conclusions. I ask that my office's report, *Comprehensive Study on the Impact of the Failure of Insured Depository Institutions* (Report No. EVAL-13-002, dated January 3, 2013), be made a part of this hearing's official record.

It is important to note that in the wake of the savings and loan and banking crisis of the 1980s, the Congress passed two laws that drove the closure and resolution decisions we have witnessed in this most recent crisis. These laws were the Financial Institutions Reform, Recovery, and Enforcement Act in 1989 and the FDIC Improvement Act in 1991. Taken together, these laws amended the Federal Deposit Insurance (FDI) Act to require, among other things, that (1) institutions maintain minimum capital levels and the chartering regulator promptly close critically undercapitalized institutions through prompt corrective action provisions, (2) the FDIC resolve banks in the least costly manner, and (3) the FDIC maximize recoveries from failed institutions. The FDI Act also placed requirements on how the regulators examine institutions, including establishing minimum examination frequency requirements, requiring the agencies to establish standards for safety and soundness, and requiring the agencies to establish appraisal standards. In response, the FDIC and the other regulators issued implementing regulations and policy statements pertaining to many of the topics discussed in our report.

Study Approach

Signed into law on January 3, 2012, Public Law 112-88 required my office to conduct this study and submit a report to the Congress not later than 1 year after the date of enactment. This study, looking into the impact of the failure of insured depository institutions, required us to address over 30 topics that fall under one of the following eight matters:

- Shared-loss agreements (SLA),
- Significance of losses at institutions that failed,
- Examiner implementation of appraisal guidelines,
- Examiner assessment of capital adequacy and private capital investment in failing institutions,
- Examiner implementation of loan workout guidance,
- Application and impact of formal enforcement orders,
- Impact of FDIC policies on investments in institutions, and
- The FDIC's handling of private equity company investments in institutions.

Our review timeframes generally covered a 4-year period (i.e., 2008 through 2011). In some cases, our data analysis preceded 2008, and in other cases we gathered information through September 30, 2012, updating data to the extent possible. As required, our scope included open and failed state member, state nonmember, and national banks. Our scope did not include institutions formerly regulated by the Office of Thrift Supervision.

The legislation required my office to conduct work at the FDIC, the Office of the Comptroller of the Currency (OCC), and the Board of Governors of the Federal Reserve System (FRB). To that end, we performed work at three FDIC regions, three OCC regions, eight reserve bank districts, and selected state banking agencies.

In conducting our work, we

- Interviewed agency officials and bank examiners, representatives at open banks, investment bankers, and compliance contractors;
- Reviewed relevant policies and guidance;
- Reviewed examination reports, working papers, material loss review reports, and documentation supporting loan workouts and enforcements orders;
- Analyzed institution financial data and agency enforcement action statistics; and
- Surveyed borrowers of failed institutions.

As discussed in our report, we developed sound, data-driven methodologies to provide fact-based, complete analyses. When appropriate, we devised sampling plans to sufficiently analyze the data and address each topic. For example, to address some of the topics related to losses, appraisals, and capital, my office reviewed a sample of 136 open institutions in Georgia, California, and New York that received a composite CAMELS rating of 3, 4, or 5.[1] This sample involved reviewing over 750 loans or loan relationships to assess examiners' reviews and analyses. To address the issues raised in the enforcement orders matter, we reviewed a sample of 119 enforcement orders and validated nearly 2,400 individual provisions. Appendices 1 and 2 of the final report contain a complete description of our approach and sampling methodologies.

We conducted our work from January 2012 through October 2012, in accordance with the Council of the Inspectors General on Integrity and Efficiency's Quality Standards for Inspection and Evaluation. KPMG LLP assisted us with several areas of review. We also coordinated with the U.S. Government Accountability Office as that office conducted its work pursuant to Public Law 112-88.

Before I discuss the study's high-level observations and resulting recommendations, and to provide helpful context, I will briefly describe the regulatory responsibilities for overseeing insured depository institutions and resolving those institutions when they fail.

Regulator Responsibilities

The OCC, FRB, and FDIC oversee the nation's insured depository institutions to ensure they operate in a safe and sound manner. The OCC supervises national banks, the FRB supervises state-chartered banks that are members of the Federal Reserve System and bank holding companies, and the FDIC supervises state-chartered banks that are not members of the Federal Reserve System (state nonmember banks). The FDIC has additional responsibilities for insuring deposits, effectively resolving failed institutions, and maximizing the recovery of receivership assets.

In examining insured depository institutions, the regulators assess the condition of institutions through off-site monitoring and on-site examinations, and have longstanding policies for reviewing an institution's lending and loan review functions, assessing capital adequacy, and recommending improvements, if needed. When regulators determine that an institution's condition is less than satisfactory, they may take a variety of supervisory actions, including informal and formal enforcement actions, to address identified deficiencies. Each regulator has somewhat different approaches to enforcement actions.

Should an institution's condition decline to a point that it becomes *Critically Undercapitalized*, the chartering regulator (a state banking authority or the OCC) is generally required by law to promptly close institutions that cannot be recapitalized. The FDIC is required by law to resolve failing institutions in the least costly manner.

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[1] Financial institution regulators and examiners use the Uniform Financial Institutions Rating System to evaluate a bank's performance in six components represented by the CAMELS acronym: **C**apital adequacy, **A**sset quality, **M**anagement practices, **E**arnings performance, **L**iquidity position, and **S**ensitivity to market risk. Each component, and an overall composite score, is assigned a rating of 1 through 5, with 1 having the least regulatory concern and 5 having the greatest concern.

Study Results

The financial crisis had devastating impacts on the banking industry, businesses, communities, and consumers. At the time of our review, over 400 institutions had failed and several of the country's largest institutions had required government intervention to remain solvent. Commercial real estate (CRE) collateral values had fallen by more than 42 percent. Construction starts remained partially complete and continued to detract from the quality of neighborhoods and home values. Trillions of dollars of household wealth had vanished, and almost 18 million loans had faced foreclosure since 2007. Unemployment peaked at 10 percent in October 2009 and remained stubbornly high at the time of our study.

Events leading to the financial crisis and subsequent efforts to resolve it involved the dynamic interplay of laws passed by the Congress, regulatory rules, agency-specific policies and practices, and the real estate and financial markets in ways that are continuing to play out. In that regard, our study indicated the following:

- The markets drove behaviors that were not always prudent. Banks expanded lending to keep pace with rapid growth in construction and real estate development, rising mortgage demands, and increased competition. Many of the banks that failed did so because management relaxed underwriting standards and did not implement adequate oversight and controls. For their part, many borrowers who engaged in commercial or residential lending arrangements did not always have the capacity to repay loans and pursued many construction projects without properly considering the risks involved. Ultimately, these loans created significant losses for the institutions involved and often left the FDIC with the challenge of managing and disposing of troubled assets.

- In response to unprecedented circumstances, the regulators generally fulfilled their supervisory and resolution responsibilities as defined by statutes, regulations, accounting standards, and interagency guidance in place at the time. In addition, the regulators reacted to a rapidly changing economic and financial landscape by establishing and revising supervisory policies and procedures to address key risks facing the industry. While not a focus of this study, our report does acknowledge, however, material loss review findings that showed the FRB, OCC, and FDIC could have provided earlier and greater supervisory attention to troubled institutions that failed. For its part, among other initiatives associated with resolutions, the FDIC reinstituted the use of SLAs with acquiring institutions and took steps to promote private capital investments in failing institutions.

As previously noted, we provided a detailed presentation of our findings and conclusions for each of the topics under the law's eight matters. In addressing these matters, we also made the following observations:

- The FDIC's resolution methods—including the SLAs that we studied—were market-driven. Often, failing banks with little or no franchise value and poor asset quality did not attract sufficient interest from viable bidders to enable the FDIC to sell the banks without a loss-share guarantee. The FDIC used SLAs to keep failed bank assets in the banking sector, support failed bank asset values, and preserve the solvency of the Deposit Insurance Fund (DIF). The FDIC has established controls over its SLA monitoring program, which help protect the FDIC's interests, promote loan modifications, and require equal treatment of SLA and legacy loans. We did find, however, that the FDIC should place additional emphasis on monitoring commercial loan extension decisions to ensure that acquiring institutions do not inappropriately reject loan modification requests as SLAs approach termination. In addition, we concluded that the FDIC needed to formulate a better strategy for mitigating the impact of impending portfolio sales and SLA terminations on the DIF so that the FDIC will be prepared to address the potentially significant volume of asset sale requests.

- The majority of community banks failed as a result of aggressive growth, asset concentrations, poor underwriting, and deficient credit administration coupled with declining real estate values. These factors led to write-downs and charge-offs on delinquent and non-performing real estate loans as opposed to examiner-required write-downs or fair value accounting losses.

- The regulators have longstanding policies for classifying problem assets, monitoring appraisal programs, assessing capital adequacy, evaluating CRE loan workouts, and administering enforcement actions, when warranted. The regulators also have processes and controls, training programs, and job aids to help ensure examiner compliance and consistency. We found that examiners generally followed relevant policies and implemented them appropriately. For example, examiners usually did not classify as loss loans that the institution claimed were paying as agreed without justification, nor did they question or reduce the appraised values of assets securing such loans. However, examiners did not always document the procedures and steps that they performed to assess institutions' appraisal and workout programs. We also noted that the regulators had different approaches to enforcement actions, particularly related to non-problem banks.

- The FDIC has investment-related policies in place to protect the DIF and to ensure the character and fitness of potential investors. These policies are largely based in statute. By their nature, such policies are going to have an impact on investments in institutions. The FDIC approved most change-in-control and merger applications, although approval rates were lower for states such as California, Florida, and Nevada that were heavily impacted by the financial crisis. The FDIC has policies and procedures for certain aspects of the review of private capital investors, and the FDIC generally followed those policies. Purchases of failed institutions by private capital investors accounted for 10 percent of total failed bank assets acquired. Finally, we identified instances where the FDIC did not accept proposed open bank investments and instead closed an institution. However, in each case, we found that the FDIC identified concerns with the proposed investment related to safety and soundness issues, proposed management, or proposed business plans, or determined that the proposed transaction would not present the least loss option to the DIF.

Recommendations

While the regulators generally implemented their policies appropriately, our study identified certain areas for improvement and issues warranting management attention. In the interest of strengthening the effectiveness of certain supervisory activities and helping ensure the success of the FDIC's ongoing resolution efforts, we made seven recommendations. Five were addressed specifically to the FDIC and two were directed to the three regulators. These recommendations involved the following areas:

- **SLA Program.** We made recommendations related to developing additional controls for monitoring acquiring institutions' commercial loan modification efforts and developing a more formal strategy for mitigating the impact of impending portfolio sales and SLA terminations on the DIF.

- **Appraisals and Workouts.** We made several recommendations related to clarifying how examiners should review institutions' appraisal programs and strengthening examiner documentation requirements to more clearly define examination methodologies and procedures performed to assess institutions' appraisal and workout programs. These recommendations should help to assure agency management that examiners are consistently applying relevant guidance.

- **Enforcement Orders.** We recommended that the regulators study differences between the types of enforcement actions that are used by the regulators and the timing of such actions to determine whether there are certain approaches that have proven to be more effective in mitigating risk and correcting deficiencies that should be implemented by all three regulators.

The regulators concurred with our recommendations and proposed actions that adequately address the intent of our recommendations.

* * * * *

This concludes my prepared statement. Thank you for the opportunity to discuss our study. I will be pleased to answer any questions that you may have.

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Fred R. Becker, Jr.
President and CEO

March 19, 2013

The Honorable Shelley Moore Capito Chairman Subcommittee on Financial Institutions and Consumer Credit House Financial Services Committee United States House of Representatives Washington, D.C. 20515	The Honorable Gregory Meeks Ranking Member Subcommittee on Financial Institutions and Consumer Credit House Financial Services Committee United States House of Representatives Washington, D.C. 20515

Re: Regulatory Relief for Credit Unions in the 113th Congress

Dear Chairman Capito and Ranking Member Meeks: Chairman Capito

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, I write today in conjunction with tomorrow's hearing, "State of Community Banking: Is the Current Regulatory Environment Adversely Affecting Community Financial Institutions?" NAFCU member credit unions and their 95 million member-owners appreciate the committee's timely focus on regulatory relief for community based financial institutions.

As you know, all community based financial services institutions, including credit unions, are struggling under an ever-increasing regulatory burden in the wake of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* [P.L.111-203]. The impact of this growing compliance burden is evident as the number of credit unions continues to decline, dropping by more than 700 institutions since 2009. Credit unions didn't cause the financial crisis and shouldn't be caught in the crosshairs of regulations aimed at those entities that did. Unfortunately, that has not been the case thus far. Accordingly, finding ways to cut-down on burdensome and unnecessary regulatory compliance costs is a chief priority of our members. We hope it will also be a priority of the Subcommittee.

Regulatory relief is critical to the survival of credit unions and, as outlined in the attached letter NAFCU sent to the Committee on February 12th, there are several areas where Congress can act to reduce the overwhelming burden credit unions face. We look forward to working with you and your staff to ensure that the views of credit unions are conveyed and that the proposals outlined in the attached letter are given due consideration during the 113th Congress.

E-mail: fbecker@nafcu.org • **Web site:** www.nafcu.org

Thank you for your attention to this important matter. If you have any questions or would like further information about any of these issues, please do not hesitate to contact me or NAFCU's Vice President of Legislative Affairs Brad Thaler by telephone at (703) 842-2204 or by e-mail at bthaler@nafcu.org.

Sincerely,

Fred R. Becker, Jr.
President and CEO

cc: Members of the Subcommittee on Financial Institutions and Consumer Credit

Enclosure: February 12, 2013 letter "NAFCU Calls on Congress to Provide Regulatory Relief for Credit Unions"

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Fred R. Becker, Jr.
President/CEO

February 12, 2013

The Honorable Tim Johnson
Chairman
Senate Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Michael Crapo
Ranking Member
Senate Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Jeb Hensarling
Chairman
House Financial Services Committee
United States House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
House Financial Services Committee
United States House of Representatives
Washington, D.C. 20515

Re: NAFCU Calls on Congress to Provide Regulatory Relief for Credit Unions

Dear Chairman Johnson, Chairman Hensarling, Ranking Member Crapo and Ranking Member Waters:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, I write today to call for Congressional action during this session of the 113th Congress to enact broad-based regulatory relief that is essential to the credit union industry's ability to serve its 95 million members.

Our nation's credit unions are struggling under an ever-increasing regulatory burden that must be immediately addressed. A survey of NAFCU members late last year found that 94% have seen their regulatory burden increase since the passage of the *Dodd-Frank Act* in July 2010. The regulatory onslaught continues to compound as credit unions now have over 5,000 pages of rules from the Consumer Financial Protection Bureau (CFPB) that they must understand, interpret, and ultimately comply with – despite the fact that Congress has widely acknowledged that credit unions were not the cause of the financial crisis. Credit unions, many of which have very small compliance departments, and in some cases only one compliance officer, must comply with the same rules and regulations as our nation's largest financial institutions that employ armies of lawyers. The impact of the ever-increasing regulatory burden is even more sobering, as the number of credit unions continues to decline. There are nearly 700 fewer credit unions today than there were before the passage of the *Dodd-Frank Act*.

It is with this regulatory onslaught in mind that we call on Congress to enact meaningful regulatory reforms and provide much needed assistance to our nation's credit unions. Over the past year, we have been actively conversing with our member credit unions to identify those areas where regulatory relief is requisite.

Our ongoing discussions with our members have led us to draft a five point plan for credit union regulatory relief:

I. Administrative Improvements for the Powers of the NCUA

We believe there are changes that must be made to strengthen and enhance the National Credit Union Administration (NCUA).

First, the NCUA should have authority to grant parity to a federal credit union on a broader state rule, if such a shift would allow them to better serve their members and continue to protect the National Credit Union Share Insurance Fund.

Second, the NCUA should have the authority to delay the implementation of a CFPB rule that applies to credit unions, if complying with the proposed timeline would create an undue hardship. Furthermore, given the unique nature of credit unions, the NCUA should have authority to modify a CFPB rule for credit unions, provided that the objectives of the CFPB rule continue to be met.

Third, the NCUA and the CFPB should be required to conduct a look-back cost-benefit analysis on all new rules after three years. The regulators should be required to revisit and modify any rules for which the cost of complying was underestimated by 20% or more from the original estimate at the time of issuance.

Fourth, new examination fairness provisions should be enacted to help ensure timeliness, clear guidance and an independent appeal process free of examiner retaliation.

Finally, the Central Liquidity Facility (CLF) should be modernized with changes such as: (1) removing the subscription requirement for membership, and (2) permanently removing the CLF borrowing cap so that it may meet the current needs of the industry.

II. Capital Reforms for Credit Unions

NAFCU believes that capital standards for credit unions should be modernized to reflect the realities of the 21st century financial marketplace.

First, the NCUA should, with input from the industry, study and report to Congress on the problems with the current prompt corrective action (PCA) system and recommended changes.

Second, a risk-based capital system for credit unions that more accurately reflects a credit union's risk profile should be authorized by Congress.

Third, the NCUA should be given the authority to allow supplemental capital accounts for credit unions that meet certain standards.

Finally, given that very few new credit unions have been chartered over the past decade, and in order to encourage the chartering of new credit unions, the NCUA should be authorized to further establish special capital requirements for newly chartered federal credit unions that recognize the unique nature and challenges of starting a new credit union.

III. Structural Improvements for Credit Unions

NAFCU believes there should be improvements to the *Federal Credit Union Act* to help enhance the federal credit union charter.

First, Congress should direct the NCUA, with input from the industry, to study and report back to Congress suggested changes to outdated corporate governance provisions in the *Federal Credit Union Act*. Congress should then act upon those recommendations.

Second, a series of improvements should be made to the field of membership (FOM) restrictions that credit unions face expanding the criteria for defining "urban" and "rural"; and allowing voluntary mergers involving multiple common bond credit unions and allowing credit unions that convert to community charters to retain their current select employee groups (SEGs).

Finally, all credit unions, regardless of charter type, should be allowed to add underserved areas to their field of membership.

IV. Operational Improvements for Credit Unions

Credit unions stand willing and ready to assist in our nation's economic recovery. Our industry's ability to do so, however, is severely inhibited by antiquated legislative restrictions.

First, Congress should show America that they are serious about creating jobs by modifying the arbitrary and outdated credit union member business lending (MBL) cap. This can be done by raising the current 12.25% limit to 27.5% for credit unions that meet certain criteria or by raising the outdated "definition" of a MBL from last century's $50,000 to a new 21st century standard of $250,000, with indexing for inflation to prevent future erosion. Furthermore, MBLs made to non-profit religious organizations, businesses in "underserved areas", or small businesses with fewer than 20 employees should be given special exemptions for the arbitrary cap.

Second, requirements to mail redundant and unnecessary privacy notices on an annual basis should be removed, provided that the credit union's policy has not changed and additional sharing of information with outside entities has not been undertaken since the distribution of the previous notice.

Third, credit unions should be given greater authority and flexibility in choosing their investments.

Fourth, the NCUA should be given greater flexibility in how it handles credit union lending, such as the ability to establish longer maturities for certain loans.

Finally, Congress should clarify that Interest on Lawyers Trust Accounts (IOLTAs) at credit unions are fully insured and also that the NCUA should have practical requirements on how credit unions provide notice of their federally-insured status in any advertising.

V. 21st Century Data Security Standards

Credit unions are being adversely impacted by ongoing cyber-attacks against the United States and continued data breaches at numerous merchants. The cost of dealing with these issues hinders the ability of credit unions to serve their members. Congress needs to enact new 21st century data security standards that include: the payment of costs associated with a data breach by those entities that were breached; establishing national standards for the safekeeping of all financial information; require merchants to disclose their data security policies to their customers; requiring the timely disclosure of entities that have suffered a data breach; establishing enforcement standards for provisions prohibiting merchants from retaining financial data; requiring the timely notification of the account servicer if an account has been compromised by a data breach; and, requiring breached entities to prove a "lack-of-fault" if they have suffered from a data breach.

We have outlined a number of proposals that are necessary to providing the regulatory relief and assistance that credit unions urgently require. The number of credit unions continues to decline on a monthly basis and the ever-increasing regulatory burden the industry is facing is accelerating that decline as compliance costs become even more onerous. It is with that in mind that we call on Congress to act on any and all of these proposals, whether as a comprehensive package, or individually. Our nation's credit unions and their 95 million members desperately need this relief and we call on Congress to enact it.

Thank you for your attention to this important matter.

If you have any questions or would like further information about any of these issues, please do not hesitate to contact me or NAFCU's Executive Vice President of Government Affairs Dan Berger by telephone at (703) 842-2203 or by e-mail at dberger@nafcu.org.

Sincerely,

Fred R. Becker, Jr.
President and CEO

cc: Members of the Senate Banking Committee
Members of the House Financial Services Committee

Congress of the United States
Washington, DC 20515

February 19, 2013

The Hon. Ben Bernanke
Chairman
The Federal Reserve System
20th Street and Constitution Ave, NW
Washington, D.C. 20429

The Hon. Martin Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

The Hon. Thomas Curry
Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, D.C. 20219

Dear Sirs:

We are writing to express our continued concern with the current approach to implementation of the Basel III capital requirements for U.S. financial institutions.

On November 29, 2012, representatives from your agencies testified at a joint hearing of the Financial Institutions and Consumer Credit Subcommittee and the Insurance, Housing, and Community Opportunity Subcommittee on the joint proposed rulemakings to implement Basel III. During the hearing, members of the subcommittees expressed near unanimous concern about the blanket application of the proposed rules to all financial institutions regardless of their asset size or business models. Members also received testimony from a diverse group of financial institutions that highlighted the significant consequences of your proposed rule for our financial system. We strongly encourage you to consider the concerns raised by members of the subcommittees as you finalize the proposed rules.

As many of the witnesses reinforced during the hearing, the Basel III capital requirements were designed for large banks that conduct business globally. We believe the application of these standards to regional and community banks could have a significant negative economic effect. Therefore, we urge you to tailor the capital requirements to ensure they are appropriate for the wide range of institutions that comprise our financial system

Unique among the world's developed countries, the United States is served by a large number of relatively small depository institutions. These institutions did not cause the financial crisis—rather they have continued to serve their communities in a prudent manner, and in many cases have played a critical role in the recovery of local economies. We are concerned that the compliance costs of implementing the Basel III framework will force many institutions that are not engaged in global banking to consolidate or go out of business altogether.

We are also concerned that the cost will ultimately be borne by consumers in the form of higher down payments and higher interest rates on residential mortgages. The Basel III standardized approach for risk-weighted assets could severely limit the types of mortgages smaller banking institutions can feasibly offer in their communities and hold in portfolio. Traditional community banking mortgage products that help lower-income consumers finance their homes will become scarcer and more expensive, as the regulatory capital needed to originate and hold these loans will increase substantially. This impact will be especially pronounced in underserved areas, in both rural towns and metropolitan neighborhoods across the nation, where smaller institutions are often the primary source of credit.

The diversity of lenders in this country has traditionally meant that consumers, small businesses, and other borrowers have many sources of credit from which to choose, adding to the resiliency of the U.S. economy. To maintain this valuable benefit, we urge you to tailor the new capital rules in way that is appropriate for the wide range of financial institutions that comprise our financial system and that reflects and preserves its diversity.

We thank you in advance for your consideration of this matter.

Sincerely,

Shelley Moore Capito

Rep. Shelley Moore Capito, M.C.

Carolyn B. Maloney

Rep. Carolyn Maloney, M.C.

Representative Tom Graves Opening Statement

"State of Community Banking: Is the Current Regulatory Environment Adversely Affecting Community Financial Institutions?"

Wednesday, March 20, 2013

Subcommittee on Financial Institutions and Consumer Credit

I would like to thank Chairwoman Capito, Ranking Member Meeks, and Representative Westmoreland for allowing me to submit an opening statement for this hearing. I commend the Members of this Subcommittee in particular for their efforts to address the issue of bank failures.

My friend Lynn Westmoreland has been a relentless defender before this Committee of the financial institutions that serve our families, businesses, and communities in Georgia, and I want to thank him for his service on our behalf. This hearing is possible today because of his efforts to craft meaningful legislation in P.L. 112-88 to address widespread concerns regarding the procedures used by the FDIC in resolving troubled and failing institutions.

The banks in Georgia serve as the lifeblood of our communities, lending valuable loans and services to our families and small businesses. They are unfortunately a dying breed for us back home. Since 2008, a staggering 84 Georgia banks have been taken over by the FDIC. This may seem like just a number to some, but for us it represents the leaders of families of our community as well as the demise of nearly 35% of the banks based in our home state.

We continue to hear from our President and other leaders in Washington that our economy is on the road to recovery. Unfortunately, the unemployment rate remains at a sluggish 8.7% in Georgia as our banks struggle to survive, our small businesses fail to receive the valuable loans that allow them to expand, and our constituents continue to fight to find meaningful employment. This continued economic uncertainty is no doubt a direct result of the sea of red tape that is coming in the form of nearly 400 new rules and regulations created by the Dodd-Frank Act in addition to excessively stringent bank examinations by federal regulators such as the FDIC.

I have met with many of the bankers in the 14th district of Georgia and have been very disturbed to hear that more time is being spent on compliance than on customer service, innovation, or expansion. I have been troubled to hear that many of the examiners coming into our communities have never serviced a loan or lived remotely close to the banks that they are shutting down. Most disturbing of all, I have heard far too often that the bankers in my district are afraid to express their honest concerns about the manner in which they are regulated because they fear retribution by their regulator. This is simply not acceptable. I hope to work with my colleagues in the 113th Congress to provide the bankers in my district with a voice to let us know what we can do in Washington, D.C. to make it easier for them to invest in our communities back home.

I am grateful to the GAO for their attention to this issue and for conducting this important study in a timely manner. I believe that we must continue to investigate FDIC loss-share agreements and their effect on our troubled community banks and their customer base to ensure that the shareholders of failing institutions have a voice in their acquisition. We must also continue to ensure flexibility in the enforcement of accounting standards for banks during difficult financial times. Finally, I must urge regulators to find the balance between prudent capital in good times and flexibility for loan losses in bad times. Too often the regulatory pendulum swings to the extremes and it is the customers and small business owners who ultimately suffer. Regulations have consequences and right now, the consequence of banks hoarding capital to meet loan loss requirements and impairment accounting standards means there is less money for businesses to create jobs.

It is my hope that we can all work together to find meaningful solutions to the problems facing our bankers back home in Georgia. They deserve a voice now more than ever. Thank you.

GAO Questions for the Record

Question from Representative Capito, Chairman, Subcommittee on Financial Institutions and Consumer Credit

Question: On page 35-39 of the study on recent bank failures, you outlined efforts by the federal financial regulatory agencies and FASB to develop models for financial institutions to estimate credit losses. FASB proposed a new model in 2012 and is in the process of refining their approach. While I agree that giving financial institutions and examiners a better method to develop loan loss allowances may provide more stability in the system, I am concerned that the end result may not be workable for community banks. Do you have the sense that federal regulatory agencies and FASB are committed to ensuring that community banks will have the capacity to implement these dynamic cash flow models?

Response: We have not conducted the work necessary to answer this question. Our discussions with the regulatory agencies focused on the need for these revised models and not the development of the models. Therefore, we do not have information on what considerations the agencies have given to community banks' capacity to implement these models at this time. However, FASB's Proposed Accounting Standards Update, Financial Instruments—Credit Losses (Subtopic 825-15) is open for comment until May 31, 2013. Comments on this proposal may provide information about concerns community banks may have, if any. Additionally, FASB posted a podcast on its website detailing its proposed credit loss model as well as a "Frequently Asked Questions" document.

Questions for the Record

Questions from Representative Posey

Question 1: The GAO found that earlier recognition of loan losses could have reduced the need for banks to recognize a sudden series of loan losses that reduced earnings and regulatory capital. Would this actually be the case, would earlier recognition simply have caused more bank failures?

Response: Earlier recognition of loan losses is associated with an expected loss model. In our report, we noted the views of staff from the Federal Deposit Insurance Corporation (FDIC) that had the expected loss model been in place instead of the incurred loss model, loan loss allowances would certainly have been higher than they were at the beginning of the financial crisis, which would have provided banks' earnings and capital more protection against the rising credit losses. Although it is not clear what effect an expected loss model would have had on bank failures given the unprecedented nature of the financial crisis, earlier recognition of loan losses would have helped address the cycle of losses that eventually led to failures in the recent crisis as banks were forced to increase loan loss allowances and raise capital when they were least able to do so. Moreover, as we detailed in our report, Federal Reserve staff noted that if management at the failed banks had been required to recognize loan losses earlier for the types of loans they were underwriting, it might have provided an incentive for them to not concentrate so heavily in the loans that later resulted in significant losses.

Question 2: Most banks that failed after 2010 were on their 2nd or 3rd bank examination since the crisis and on their 3rd or 4th round of asset write-downs. At this point, it was not the shock after the crisis, but the impact of regulatory policies, like TARP and Loss Share Agreements, driving down asset prices. What would you have banks do – recognize all their loans as immediately uncollectible and write them down to zero on Day One?

Response: Pub. L. No. 112-88 asked GAO to study the causes and potential solutions for cycle of write downs, capital raising and failures. We concluded that loan loss allowances were not adequate to absorb the wave of credit losses that occurred when the financial crisis began, in part because current accounting standards for loan loss provisioning require banks to estimate losses using an incurred loss model. Furthermore, we noted that earlier recognition of loan losses could have potentially reduced the procyclicality in the recent crisis. In contrast to the current accounting model for estimating credit losses under Generally Accepted Accounting Principles (GAAP), FASB's proposed model for estimating credit losses would incorporate forward-looking information about expected losses such as changes in the credit risk of assets held by the entity and changes in conditions since the previous reporting date. Again, given the severity of the declines in the value of assets during the crisis, it is not clear that to what extent the bank failures would have been prevented had an expected loss model been in effect. However, such a model would result in comparatively larger loan loss allowances and thus provide a greater cushion for financial institutions in times of stress.

Question 3: The GAO conducted a study on CRE loans in 2011. In it, the GAO reported that banks from across the country had identified multiple concerns with examiner treatment of CRE loans and loan losses. Did the GAO find the situation had improved between the 2011 study and the study we're looking at today? If, not why not?

Response: We have not conducted the work necessary to answer this question. While we released the bank failure report in 2013, the mandate for our study required us to examine bank failures between 2008 and 2011 and did not require us to review examiners' treatment of CRE loans after that period.

Question 4: In your reviews of studies of various accounting and regulatory policies that may or may not have led to more bank failures than necessary, what other factors did you uncover in your work that could be helpful for us to know if you were authorized to dig a little deeper?

Response: Within the scope of our work examining the causes of the bank failures, we did not identify additional issues related to accounting and regulatory policies that would warrant greater audit authority. GAO plans to continue to monitor the progress of the ongoing activities of the accounting standardsetters to address concerns with the loan loss provisioning model.

Question 5: From your research, do you believe impairment accounting (FAS 5 and FAS 114), as applied in the examination process, fuels the vicious spiral or negative balance sheet pressures, leading to more failures and write-downs?

Response: As we stated in our report, the failures were largely related to nonperforming real estate loans. While data are not publicly available to determine the extent to which losses at the failed banks were driven by declines in the fair value of the collateral, several state regulators and community banking association officials told us that declining collateral values of impaired collateral-dependent loans drove both credit losses and charge offs and resulted in reductions to regulatory capital at some small banks. Two state banking associations said that these effects were exacerbated by federal bank examiners' adverse classification of performing collateral-dependent loans. We did not conduct additional analysis on the examination process but we noted regulatory guidance issued in 2006 was at odds with this experience. The FDIC IG study covered the role of field examinations and appraisals more exhaustively. The IG found that examiners generally followed relevant policies and implemented them appropriately, although it noted several areas for improvement. For example, the IG noted that examiners did not always document the procedures and steps that they performed to assess institutions' appraisal and workout programs and that the regulators had different approaches to enforcement actions, particularly related to non-problem banks.

Questions for the Record

Questions from Representative Westmoreland

Question 1: GAO noted that bank failures significantly impacted market concentration in a few metro areas and rural counties. Will you please provide for the record a list of counties in Georgia that experienced increased bank concentration?

Response:

As discussed in the report, we analyzed the impact of bank failures and failed bank acquisitions on local credit markets using data for the period from June 2007 to June 2012 to calculate the Herfindahl-Hirschman Index (HHI), a key statistical measure used to assess market concentration and the potential for firms to exercise their ability to influence market prices. We described an increase in market concentration as significant if the difference between pre- and postfailure HHI in a local market was at least 100 and the postfailure HHI was 1,500 or more. We described an increase in market concentration as small if the difference between the pre- and postfailure HHI in a local market was between 1 and 100 and if the post failure HHI was between 1 and 1,500.

Table 1 below provides a list of metropolitan areas and rural counties in Georgia that experienced a potential increase in market concentration between June 30, 2007 and June 29, 2012 as a result of bank failures.

Table 1: Metro Areas and Rural Counties in Georgia that Experienced Potential Increases in Market Concentration Due to Bank Failures, June 30, 2007 –June 29, 2012.

Year[a]	Metropolitan area or Rural county	Name of Metropolitan area or Rural county	Potential change in market concentration
June 30, 2008-June 29, 2009	Metropolitan area	Atlanta-Sandy Springs-Marietta, GA	Small increase
June 30, 2008-June 29, 2009	Metropolitan area	Dalton, GA	Small increase
June 30, 2008-June 29, 2009	Rural county	Banks, GA	Significant increase
June 30, 2008-June 29, 2009	Rural county	Glascock, GA	Significant increase
June 30, 2008-June 29, 2009	Rural county	Jackson, GA	Small increase
June 30, 2009-June 29, 2010	Metropolitan area	Atlanta-Sandy Springs-Marietta, GA	Small increase
June 30, 2009-June 29, 2010	Metropolitan area	Columbus, GA-AL	Significant increase
June 30, 2009-June 29, 2010	Metropolitan area	Macon, GA	Small increase

June 30, 2009-June 29, 2010	Metropolitan area	Savannah, GA	Small increase
June 30, 2009-June 29, 2010	Metropolitan area	St. Marys, GA	Significant increase
June 30, 2010-June 29, 2011	Metropolitan area	Atlanta-Sandy Springs-Marietta, GA	Small increase
June 30, 2010-June 29, 2011	Metropolitan area	Cornelia, GA	Significant increase
June 30, 2010-June 29, 2011	Metropolitan area	Gainesville, GA	Small increase
June 30, 2010-June 29, 2011	Metropolitan area	Tifton, GA	Significant increase
June 30, 2010-June 29, 2011	Metropolitan area	Toccoa, GA	Small increase
June 30, 2010-June 29, 2011	Rural county	Gilmer, GA	Significant increase
June 30, 2010-June 29, 2011	Rural county	White, GA	Significant increase
June 30, 2010-June 29, 2011	Rural county	Wilcox, GA	Significant increase
June 30, 2011-June 29, 2012	Metropolitan area	Atlanta-Sandy Springs-Marietta, GA	Small increase
June 30, 2011-June 29, 2012	Metropolitan area	Macon, GA	Significant increase
June 30, 2011-June 29, 2012	Metropolitan area	Statesboro, GA	Significant increase

Source: GAO analysis of Census Bureau, FDIC, and OCC data

[a]We did not find potential increases in market concentration during the June 30, 2007 to June 29, 2008 period in those local markets that experienced bank failures.

Question 2: On page 46 you state "8 of 188 metropolitan areas...met the criteria for raising significant competitive concerns." Additionally, "62 of 68 rural counties....likely experienced no change in concentration." Please submit for the record a list of the 188 metro areas and 68 rural counties and identify if each increased, decreased, or registered no change in market concentration.

Response: See table 2 below for potential changes in market concentration in those metropolitan areas and rural counties in the U.S. between June 30, 2009 and June 29, 2010 that experienced bank failures.

Table 2: Potential Changes in Market Concentration in Metropolitan Areas and Rural Counties in the U.S. that Experienced Bank Failures, June 30, 2009–June 29, 2010.

Metropolitan area or Rural county	Name of Metropolitan area or Rural county	Potential change in market concentration
Metropolitan area	Aguadilla-Isabela-San Sebastián, PR	Significant increase
Metropolitan area	Akron, OH	No change
Metropolitan area	Albertville, AL	No change
Metropolitan area	Albuquerque, NM	No change
Metropolitan area	Alexander City, AL	No change
Metropolitan area	Altus, OK	No change
Metropolitan area	Anniston-Oxford, AL	Significant increase
Metropolitan area	Athens-Clarke County, GA	No change
Metropolitan area	Atlanta-Sandy Springs-Marietta, GA	Small increase
Metropolitan area	Auburn-Opelika, AL	No change
Metropolitan area	Austin-Round Rock-San Marcos, TX	Small increase
Metropolitan area	Bakersfield-Delano, CA	Small increase
Metropolitan area	Baltimore-Towson, MD	Small increase
Metropolitan area	Baraboo, WI	Significant increase
Metropolitan area	Beatrice, NE	No change
Metropolitan area	Beaumont-Port Arthur, TX	Small increase
Metropolitan area	Bellingham, WA	Small increase
Metropolitan area	Bend, OR	No change
Metropolitan area	Birmingham-Hoover, AL	No change
Metropolitan area	Bloomington, IN	No change
Metropolitan area	Bloomington-Normal, IL	Small increase
Metropolitan area	Boston-Cambridge-Quincy, MA-NH	No change
Metropolitan area	Bremerton-Silverdale, WA	Small increase
Metropolitan area	Brenham, TX	No change
Metropolitan area	Buffalo-Niagara Falls, NY	Small increase
Metropolitan area	Calhoun, GA	No change
Metropolitan area	Cape Coral-Fort Myers, FL	Small increase
Metropolitan area	Carson City, NV	Significant increase
Metropolitan area	Centralia, WA	No change
Metropolitan area	Chicago-Joliet-Naperville, IL-IN-WI	Small increase

Metropolitan area	Cincinnati-Middletown, OH-KY-IN	Small increase
Metropolitan area	Cleveland, MS	No change
Metropolitan area	Cleveland-Elyria-Mentor, OH	No change
Metropolitan area	Clewiston, FL	No change
Metropolitan area	College Station-Bryan, TX	Small increase
Metropolitan area	Columbus, GA-AL	Significant increase
Metropolitan area	Columbus, IN	Significant increase
Metropolitan area	Columbus, NE	No change
Metropolitan area	Cornelia, GA	No change
Metropolitan area	Crestview-Fort Walton Beach-Destin, FL	No change
Metropolitan area	Dallas-Fort Worth-Arlington, TX	Small increase
Metropolitan area	Dalton, GA	No change
Metropolitan area	Danville, IL	Small increase
Metropolitan area	Daphne-Fairhope-Foley, AL	No change
Metropolitan area	Deltona-Daytona Beach-Ormond Beach, FL	Small increase
Metropolitan area	Des Moines-West Des Moines, IA	No change
Metropolitan area	Detroit-Warren-Livonia, MI	Small increase
Metropolitan area	Dixon, IL	No change
Metropolitan area	Dothan, AL	No change
Metropolitan area	Duluth, MN-WI	No change
Metropolitan area	Enterprise-Ozark, AL	No change
Metropolitan area	Eufaula, AL-GA	No change
Metropolitan area	Fajardo, PR	Significant increase
Metropolitan area	Fallon, NV	No change
Metropolitan area	Flagstaff, AZ	No change
Metropolitan area	Fredericksburg, TX	No change
Metropolitan area	Freeport, IL	No change
Metropolitan area	Fremont, NE	No change
Metropolitan area	Fresno, CA	No change
Metropolitan area	Gadsden, AL	No change
Metropolitan area	Gainesville, GA	No change
Metropolitan area	Gardnerville Ranchos, NV	No change
Metropolitan area	Georgetown, SC	No change
Metropolitan area	Grand Island, NE	No change

Metropolitan area	Grand Rapids-Wyoming, MI	No change
Metropolitan area	Greensburg, IN	No change
Metropolitan area	Guayama, PR	No change
Metropolitan area	Hastings, NE	No change
Metropolitan area	Hilton Head Island-Beaufort, SC	No change
Metropolitan area	Homosassa Springs, FL	Small increase
Metropolitan area	Hood River, OR	No change
Metropolitan area	Houston-Sugar Land-Baytown, TX	Small increase
Metropolitan area	Huntsville, AL	No change
Metropolitan area	Huntsville, TX	No change
Metropolitan area	Indianapolis-Carmel, IN	Small increase
Metropolitan area	Jacksonville, FL	No change
Metropolitan area	Jacksonville, IL	No change
Metropolitan area	Kalamazoo-Portage, MI	No change
Metropolitan area	Kansas City, MO-KS	No change
Metropolitan area	Kearney, NE	No change
Metropolitan area	Kennewick-Pasco-Richland, WA	No change
Metropolitan area	Kerrville, TX	No change
Metropolitan area	Key West, FL	Small increase
Metropolitan area	Killeen-Temple-Fort Hood, TX	Small increase
Metropolitan area	La Crosse, WI-MN	No change
Metropolitan area	LaGrange, GA	No change
Metropolitan area	Lakeland-Winter Haven, FL	No change
Metropolitan area	Lansing-East Lansing, MI	No change
Metropolitan area	Las Vegas-Paradise, NV	Small increase
Metropolitan area	Lexington, NE	No change
Metropolitan area	Lincoln, NE	No change
Metropolitan area	Longview, TX	No change
Metropolitan area	Los Angeles-Long Beach-Santa Ana, CA	Small increase
Metropolitan area	Louisville/Jefferson County, KY-IN	No change
Metropolitan area	Macon, GA	Small increase
Metropolitan area	Madison, WI	No change
Metropolitan area	Marble Falls, TX	No change

Metropolitan area	Marshall, TX	No change
Metropolitan area	Mayagüez, PR	Significant increase
Metropolitan area	Merced, CA	No change
Metropolitan area	Miami-Fort Lauderdale-Pompano Beach, FL	Small increase
Metropolitan area	Milledgeville, GA	No change
Metropolitan area	Milwaukee-Waukesha-West Allis, WI	No change
Metropolitan area	Minneapolis-St. Paul-Bloomington, MN-WI	Small increase
Metropolitan area	Mobile, AL	No change
Metropolitan area	Modesto, CA	No change
Metropolitan area	Monroe, WI	No change
Metropolitan area	Montgomery, AL	No change
Metropolitan area	Mount Vernon-Anacortes, WA	Small increase
Metropolitan area	Myrtle Beach-North Myrtle Beach-Conway, SC	No change
Metropolitan area	Napa, CA	Small increase
Metropolitan area	Naples-Marco Island, FL	Small increase
Metropolitan area	New Orleans-Metairie-Kenner, LA	No change
Metropolitan area	New York-Northern New Jersey-Long Island, NY-NJ-PA	No change
Metropolitan area	Newton, IA	No change
Metropolitan area	Norfolk, NE	No change
Metropolitan area	North Platte, NE	No change
Metropolitan area	North Port-Bradenton-Sarasota, FL	Small increase
Metropolitan area	Ocala, FL	Small increase
Metropolitan area	Ogden-Clearfield, UT	Significant increase
Metropolitan area	Okeechobee, FL	No change
Metropolitan area	Olympia, WA	No change
Metropolitan area	Omaha-Council Bluffs, NE-IA	Small increase
Metropolitan area	Orlando-Kissimmee-Sanford, FL	Small increase
Metropolitan area	Ottawa-Streator, IL	No change
Metropolitan area	Oxnard-Thousand Oaks-Ventura, CA	Small increase
Metropolitan area	Pahrump, NV	Significant increase

Metropolitan area	Palatka, FL	No change
Metropolitan area	Palm Bay-Melbourne-Titusville, FL	Small increase
Metropolitan area	Palm Coast, FL	Small increase
Metropolitan area	Panama City-Lynn Haven-Panama City Beach, FL	Small increase
Metropolitan area	Payson, AZ	No change
Metropolitan area	Pendleton-Hermiston, OR	No change
Metropolitan area	Pensacola-Ferry Pass-Brent, FL	Small increase
Metropolitan area	Phoenix Lake-Cedar Ridge, CA	No change
Metropolitan area	Phoenix-Mesa-Glendale, AZ	Small increase
Metropolitan area	Pittsburgh, PA	Small increase
Metropolitan area	Ponce, PR	Significant increase
Metropolitan area	Port Angeles, WA	No change
Metropolitan area	Port St. Lucie, FL	No change
Metropolitan area	Portland-Vancouver-Hillsboro, OR-WA	No change
Metropolitan area	Prescott, AZ	No change
Metropolitan area	Prineville, OR	No change
Metropolitan area	Provo-Orem, UT	Small increase
Metropolitan area	Pueblo, CO	Small increase
Metropolitan area	Punta Gorda, FL	Small increase
Metropolitan area	Racine, WI	Small increase
Metropolitan area	Reno-Sparks, NV	No change
Metropolitan area	Riverside-San Bernardino-Ontario, CA	Small increase
Metropolitan area	Rochelle, IL	No change
Metropolitan area	Rockford, IL	No change
Metropolitan area	Rome, GA	No change
Metropolitan area	Sacramento--Arden-Arcade--Roseville, CA	Small increase
Metropolitan area	Salem, OR	No change
Metropolitan area	Salt Lake City, UT	Small increase
Metropolitan area	San Antonio-New Braunfels, TX	Small increase
Metropolitan area	San Diego-Carlsbad-San Marcos, CA	Small increase
Metropolitan area	San Francisco-Oakland-Fremont, CA	Small increase

Metropolitan area	San Germán-Cabo Rojo, PR	Significant increase
Metropolitan area	San Jose-Sunnyvale-Santa Clara, CA	Small increase
Metropolitan area	San Juan-Caguas-Guaynabo, PR	Significant increase
Metropolitan area	Santa Fe, NM	No change
Metropolitan area	Savannah, GA	Small increase
Metropolitan area	Scottsbluff, NE	No change
Metropolitan area	Scottsboro, AL	No change
Metropolitan area	Seattle-Tacoma-Bellevue, WA	Small increase
Metropolitan area	Sebastian-Vero Beach, FL	No change
Metropolitan area	Sebring, FL	No change
Metropolitan area	Seymour, IN	No change
Metropolitan area	Shelton, WA	No change
Metropolitan area	Sioux City, IA-NE-SD	No change
Metropolitan area	Sioux Falls, SD	No change
Metropolitan area	Springfield, IL	No change
Metropolitan area	Springfield, MO	No change
Metropolitan area	St. Cloud, MN	Small increase
Metropolitan area	St. George, UT	Small increase
Metropolitan area	St. Louis, MO-IL	No change
Metropolitan area	St. Marys, GA	Significant increase
Metropolitan area	Sterling, IL	No change
Metropolitan area	Stockton, CA	No change
Metropolitan area	Tallahassee, FL	Small increase
Metropolitan area	Tampa-St. Petersburg-Clearwater, FL	Small increase
Metropolitan area	The Dalles, OR	No change
Metropolitan area	The Villages, FL	No change
Metropolitan area	Toccoa, GA	No change
Metropolitan area	Traverse City, MI	No change
Metropolitan area	Troy, AL	No change
Metropolitan area	Tuscaloosa, AL	No change
Metropolitan area	Tyler, TX	Small increase
Metropolitan area	Valley, AL	No change
Metropolitan area	Waco, TX	Small increase
Metropolitan area	Warner Robins, GA	No change
Metropolitan area	Warrensburg, MO	No change
Metropolitan area	Washington-Arlington-Alexandria, DC-VA-MD-WV	No change

Metropolitan area	Yakima, WA	No change
Metropolitan area	Yauco, PR	Significant increase
Rural county	Amador, CA	No change
Rural county	Banks, GA	No change
Rural county	Boone, NE	No change
Rural county	Box Butte, NE	No change
Rural county	Butler, AL	No change
Rural county	Calaveras, CA	No change
Rural county	Cass, IA	No change
Rural county	Cheyenne, NE	No change
Rural county	Clay, AL	No change
Rural county	Cleburne, AL	No change
Rural county	Conecuh, AL	No change
Rural county	Covington, AL	No change
Rural county	Crenshaw, AL	Significant increase
Rural county	Custer, NE	No change
Rural county	De Witt, IL	No change
Rural county	Douglas, IL	Significant increase
Rural county	Escambia, AL	No change
Rural county	Falls, TX	No change
Rural county	Fannin, GA	Decrease
Rural county	Freestone, TX	No change
Rural county	Garfield, NE	No change
Rural county	Gilmer, GA	No change
Rural county	Grimes, TX	No change
Rural county	Holmes, FL	No change
Rural county	Holt, NE	Significant increase
Rural county	Hot Springs, WY	No change
Rural county	Huron, MI	No change
Rural county	Jackson, FL	No change
Rural county	Jackson, GA	No change
Rural county	Jefferson, NE	No change
Rural county	Jefferson, OR	No change
Rural county	Jefferson, WA	No change
Rural county	Jo Daviess, IL	Significant increase
Rural county	Johnson, NE	No change
Rural county	Kittson, MN	No change
Rural county	Klickitat, WA	No change
Rural county	Knox, NE	No change
Rural county	Lafayette, WI	No change
Rural county	Limestone, TX	No change
Rural county	Lumpkin, GA	No change
Rural county	Madison, TX	No change

Rural county	Marshall, KS	No change
Rural county	Monona, IA	No change
Rural county	Montgomery, IA	Significant increase
Rural county	Nemaha, NE	No change
Rural county	Otoe, NE	No change
Rural county	Page, IA	No change
Rural county	Phelps, NE	No change
Rural county	Plymouth, IA	No change
Rural county	Polk, TX	No change
Rural county	Rabun, GA	No change
Rural county	Randolph, AL	No change
Rural county	Red Lake, MN	No change
Rural county	Red Willow, NE	No change
Rural county	Richardson, NE	No change
Rural county	Saline, NE	No change
Rural county	Sanilac, MI	No change
Rural county	Shenandoah, VA	No change
Rural county	Stevens, MN	No change
Rural county	Swift, MN	No change
Rural county	Tattnall, GA	No change
Rural county	Thayer, NE	No change
Rural county	Towns, GA	No change
Rural county	Union, GA	No change
Rural county	Valley, NE	No change
Rural county	Walton, FL	No change
Rural county	Washington, FL	No change
Rural county	White, GA	No change

Source: GAO analysis of Census Bureau, FDIC, and OCC data

Question 3: The GAO analysis in the study indicates IndyMac was the only bank that failed with heavy fair-value losses. Meaning losses from FAS 157. Did GAO conduct an analysis comparing the top 10 largest banks and their FAS 157 losses during the 2007-2008 period to IndyMac's FAS 157 losses? If not, will you please conduct this comparison and submit it for the record?

Response:

Our analysis indicated that IndyMac was the only large bank that failed with heavy fair-value losses.[1] As part of our methodology we analyzed, on an aggregate as well as on an individual

[1]Statement of Financial Accounting Standards (SFAS) 157, as issued in 2006 and effective for an entity's first fiscal year beginning after November 15, 2007, is the standard that defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 does not determine when fair value should be applied nor does it require that fair value be applied to specific assets or liabilities; however, it does clarify how to determine fair value if an asset or liability is to be valued according to fair value criteria. The requirement of mark-to-market and fair value accounting is set forth in other accounting standards, including but not limited to, SFAS 115, Accounting for Certain

basis, the impact of fair value accounting on the nine large banks and thrifts (those that had $10 billion or more in assets) that failed between 2008 and 2011. These included three commercial banks: (1) United Commercial Bank, (2) Colonial Bank, and (3) Westernbank of Puerto Rico and six thrifts:(1) IndyMac, (2) Downey Savings and Loan, (3) Washington Mutual, (4) Amtrust, (5) BankUnited, and (6) Guaranty Bank. For each of these large banks and thrifts, we determined the extent to which these banks and thrifts' assets were measured at historical cost versus fair value and the extent to which losses were credit-related. These analyses can be found in appendices IV and V of our report.

In summary, we found that HFI loans, which are recorded at amortized cost and thus not subject to fair value accounting, generally represented the majority of large failed banks and thrifts' assets. For example, in 2007 and 2008, HFI loans represented an average 60.80 percent and 56.25 percent respectively, of the three failed large commercial banks, and an average 68.91 percent and 75.42 percent, respectively, of the six failed large thrifts. For IndyMac specifically, however, HFI loans represented 33.7 percent and 60.9 percent of total assets over these two years—the lowest of the six thrifts.

In contrast, we found that assets and liabilities measured at fair value generally did not account for a significant percentage of the assets of large failed banks and thrifts. For example, table 3 shows the percentage of assets and liabilities measured at fair value through earnings on a recurring basis (each reporting period), which comprise mainly trading assets, nontrading derivative assets, and nonfinancial assets such as servicing rights for mortgages for which the fair value option has been elected.[2] For these assets and liabilities, unrealized fair value gains or losses flow through the bank or thrift's earnings in the income statement and affect regulatory capital. Table 3 shows that these assets and liabilities accounted for a small percentage overall of large failed banks and thrifts' assets during 2007 and 2008. For IndyMac specifically, however, the level of these assets it held was relatively higher. In particular, nonfinancial assets represented 7.45 percent and 8.15 percent of total assets in 2007 and 2008, respectively. These nonfinancial assets included mortgage servicing rights (MSR), which arise when banks sell mortgage loans and keep the right to service those loans, and reflected IndyMac's active role in mortgage securitization.

Table 3: Assets and Liabilities Measured at Fair Value on a Recurring Basis as a Percentage of Total Assets for Large Failed Banks, Large Failed Thrifts, and IndyMac, 2007 and 2008

Institution	Description	2007	2008
Large failed banks	Trading assets	0.04%	0.04%
	Nontrading assets	0.00%	0.00%
	Nonfinancial assets	0.00%	0.00%
	Liabilities	0.01%	0.02%
Large failed thrifts	Trading assets	1.28%	0.35%
	Nontrading assets	0.87%	1.24%
	Nonfinancial assets	2.21%	1.18%
	Liabilities	0.04%	0.15%
IndyMac	Trading assets	3.42%	1.74%

Investments in Debt and Equity Securities; SFAS 130, Reporting Other Comprehensive Income; SFAS 133, Accounting for Derivative Instruments and Hedging Activities; and SFAS 155, Accounting for Certain Hybrid Financial Instruments.

[2]ASC 825 (formerly FAS 159), "*The Fair Value Option for Financial Assets and Financial Liabilities*," (February 2007) allows a one-time election to report certain financial instruments at fair value. At initial recognition for certain financial assets and liabilities, an entity may irrevocably elect fair value as the initial and subsequent measurement attribute, with changes in fair value included in current earnings.

	Nontrading assets	2.05%	4.76%
	Nonfinancial assets	7.45%	8.15%
	Liabilities	0.51%	0.64%

Source: GAO analysis of FDIC call report and thrift financial report data.

We also analyzed those assets measured at fair value on a nonrecurring basis through income (table 4). Such assets include investments in debt securities classified as held to maturity (HTM) and as available for sale (AFS). For large failed banks and thrifts, securities AFS represented the largest percentage of assets held after loans HFI in 2008. However, fair value changes for these securities do not generally impact current earning or regulatory capital. Both HTM and AFS securities are measured at amortized cost unless any declines in fair value can be categorized as other than temporary, in which case credit losses are recognized in earnings.

Table 4: Assets and Liabilities Measured at Fair Value on a Nonecurring Basis as a Percentage of Total Assets for Large Failed Banks, Large Failed Thrifts, and IndyMac, 2007 and 2008

Institution	Description	2007	2008
Large failed banks	HTM securities	13.60%	5.04%
	AFS securities	9.94%	16.47%
Large failed thrifts	HTM securities	1.79%	4.94%
	AFS securities	8.44%	6.29%
IndyMac	HTM securities	0.00%	9.50%
	AFS securities	14.37%	8.30%

Source: GAO analysis of FDIC call report and thrift financial report data.

Finally, we analyzed those assets that are carried at the lower of cost or fair value. These include loans held for sale (HFS), which are loans that are originated with the intent to sell in the secondary market, and Other Real Estate Owned (OREO), which comprise those assets repossessed through a foreclosure process for defaulted loans. Table 5 shows that loans HFS accounted for less than 5 percent of assets held by large failed banks in 2007 and 2008. For large failed thrifts, loans HFS accounted for an average of 6.81 percent of assets in 2007, but this result is driven by IndyMac, which held a significant level of HFS loans in 2007 due to its active involvement in mortgage loan securitization.[3]

Table 5: Assets and Liabilities Measured at the Lower of Cost or Fair as a Percentage of Total Assets for Large Failed Banks, Large Failed Thrifts, and IndyMac, 2007 and 2008

Institution	Description	2007	2008
Large failed banks	Loans HFS	3.08%	4.19%
	OREO	0.04%	0.39%
Large failed thrifts	Loans HFS	6.81%	1.26%
	OREO	0.26%	0.96%
IndyMac	Loans HFS	31.8%	1.40%
	OREO	0.3%	0.90%

Source: GAO analysis of FDIC call report and thrift financial report data.

[3]IndyMac was the failed bank with the largest share of HFS loans as a percent of its total assets during our period of study. From the first quarter of 2007 to the third quarter of 2007, IndyMac's HFS loans ranged between about 36 percent to 42 percent of its total assets. However, as of the fourth quarter of 2007, it started curtailing the volume of its HFS loans. In its regulatory filing with the Securities Exchange Commission, IndyMac reported that in the fourth quarter of 2007, it transferred HFS loans with an original cost basis of $10.9 billion to HFI loans as it no longer intended to sell these loans given the extreme disruption in the secondary mortgage market.

As discussed in appendices IV and V in our report, with the exception of IndyMac, fair value-related losses contributed very little to the decline in net interest income and regulatory capital experienced by the large failed banks and thrifts. Instead, we found that the failures were driven by rising levels of credit losses related to nonperforming HFI loans. These losses had a greater negative impact on the large banks and thrift institutions' net interest income and regulatory capital levels than those recorded at fair value. While IndyMac also experienced significant levels of credit losses related to nonperforming HFI loans in 2007 and 2008, it also experienced heavy losses related to declines in those assets and liabilities measured at fair value on a recurring basis and losses on loans HFS it held in 2007.

Response to Questions from
the Honorable Spencer Bachus
by the Federal Deposit Insurance Corporation

Q1: The FDIC announced community banks initiatives in 2012 including regional round tables, community bank study and more importantly examination and rule making review. Where are these in the process; what are the findings or results? What has been implemented as a result of these efforts? What have they done to help our community banks?

A1: The FDIC launched the Community Banking Initiative in February 2012 with a national conference on community banking. The FDIC held Roundtable discussions in the FDIC's six regions from March 2012 to October 2012. The FDIC released the *FDIC Community Banking Study* in December 2012. Throughout 2012, the FDIC's Division of Risk Management Supervision and Division of Depositor and Consumer Protection undertook a comprehensive review of the examination and rulemaking processes to identify opportunities to make these processes more efficient and effective, without altering the FDIC's supervisory standards. A full report of the findings from the roundtables and the examination and rulemaking review is available at http://www.fdic.gov/regulations/resources/cbi/rtreport.html#FullReport.

Overall, the findings from these initiatives indicate the community banking model remains viable, and that community banks will be an important part of the financial landscape for years to come. The findings also identified financial and operational challenges facing community banks as well as opportunities for the FDIC to strengthen the efficiency and effectiveness of its examination and rulemaking processes.

The FDIC has undertaken the following actions to address the examination and rulemaking review findings:

- Developed a tool that generates pre-examination request documents tailored to a bank's specific operations and business lines;
- Improved how information is shared electronically between bankers and examiners through its secure Internet channel, FDIC*connect*, which will ensure better access for bankers and examiners;
- Revised the classification system for citing violations in Compliance Reports of Examination to better communicate to institutions the severity of violations and provide more consistency in the classification of violations;
- Developed and posted a Regulatory Calendar on www.fdic.gov to keep bankers current on the issuance of rules, regulations, and guidance;
- Released the first in a series of technical assistance videos to provide useful information to bank directors, officers, and employees on areas of supervisory focus and proposed regulatory changes; and
- Created the Director's Resource Center web page to enhance technical assistance provided to bankers on a range of bank regulatory issues.

Response to Questions from
the Honorable Shelley Moore Capito
by the Federal Deposit Insurance Corporation

Q1: The Dodd-Frank Act calls for coordination between the CFPB and prudential regulators during the rulewriting process. Please provide the subcommittee with an account of the advice the FDIC provided to the CFPB of how the recent CFPB mortgage rules will affect community banks. Please include a list of recommendations the CFPB accepted and a list of recommendations the CFPB ignored.

A1: As you know, the Dodd-Frank Act established the Consumer Financial Protection Bureau (CFPB) and included a series of changes to the laws governing mortgage lending. These statutory changes have been the subject of rulemaking by the CFPB in consultation with the FDIC and the other prudential regulators.

In our experience, the CFPB's consultation process regarding the mortgage rules has been robust and useful. The CFPB shares information, convenes meetings regularly, and engages in substantive discussions with the FDIC and the other prudential regulators, along with HUD, FHFA, and Treasury.

In requiring these rulemakings, Congress directed the CFPB, the FDIC, and the other prudential regulators to be cognizant of the differences that exist among banks, specifically citing rural and community banks for somewhat differential treatment. As the primary regulator of the nation's community banks, the FDIC has been mindful of these distinctions and of congressional intent in this regard. The FDIC engages in frequent communication with community banks, trade associations, and other industry stakeholders and with our Community Bank Advisory Committee. These interactions provide invaluable and current insight to the FDIC about how community banks undertake their mortgage business, and the opportunity to hear directly from community bankers about their concerns. We have brought our knowledge and understanding of community banks, gained through both these conversations and our examination program, as well as our commitment to consumer protection, to the various consultations and meetings with the CFPB on all the mortgage regulations. This includes conveying our understanding of the role community banks play in providing mortgage lending services in rural and underserved areas, and the challenges and opportunities these institutions face on an ongoing basis.

In 2011, the FDIC also launched a Community Bank Initiative that on an ongoing basis updates the FDIC's understanding of the role of community banks in the financial marketplace and further assists the FDIC in identifying the challenges and opportunities these institutions face going forward. Consistent with the results of the knowledge gained through the FDIC's Community Bank Initiative, FDIC staff put particular emphasis on the unique business model of these community banks in its consultations with the CFPB.

Community banks have a business model that is based on an overall banking relationship with their customers. As a general rule, community banks use a "high touch" model, rather than a "high volume, low margin" model. This allows community banks to compete in the mortgage marketplace based on customer service and underwriting that is successful because of strong relationships with customers. We also have highlighted that, in general, smaller institutions with a relationship-based model did not face the considerable challenges that affected large financial organizations during the mortgage crisis. The majority of community banks used sensible mortgage underwriting practices during the pre-crisis years, even as overall market discipline declined.

Specific concerns about the proposed rules that we heard from community bankers and trade associations and shared with the CFPB are as follows:

- Restrictions on the origination of balloon loans would have a significant adverse effect on community banks, particularly those located in rural areas given that balloon loans may comprise a significant portion of available and customary mortgage credit in the communities they serve.
- The Qualified Mortgage definitions of "rural" and "underserved" were complicated and, in addition, would not cover enough community banks.
- Mortgage servicing requirements would have a disproportionate impact on small mortgage servicers, who have not demonstrated the problems associated with the large mortgage servicers.
- Requiring escrow would drive community banks, particularly rural community banks, out of the mortgage business because of the associated costs.
- Mortgage loan originator rules were making it difficult for community banks to maintain their level of personal service.

In addition to hearing these concerns conveyed through the FDIC, we are aware that the CFPB also met with community banks and trade associations, and received thousands of comment letters from community banking organizations, consumer advocacy groups, and others. The final rules promulgated by the CFPB suggest greater sensitivity to the needs and interests of community banks, particularly rural community banks, as those needs and interests were expressed to the FDIC and subsequently transmitted to the CFPB, than did the proposed rules. In addition, several of the final rules reduce requirements for community banks compared to current law.

Q2: Appendix B of the study provides information from interviews with community bankers on the growing cost of compliance. While I understand it is difficult to quantify this costs as it is a time burden on the institutions; policy makers, regulators, and financial institutions have to work together to reduce this burden. Is there anyone within the FDIC that is designated as quantifying the overall regulatory burden facing community banks?

A2: The FDIC takes seriously its commitment to better understand the costs of regulation and we have several of our divisions working on initiatives to monitor and find ways to keep those costs to a minimum consistent with the imperatives of safe and sound banking and consumer protection.

As described in Appendix B of the *FDIC Community Banking Study*, community banks often do not specifically track and do not specifically report compliance costs. In fact, bankers that participated in the interviews indicated that they do not track compliance costs because it is too time consuming, costly, and difficult to break out specific costs. Nevertheless, the Study was able to make extensive use of the available regulatory data to better understand the factors that determine community bank earnings, including changes in noninterest expenses (which include compliance costs). We continue to monitor these trends, and have immediate plans to update several elements of our analysis of bank earnings. The FDIC actively seeks, receives, and acts upon feedback from community bankers about the supervisory process in general and regulatory burden in particular. For example, the FDIC has established the FDIC Advisory Committee on Community Banking, held FDIC regional roundtable discussions of the community banking operating environment, conducted a 2012 review of examination and supervisory guidance, and conducted post examination surveys, as well as undertaking other initiatives.

We have found the interviews and roundtable discussions conducted with community bankers as part of the *Community Banking Study* to be useful in understanding regulatory cost issues.

Q3: Appendix B identified specific regulations that required significant time and resources for compliance, including HMDA, BSA, UDAP, Fair Lending, USA PATRIOT Act, and EFTA. Is the FDIC working with other prudential regulators and the CFPB to review these regulations to identify ones that are duplicative, unnecessary, or outdated? If not, please identify ways the FDIC is working to review these laws to reduce regulatory burden.

A3: The FDIC does not have rulemaking authority for the laws listed in this question. However, the FDIC undertakes a comprehensive review of its regulations every ten years, has taken steps to refine examination and enforcement procedures related to the Home Mortgage Disclosure Act, and is taking other steps to identify and eliminate unnecessary regulatory burden generally.

- The FDIC, jointly with the other federal banking agencies, every ten years undertakes a comprehensive review of each of its regulations as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). The focus of the EGRPRA review is to identify any outdated, unnecessary, or unduly burdensome regulatory requirements imposed on insured depository institutions. The FDIC completed its last review under EGRPRA in 2006 and must complete the next comprehensive review by 2016. To prepare for the upcoming EGRPRA review process, the FDIC published on its website and sought public comment in early 2012 on a plan outlining the process for this review. To the extent the FDIC receives comments on regulations for which it does not have rulemaking authority, the FDIC will forward these comments to the relevant agencies.

- Examination and enforcement procedures related to the Home Mortgage Disclosure Act (HMDA) have been the subject of significant attention by the FDIC during the past several years. We have sought to refine our processes to best achieve our supervisory objective of the accurate reporting of loan-level mortgage data by the 60 percent of FDIC-supervised institutions subject to HMDA reporting thresholds. The majority of HMDA reporters have less than 100 reportable transactions per year. In 2011, the FDIC implemented changes related to its examination procedures associated with HMDA data validation and submission to improve the efficiency of examinations of large HMDA reporters (over 500 reportable transactions in a year). The changes include reviewing these data before the start of an examination, segmenting sampling techniques by the size of the institution's mortgage activity, and refining statistical methods to increase confidence in sampling results.

- Based on the experience implementing the 2011 changes and a review of our supervisory strategy, the FDIC implemented further refinements in October 2012 to our HMDA examination and enforcement procedures. Key changes include: 1) revising sampling techniques for small reporters (less than 100 reportable transactions) to avoid triggering additional file review for minor errors; and 2) limiting imposition of civil money penalties to situations where an institution's level of errors is significantly above the threshold for resubmission and the violations are deemed egregious. We are monitoring the results of these changes to ensure we achieve our supervisory objectives of accurate data reporting in an efficient and reasonable manner.

- As part of the FDIC's Community Banking Initiative, the FDIC undertook comprehensive reviews of examination and rulemaking processes and has taken several actions to address findings from those reviews. For example, we have developed a tool that generates pre-examination request documents tailored to the bank's specific operations and business lines. In addition, we revised the classification system for citing violations in Compliance Reports of Examination to better communicate to institutions the severity of violations and provide more consistency in the classification of violations. We also have modified our Financial Institution Letters (FIL), the vehicle we use to alert banks to any regulatory changes or guidance, to include a section making clear the applicability to smaller institutions (under $1 billion).

Q4: Representatives from the FDIC often mention the FDIC ombudsman as a way for FDIC supervised institutions to appeal the decision of an examiner. Please describe the different avenues FDIC supervised institution can appeal a decision by an examiner.

A4: The FDIC provides the insured financial institutions it supervises a variety of formal and informal processes for appealing examination results. These processes include: an informal resolution of issues through the field and regional supervision staffs; an informal resolution of issues through the FDIC's Ombudsman; formal and informal reviews by the appropriate Division Director; and ultimately a formal appeal to a FDIC Board-level committee, the Supervisory Appeals Review Committee (SARC), in appropriate circumstances. The FDIC outlined these formal and informal appeals processes to financial institutions in the FIL *Reminder on FDIC Examination Findings*, dated March 1, 2011, and in an article published in the Summer 2012 issue of *Supervisory Insights* entitled "The Risk Management Examination and Your Community Bank."

Both the FIL and the *Supervisory Insights* article encourage institutions to discuss concerns about examination findings, assigned ratings, or other supervisory determinations with the examiner-in-charge or the appropriate field or regional office. They also remind financial institutions of the option to contact the FDIC's Office of the Ombudsman, which serves as an independent, confidential, and neutral liaison. When contacted, the Ombudsman's office explains and, as appropriate, assists institutions with questions or concerns related to appeals of material supervisory determinations; answers questions about FDIC policies and procedures and concerns regarding open or closed bank matters; and assists with complaints regarding FDIC operations, employees, and contractors. The Ombudsman also can help resolve complaints against the FDIC by listening, clarifying the issues, and working with both parties to reach an acceptable solution. The FDIC Ombudsman does not take sides and seeks to ensure a fair process.

The FIL also communicates the formal appeals process outlined in the Amendments to the *Guidelines for Appeals of Material Supervisory Determinations* (adopted April 13, 2010). Under these guidelines, a financial institution may file a request for review of a material supervisory determination with the Division Director. The Director issues a written determination, including the grounds for that determination, within 45 days of receipt of request. If the institution is not satisfied with the results of this review, it can appeal the Director's decision to the SARC. The SARC will review the appeal for consistency with the policies, practices, and mission of the FDIC and the overall reasonableness of, and the support offered for, the positions advanced. The SARC will notify the institution, in writing, of its decision concerning the disputed material supervisory determination(s) within 45 days from the date the SARC meets to consider the appeal.

Q4(a): Please provide the subcommittee with a statistical breakdown of how many financial institutions pursued either an informal or formal appeal with the FDIC in 2012.

A4(a): In 2012, approximately 347 industry representatives contacted the FDIC Ombudsman to request assistance. Of this number, 20 lodged complaints about the FDIC. Other informal channels encourage financial institutions to resolve disputes during the examination at the field office level and review process at the regional office level; however, these discussions are not tracked. With respect to formal appeals in 2012, nine institutions filed a Request for Review with the Director of the Division of Risk Management Supervision, and one institution filed an Appeal with the SARC. During 2012, no institutions filed a Request for Review with the Director of Depositor and Consumer Protection or filed an Appeal with the SARC.

Q4(b): Please include a statistical analysis of the ombudsman decision including the number of appeals that were ruled in favor of the institution, the number ruled in favor of the agency, and split decisions.

A4(b): The Ombudsman resolved or mitigated the 20 complaints (referenced in our response above) or referred them to another party for resolution when appropriate. In the majority of these cases, the Ombudsman was able to provide assistance by explaining FDIC policy and procedures and identifying appropriate FDIC contacts. With respect to the nine Requests for Review filed with the Director of the Division of Risk Management Supervision, three were denied; one was returned because the bank self-liquidated; one was a split decision, with the RMS Director finding in favor of the bank on some issues and in favor of the region in others; and four were withdrawn, after the material supervisory determinations in dispute were satisfactorily resolved in favor of the banks by the applicable regional office. The SARC appeal was denied. The FDIC Office of Inspector General's August 2012 Report entitled *The FDIC's Examination Process for Small Community Banks* reviewed the appeals process and stated that "determinations provide evidence that the SARC is considering the underlying merits of both the institution and the examiners' positions and, as such, is considering the substance of the disagreement and not simply whether or not the examiners followed established policy."

Response to Questions from
the Honorable Steve Pearce
by the Federal Deposit Insurance Corporation

Q1: Over the past two years the FDIC has taken a position that there is a misconception that regulators require the write downs of loans to creditworthy buyers. In recent testimony, FDIC directors reasserted that they "are not aware of, and the OIG did not identify, any instances where a bank failed due to supervisor required write-downs of current loans – so-called "paper losses." I would like the FDIC to provide proof of this misconception.

A1: Public Law 112-88, signed into law on January 3, 2012, required the FDIC Office of Inspector General to conduct a study that included a review of the impacts of significant losses arising from current loans. In its January 2013 Report to Congress titled *Comprehensive Study on the Impact of the Failure of Insured Depository Institutions* (OIG Report), the Office of Inspector General did not note improper classification of performing loans. The OIG Report states, "We did not identify any instance of an institution failure caused by significant losses arising from loans for which all payments of principal, interest, and fees were current." They also found that "…examiners usually did not classify as loss loans that the institution claimed were paying as agreed without justification…" Additionally, the OIG Report indicated that, "Examiners most frequently supported loan charge-offs on current loans for conditions such as lack of performance and lack of guarantor support (35 percent of the classification reasons), repayment capacity such as inadequate cash flow or unknown ability to service debt (32 percent of the classification reasons), or weak or inadequate collateral or collateral-dependent loans (25 percent of the classification reasons)." The OIG Report states that "[aggressive growth, asset concentrations, poor underwriting, and deficient credit administration coupled with declining real estate values] led to write-downs and charge-offs on delinquent and non-performing real estate loans as opposed to examiner-required write-downs or fair value accounting losses."

It is important to recognize that some loans may be reflected as "current" on a bank's books due to the inappropriate use of extensions, renewals, interest reserves, capitalization of accrued interest, below market terms, or failure to consider the borrower's ability to repay for the foreseeable future on a global cash flow basis. Examiners are instructed in the *Risk Management Manual of Examination Policies* to assess each loan on the basis of its own characteristics and consider multiple factors that go beyond payment status, such as: the risk of the project being financed; the nature and degree of collateral security; the character, capacity, financial responsibility, and record of the borrower; and the feasibility and probability of the loan's orderly liquidation in accordance with specified terms.

Q2: Please provide information as to how the FDIC evaluates the ability of the borrower to repay.

A2: As stated in the FDIC *Risk Management Manual of Examination Policies*, ability of the borrower to repay generally means the borrower must have the earnings or liquid assets sufficient to meet interest payments and provide for reduction or liquidation of principal as agreed at a reasonable and foreseeable date.

Q3: Please provide information on loans that have been or are being written down across the United States from 2011- to present date. Please provide this information nationally, and specifically for the state of New Mexico.

A3: The following table provides charge-off data for the nation and for the state of New Mexico. The charge-off data are provided as a dollar amount and as a percentage of loans.

	National	New Mexico
2011 Net Charge-Offs ($)	$113.2 billion	$99.5 million
2011 Net Charge-Off Rate	1.55%	1.17%
2012 Net Charge-Offs ($)	$82.8 billion	$51.9 million
2012 Net Charge-Off Rate	1.10%	0.61%

Response to Questions from
the Honorable Lynn Westmoreland
by the Federal Deposit Insurance Corporation

Q1: Please provide the percentage of payouts to date for each SLA (shared loss agreement)

A1: A chart of Shared Loss Agreements and the percentage of claims paid from the initially covered assets for each agreement is attached.

Q2: How many banks with pre-2007 UFIRs rating of 1 and 2 have failed from 2008-2013? Please provide a list of these failed banks.

A2: Of the 470 banks and thrifts that were closed by their chartering authorities from January 1, 2008 through April 12, 2013, where the FDIC was appointed receiver, 401, or 85 percent, were 1- or 2-rated on December 31, 2006. The sudden declines in real estate values during the crisis caused rapid deterioration in the financial condition of many depository institutions. In its *Comprehensive Study on the Impact of the Failure of Insured Depository Institutions*, the FDIC Office of Inspector General found that many banks that failed expanded lending and relaxed underwriting standards "to keep pace with rapid growth in construction and real estate development, rising mortgage demands, and increased competition." When the financial crisis hit and real estate values declined precipitously (according to the Inspector General's report, commercial real estate values declined by more than 42 percent), many institutions with rapid growth in construction and real estate development lending faced significant losses that resulted in rapid deterioration in financial condition, and ultimately, in failure.

A list of the failed banks that were 1- or 2- rated as of year-end 2006 is attached.

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
IndyMac Federal Bank, FSB	3%	N/A
Downey Savings & Loan Assn	1%	N/A
PFF Bank & Trust	5%	18%
Suburban Federal Savings Bank	6%	28%
County Bank	2%	8%
Alliance Bank	11%	14%
Pinnacle Bank of Oregon	0%	12%
Heritage Community Bank	11%	30%
Freedom Bank of Georgia	5%	25%
Colorado National Bank	20%	12%
Teambank, NA	5%	20%
Cape Fear Bank	4%	10%
Great Basin Bank of Nevada	2%	7%
American Sterling Bank	22%	9%
BankUnited, FSB	22%	16%
Strategic Capital Bank	0%	29%
Cooperative Bank	6%	30%
First National Bank of Anthony	15%	13%
Southern Community Bank	10%	41%
Neighborhood Community Bank	19%	38%
Horizon Bank	13%	12%
Mirae Bank	N/A	13%
Elizabeth State Bank	3%	13%
Founders Bank	4%	20%
Rock River Bank	6%	16%
The John Warner Bank	0%	40%
First State Bank of Winchester	1%	23%
First National Bank of Danville	3%	25%
Temecula Valley Bank	0%	0%
Vineyard Bank	7%	12%
First Piedmont Bank	3%	33%
Security Bank of Bibb County	17%	22%
Security Bank of Gwinnett County	43%	51%
Security Bank of Houston County	8%	18%
Security Bank of Jones County	9%	29%
Security Bank of North Fulton	32%	29%
Security Bank of North Metro	31%	40%
Waterford Village Bank	1%	3%
Community First Bank	15%	24%
Mutual Bank	4%	31%
Peoples Community Bank	4%	17%
First State Bank	16%	21%
Community National Bank of Sarasota County	10%	16%
Community Bank of Arizona	41%	24%
Colonial Bank	3%	16%
Guaranty Bank	6%	5%
Capital South Bank	9%	14%
Ebank	14%	34%
First Coweta	21%	33%
Bradford Bank	2%	16%
Affinity Bank	4%	14%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
Mainstreet Bank	13%	19%
Vantus Bank	1%	13%
Brickwell Community Bank	13%	23%
Venture Bank	10%	18%
Irwin Union Bank and Trust Company	7%	9%
Irwin Union Bank, FSB	5%	11%
Georgian Bank	10%	26%
Southern Colorado National Bank	11%	9%
Jennings State Bank	19%	15%
San Joaquin Bank	7%	11%
American United Bank	N/A	20%
First DuPage Bank	9%	31%
Flagship National Bank	17%	25%
Riverview Community Bank	9%	13%
California National Bank	1%	8%
San Diego National Bank	2%	7%
Bank USA, NA	8%	13%
Community Bank of Lemont	14%	36%
North Houston Bank	14%	10%
Pacific National Bank	2%	7%
Park National Bank	4%	9%
Citizens National Bank	0%	5%
Madisonville State Bank	N/A	3%
Prosperan Bank	12%	23%
United Security Bank	31%	21%
United Commercial Bank	1%	8%
Century Bank, FSB	19%	40%
Orion Bank	7%	31%
Commerce Bank of Southwest Florida	25%	20%
The Buckhead Community Bank	32%	31%
Benchmark Bank	6%	30%
AmTrust Bank	6%	6%
Greater Atlantic Bank	0%	4%
First Security National Bank	19%	30%
Republic Federal Bank, N.A.	3%	10%
Valley Capital Bank, N.A.	32%	38%
SolutionsBank	7%	19%
Imperial Capital Bank	1%	15%
New South Federal Savings Bank	7%	20%
Peoples First Community Bank	8%	34%
First Federal Bank of California	0%	0%
Horizon Bank	3%	16%
St. Stephen State Bank	5%	19%
Town Community Bank and Trust	18%	25%
Evergreen Bank	4%	7%
Premier American Bank	5%	20%
Charter Bank	2%	9%
Columbia River Bank	7%	10%
First Regional Bank	N/A	12%
American Marine Bank	6%	10%
First National Bank of Georgia	16%	23%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
Community Bank & Trust	20%	32%
Florida Community Bank	6%	20%
1st American State Bank of Minnesota	N/A	6%
George Washington Savings Bank	12%	34%
La Jolla Bank, FSB	5%	13%
Marco Community Bank	8%	14%
Carson River Community Bank	6%	6%
Rainier Pacific Bank	2%	7%
Bank of Illinois	5%	10%
Sun American Bank	9%	17%
LibertyPointe Bank	0%	7%
The Park Avenue Bank	1%	18%
Statewide Bank	8%	9%
Old Southern Bank	26%	12%
Century Security Bank	0%	27%
Appalachian Community Bank	13%	38%
American National Bank	N/A	5%
Bank of Hiawassee	6%	21%
First Lowndes Bank	8%	5%
Desert Hills Bank	25%	23%
Key West Bank	5%	3%
McIntosh Commercial Bank	20%	42%
Unity National Bank	7%	20%
Beach First National Bank	9%	24%
AmericanFirst Bank	11%	16%
Butler Bank	2%	15%
City Bank	1%	9%
First Federal Bank of North Florida	3%	12%
Innovative Bank	N/A	9%
Riverside National Bank of Florida	3%	5%
Tamalpais Bank	0%	0%
Amcore Bank, National Association	3%	13%
Broadway Bank	14%	28%
Lincoln Park Savings Bank	7%	26%
New Century Bank	10%	30%
Peotone Bank and Trust Company	11%	25%
Wheatland Bank	21%	31%
BC National Banks	2%	8%
CF Bancorp	10%	19%
Champion Banks	8%	20%
Frontier Bank	4%	17%
Eurobank	1%	22%
R-G Premier Banks of Puerto Rico	2%	20%
Westernbank Puerto Rico	1%	14%
1st Pacific Bank of California	8%	4%
Towne Bank of Arizona	40%	22%
Midwest Bank and Trust Company	4%	8%
New Liberty Bank	3%	11%
Satilla Community Bank	11%	19%
Southwest Community Bank	19%	21%
Bank of Florida - Southeast	0%	0%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
Bank of Florida - Southwest	0%	0%
Bank of Florida - Tampa Bay	0%	0%
Granite Community Bank, National Association	5%	12%
Sun West Bank	17%	31%
Tierone Bank	3%	9%
Washington First International Bank	3%	14%
Nevada Security Bank	3%	19%
High Desert State Bank	13%	22%
Peninsula Bank	11%	37%
USA Bank	13%	12%
Home National Bank	10%	19%
Mainstreet Savings Bank, FSB	3%	23%
Metro Bank of Dade County	7%	16%
Olde Cypress Community Bank	5%	17%
Turnberry Bank	4%	13%
Woodlands Bank	8%	18%
First National Bank of the South	7%	12%
Crescent Bank and Trust Company	7%	31%
Home Valley Bank	4%	13%
SouthwestUSA Bank	18%	29%
Sterling Bank	6%	18%
Williamsburg First National Bank	4%	7%
Bayside Savings Bank	13%	20%
Coastal Community Bank	12%	18%
Libertybank	9%	14%
Northwest Bank and Trust	2%	16%
The Cowlitz Bank	10%	2%
Ravenswood Bank	8%	32%
Palos Bank and Trust Company	1%	23%
Butte Community Bank	8%	9%
Community National Bank at Bartow	10%	6%
Independent National Bank	2%	8%
Los Padres Bank	4%	13%
Pacific State Bank	9%	14%
Shorebank	4%	14%
Horizon Bank	13%	16%
The Bank of Ellijay	13%	30%
First Commerce Community Bank	15%	27%
ISN Bank	5%	14%
The Peoples Bank	6%	22%
Haven Trust Bank Florida	5%	18%
North County Bank	8%	10%
Shoreline Bank	13%	4%
Wakulla Bank	3%	4%
Premier Bank	4%	15%
Security Savings Bank, F.S.B.	2%	12%
Westbridge Bank and Trust	10%	18%
First Bank of Jacksonville	4%	6%
First Suburban National Bank	1%	9%
Hillcrest Bank	0%	12%
Progress Bank of Florida	5%	26%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
The First National Bank of Barnesville	12%	24%
K Bank	7%	27%
Western Commercial Bank	N/A	15%
Copper Star Bank	16%	22%
Darby Bank & Trust Company	9%	21%
Tifton Banking Company	6%	14%
Allegiance Bank Of North America	4%	2%
First Banking Center	4%	13%
Gulf State Community Bank	6%	14%
Earthstar Bank	2%	1%
Paramount Bank	10%	17%
Appalachian Community Bank, F.S.B.	8%	15%
Chestatee State Bank	3%	23%
United Americas Bank	10%	28%
The Bank Of Miami	4%	6%
First Commercial Bank Of Florida	11%	17%
Legacy Bank	6%	22%
Oglethorpe Bank	9%	20%
CommunitySouth Bank & Trust	N/A	9%
Bank Of Asheville (The)	5%	12%
United Western Bank	1%	12%
American Trust Bank	0%	3%
Community First Bank-Chicago	9%	16%
North Georgia Bank	6%	22%
Peoples State Bank	2%	21%
Citizens Bank Of Effingham	2%	14%
Habersham Bank	3%	32%
San Luis Trust Bank, Fsb	12%	16%
Legacy Bank	2%	5%
The Bank Of Commerce	5%	18%
Nevada Commerce Bank	1%	25%
Western Springs National Bank & Trust	N/A	15%
Bartow County Bank	2%	17%
Heritage Banking Group	1%	3%
New Horizons Bank	9%	20%
Nexity Bank	4%	17%
Superior Bank	1%	20%
Community Central Bank	6%	13%
Cortez Community Bank	5%	18%
First Choice Community Bank	1%	20%
First National Bank Of Central Florida	1%	17%
Park Avenue Bank (The)	1%	18%
Coastal Bank	3%	17%
Atlantic Southern Bank	5%	22%
First Georgia Banking Company	2%	13%
Summit Bank	11%	14%
First Heritage Bank	10%	16%
Atlantic Bank and Trust	3%	9%
Mcintosh State Bank	2%	20%
Mountain Heritage Bank	7%	24%
Colorado Capital Bank	3%	28%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
First Chicago Bank & Trust	9%	19%
High Trust Bank	5%	18%
One Georgia Bank	5%	11%
BankMeridian, N.A.	5%	15%
Integra Bank, National Association	1%	9%
The First National Bank Of Olathe	2%	25%
First Southern National Bank	2%	7%
Lydian Private Bank	3%	8%
Creekside Bank	13%	25%
Patriot Bank Of Georgia	6%	30%
The First National Bank Of Florida	4%	18%
Bank Of The Commonwealth	2%	10%
The Riverbank	1%	12%
Sun Security Bank	10%	16%
Blue Ridge Savings Bank, Inc.	11%	15%
Piedmont Community Bank	0%	32%
Community Banks Of Colorado	N/A	17%
Community Capital Bank	1%	25%
Decatur First Bank	7%	12%
Old Harbor Bank	4%	7%
SunFirst Bank	0%	13%
Premier Community Bank Of The Emerald Coast	6%	18%
Central Florida State Bank	1%	10%
The First State Bank	7%	25%
First Guaranty Bank And Trust Co. Of Jacksonville	0%	14%
Patriot Bank Minnesota	N/A	0%
Charter National Bank And Trust	3%	19%
Central Bank of Georgia	4%	8%
Covenant Bank & Trust	1%	11%
Inter Savings Bank, Fsb	3%	3%
Plantation Federal Bank	N/A	9%
Waccamaw Bank	0%	3%
Putnam State Bank	N/A	10%
Security Exchange Bank	N/A	21%
FIRST CHEROKEE STATE BANK	N/A	11%
GEORGIA TRUST BANK	N/A	6%
HEARTLAND BANK	N/A	2%
Jasper Banking Company	N/A	6%
Truman Bank	N/A	4%
First United Bank	0%	0%
Excel Bank	N/A	0%
Community Bank Of The Ozarks	0%	0%
Aggregate Claim Payments as a percent of initial assets under SLA	6%	15%

Disclaimer:
The information presented in the table above has been compiled from loan data supplied by Assuming Institutions as part of their reporting requirements under their respective Shared Loss Agreements. This information has not been subject to audit and no representation is made as to the completeness or accuracy of the information.

Failed Banks with pre-2007 UFIRs 1 and 2

Name	City	State
CAPITALSOUTH BANK	BIRMINGHAM	AL
NEXITY BANK	BIRMINGHAM	AL
SUPERIOR BANK	BIRMINGHAM	AL
FIRST LOWNDES BANK	FORT DEPOSIT	AL
NEW SOUTH FSB	IRONDALE	AL
COLONIAL BANK NATIONAL ASSN	MONTGOMERY	AL
ALABAMA TRUST BANK NA	SYLACAUGA	AL
FIRST SOUTHERN BANK	BATESVILLE	AR
ANB FINANCIAL NATIONAL ASSN	BENTONVILLE	AR
FIRST STATE BANK	FLAGSTAFF	AZ
UNION BANK NATIONAL ASSN	GILBERT	AZ
CACTUS COMMERCE BANK	GLENDALE	AZ
TOWNE BANK OF ARIZONA	MESA	AZ
BANK USA FSB	PHOENIX	AZ
DESERT HILLS BANK	PHOENIX	AZ
WESTERN NATIONAL BANK	PHOENIX	AZ
SUMMIT BANK	PRESCOTT	AZ
COPPER STAR BANK	SCOTTSDALE	AZ
FIRST ARIZONA SAVINGS A FSB	SCOTTSDALE	AZ
LEGACY BANK	SCOTTSDALE	AZ
SAN JOAQUIN BANK	BAKERSFIELD	CA
FIRST BANK OF BEVERLY HILLS	CALABASAS	CA
BUTTE COMMUNITY BANK	CHICO	CA
ALLIANCE BANK	CULVER CITY	CA
GRANITE COMMUNITY BANK N A	GRANITE BAY	CA
IMPERIAL CAPITAL BANK	LA JOLLA	CA
LA JOLLA BANK FSB	LA JOLLA	CA
CALIFORNIA NATIONAL BANK	LOS ANGELES	CA
SECURITY PACIFIC BANK	LOS ANGELES	CA
COUNTY BANK	MERCED	CA
CHARTER OAK BANK	NAPA	CA
CITIZENS BANK OF NORTHERN CA	NEVADA CITY	CA
FIRST HERITAGE BANK N A	NEWPORT BEACH	CA
PALM DESERT NATIONAL BANK	PALM DESERT	CA
CANYON NATIONAL BANK	PALM SPRINGS	CA
INDYMAC BANK FSB	PASADENA	CA
PFF BANK&TRUST	POMONA	CA
VINEYARD BANK NATIONAL ASSN	RANCHO CUCAMONGA	CA
1ST CENTENNIAL BANK	REDLANDS	CA
PACIFIC COAST NATIONAL BANK	SAN CLEMENTE	CA
1ST PACIFIC BANK OF CA	SAN DIEGO	CA
SAN DIEGO NATIONAL BANK	SAN DIEGO	CA
CALIFORNIA SAVINGS BANK	SAN FRANCISCO	CA
UNITED COMMERCIAL BANK	SAN FRANCISCO	CA

Failed Banks with pre-2007 UFIRs 1 and 2

TAMALPAIS BANK	SAN RAFAEL	CA
LOS PADRES BANK	SOLVANG	CA
SONOMA VALLEY BANK	SONOMA	CA
PACIFIC STATE BANK	STOCKTON	CA
TEMECULA VALLEY BANK	TEMECULA	CA
AFFINITY BANK	VENTURA	CA
BANK OF CHOICE COLORADO	ARVADA	CO
COLORADO CAPITAL BANK	CASTLE ROCK	CO
COLORADO NATIONAL BANK	COLORADO SPRINGS	CO
UNITED WESTERN BANK	DENVER	CO
NEW FRONTIER BANK	GREELEY	CO
COMMUNITY BANKS OF COLORADO	GREENWOOD VILLAG	CO
FIRSTIER BANK	LOUISVILLE	CO
SOUTHERN COLORADO NB	PUEBLO	CO
SIGNATURE BANK	WINDSOR	CO
SOUTHSHORE COMMUNITY BANK	APOLLO BEACH	FL
TURNBERRY BANK	AVENTURA	FL
COMMUNITY NB OF BARTOW	BARTOW	FL
CENTRAL FLORIDA STATE BANK	BELLEVIEW	FL
SUN AMERICAN BANK	BOCA RATON	FL
BANK OF BONIFAY	BONIFAY	FL
FIRST PRIORITY BANK	BRADENTON	FL
FLAGSHIP NATIONAL BANK	BRADENTON	FL
FREEDOM BANK	BRADENTON	FL
HORIZON BANK	BRADENTON	FL
CORTEZ COMMUNITY BANK	BROOKSVILLE	FL
RIVERSIDE BK GULF COAST	CAPE CORAL	FL
GULF STATE COMMUNITY BANK	CARRABELLE	FL
OLD HARBOR BANK	CLEARWATER	FL
AMERICANFIRST BANK	CLERMONT	FL
OLDE CYPRESS COMMUNITY BANK	CLEWISTON	FL
BANKUNITED FSB	CORAL GABLES	FL
WAKULLA BANK	CRAWFORDVILLE	FL
GULFSOUTH PRIVATE BANK	DESTIN	FL
PENINSULA BANK	ENGLEWOOD	FL
BANK OF FLORIDA SOUTHEAST	FORT LAUDERDALE	FL
COMMERCE BANK OF SW FL	FORT MYERS	FL
RIVERSIDE NB OF FLORIDA	FORT PIERCE	FL
FIRST BANK OF JACKSONVILLE	JACKSONVILLE	FL
FIRST GUARANTY B&T JACKSONVI	JACKSONVILLE	FL
INTEGRITY BANK	JUPITER	FL
KEY WEST BANK	KEY WEST	FL
STERLING BANK	LANTANA	FL
HERITAGE BANK OF FLORIDA	LUTZ	FL
MARCO COMMUNITY BANK	MARCO ISLAND	FL

Failed Banks with pre-2007 UFIRs 1 and 2

COASTAL BANK	MERRITT ISLAND	FL
METRO BANK OF DADE COUNTY	MIAMI	FL
PREMIER AMERICAN BANK	MIAMI	FL
FIRST NB OF FLORIDA	MILTON	FL
BANK OF FLORIDA SOUTHWEST	NAPLES	FL
ORION BANK	NAPLES	FL
PARTNERS BANK	NAPLES	FL
SECURITY BANK NATIONAL ASSN	NORTH LAUDERDALE	FL
INDEPENDENT NATIONAL BANK	OCALA	FL
OCALA NATIONAL BANK	OCALA	FL
FIRST COMMERCIAL BANK OF FL	ORLANDO	FL
OLD SOUTHERN BANK	ORLANDO	FL
FIRST FEDERAL BANK OF N FL	PALATKA	FL
PUTNAM STATE BANK	PALATKA	FL
LYDIAN PRIVATE BANK	PALM BEACH	FL
PEOPLES FIRST COMMUNITY BANK	PANAMA CITY	FL
COASTAL COMMUNITY BANK	PANAMA CITY BEAC	FL
SUNSHINE STATE CMTY BANK	PORT ORANGE	FL
BAYSIDE SAVINGS BANK	PORT SAINT JOE	FL
FIRST PEOPLES BANK	PORT SAINT LUCIE	FL
CENTURY BANK A FSB	SARASOTA	FL
FIRST STATE BANK	SARASOTA	FL
LANDMARK BANK OF FLORIDA	SARASOTA	FL
BANK OF FLORIDA TAMPA BAY	TAMPA	FL
FIRST COML BK OF TAMPA BAY	TAMPA	FL
COMMUNITY NB SARASOTA CNTY	VENICE	FL
FIRST NB OF CENTRAL FLORIDA	WINTER PARK	FL
ENTERPRISE BANKING CO	ABBEVILLE	GA
NORTHWEST BANK&TRUST	ACWORTH	GA
MONTGOMERY BANK&TRUST	AILEY	GA
ALPHA BANK&TRUST	ALPHARETTA	GA
INTEGRITY BANK	ALPHARETTA	GA
SECURITY BANK OF N FULTON	ALPHARETTA	GA
BANKERS BANK	ATLANTA	GA
BUCKHEAD COMMUNITY BANK	ATLANTA	GA
GEORGIAN BANK	ATLANTA	GA
OMNI NATIONAL BANK	ATLANTA	GA
ONE GEORGIA BANK	ATLANTA	GA
UNITED AMERICAS BANK NA	ATLANTA	GA
FIRST NB OF BARNESVILLE	BARNESVILLE	GA
HOMETOWN COMMUNITY BANK	BRASELTON	GA
OGLETHORPE BANK	BRUNSWICK	GA
GEORGIA TRUST BANK	BUFORD	GA
MCINTOSH COMMERCIAL BANK	CARROLLTON	GA
WEST GEORGIA NATIONAL BANK	CARROLLTON	GA

Failed Banks with pre-2007 UFIRs 1 and 2

BARTOW COUNTY BANK	CARTERSVILLE	GA
UNITY NATIONAL BANK	CARTERSVILLE	GA
HABERSHAM BANK	CLARKESVILLE	GA
MOUNTAIN HERITAGE BANK	CLAYTON	GA
FREEDOM BANK OF GEORGIA	COMMERCE	GA
COMMUNITY BANK&TRUST	CORNELIA	GA
CHESTATEE STATE BANK	DAWSONVILLE	GA
DECATUR FIRST BANK	DECATUR	GA
GLOBAL COMMERCE BANK	DORAVILLE	GA
FIRST COMMERCE CMTY BANK	DOUGLASVILLE	GA
CENTURY SECURITY BANK	DULUTH	GA
HAVEN TRUST BANK	DULUTH	GA
NEW HORIZONS BANK	EAST ELLIJAY	GA
APPALACHIAN COMMUNITY BANK	ELLIJAY	GA
BANK OF ELLIJAY	ELLIJAY	GA
FIRST GEORGIA BANKING CO	FRANKLIN	GA
GORDON BANK	GORDON	GA
PIEDMONT COMMUNITY BANK	GRAY	GA
SECURITY BANK OF JONES CNTY	GRAY	GA
BANK OF HIAWASSEE	HIAWASSEE	GA
MCINTOSH STATE BANK	JACKSON	GA
CRESCENT BANK&TRUST CO	JASPER	GA
JASPER BANKING CO	JASPER	GA
COMMUNITY CAPITAL BANK	JONESBORO	GA
FRONTIER BANK	LAGRANGE	GA
AMERICAN UNITED BANK	LAWRENCEVILLE	GA
COMMUNITY BANK	LOGANVILLE	GA
ATLANTIC SOUTHERN BANK	MACON	GA
SECURITY BANK OF BIBB COUNTY	MACON	GA
SECURITY EXCHANGE BANK	MARIETTA	GA
FIRST BANK OF HENRY COUNTY	MCDONOUGH	GA
FIRST COWETA BANK	NEWNAN	GA
NEIGHBORHOOD COMMUNITY BANK	NEWNAN	GA
FIRST SECURITY NATIONAL BANK	NORCROSS	GA
SECURITY BK OF HOUSTON CNTY	PERRY	GA
TATTNALL BANK	REIDSVILLE	GA
COVENANT BANK&TRUST	ROCK SPRING	GA
COMMUNITY BANK OF ROCKMART	ROCKMART	GA
AMERICAN SOUTHERN BANK	ROSWELL	GA
AMERICAN TRUST BANK	ROSWELL	GA
SATILLA COMMUNITY BANK	SAINT MARYS	GA
FIRST NATIONAL BANK	SAVANNAH	GA
UNITED SECURITY BANK	SPARTA	GA
CITIZENS BANK OF EFFINGHAM	SPRINGFIELD	GA
FIRST SOUTHERN NATIONAL BANK	STATESBORO	GA

Failed Banks with pre-2007 UFIRs 1 and 2

FIRST STATE BANK	STOCKBRIDGE	GA
FIRSTCITY BANK	STOCKBRIDGE	GA
SOUTHERN HORIZON BANK	STOCKBRIDGE	GA
PATRIOT BANK OF GEORGIA	SUWANEE	GA
SECURITY BK OF GWINNETT CNTY	SUWANEE	GA
TIFTON BANKING CO	TIFTON	GA
PARK AVENUE BANK	VALDOSTA	GA
DARBY BANK &TRUST CO	VIDALIA	GA
COMMUNITY BANK OF WEST GA	VILLA RICA	GA
NORTH GEORGIA BANK	WATKINSVILLE	GA
FIRST PIEDMONT BANK	WINDER	GA
PEOPLES BANK	WINDER	GA
CREEKSIDE BANK	WOODSTOCK	GA
FIRST CHEROKEE STATE BANK	WOODSTOCK	GA
SECURITY BANK OF NORTH METRO	WOODSTOCK	GA
POLK COUNTY BANK	JOHNSTON	IA
FIRST FEDERAL BANK	SIOUX CITY	IA
FIRST BANK OF IDAHO FSB	KETCHUM	ID
COUNTRY BANK	ALEDO	IL
BENCHMARK BANK	AURORA	IL
NATIONAL BANK OF COMMERCE	BERKELEY	IL
STRATEGIC CAPITAL BANK	CHAMPAIGN	IL
BROADWAY BANK	CHICAGO	IL
COMMUNITY FIRST BANK CHICAGO	CHICAGO	IL
CORUS BANK NATIONAL ASSN	CHICAGO	IL
FIRST EAST SIDE SAVINGS BANK	CHICAGO	IL
LINCOLN PARK SAVINGS BANK	CHICAGO	IL
NEW CENTURY BANK	CHICAGO	IL
NEW CITY BANK	CHICAGO	IL
PARK NATIONAL BANK	CHICAGO	IL
RAVENSWOOD BANK	CHICAGO	IL
SHOREBANK	CHICAGO	IL
JOHN WARNER BANK	CLINTON	IL
FIRST UNITED BANK	CRETE	IL
FIRST NB OF DANVILLE	DANVILLE	IL
MERIDIAN BANK	ELDRED	IL
ELIZABETH STATE BANK	ELIZABETH	IL
MIDWEST BANK&TRUST CO	ELMWOOD PARK	IL
FIRST CHOICE BANK	GENEVA	IL
HERITAGE COMMUNITY BANK	GLENWOOD	IL
MUTUAL BANK	HARVEY	IL
CHARTER NATIONAL BANK&TRUST	HOFFMAN ESTATES	IL
FIRST CHICAGO BANK&TRUST	ITASCA	IL
COMMUNITY BANK OF LEMONT	LEMONT	IL
BANK OF LINCOLNWOOD	LINCOLNWOOD	IL

Failed Banks with pre-2007 UFIRs 1 and 2

CITIZENS NATIONAL BANK	MACOMB	IL
FIRST SUBURBAN NATIONAL BANK	MAYWOOD	IL
BANK OF ILLINOIS	NORMAL	IL
INTERSTATE BANK	OAK FOREST	IL
ROCK RIVER BANK	OREGON	IL
GEORGE WASHINGTON SB	ORLAND PARK	IL
PALOS BANK&TRUST CO	PALOS HEIGHTS	IL
PEOTONE BANK&TRUST CO	PEOTONE	IL
CITIZENS FIRST NATIONAL BANK	PRINCETON	IL
AMCORE BANK NATIONAL ASSN	ROCKFORD	IL
FARMERS &TRADERS STATE BANK	SHABBONA	IL
BANK OF SHOREWOOD	SHOREWOOD	IL
INDEPENDENT BANKERS BANK	SPRINGFIELD	IL
VALLEY COMMUNITY BANK	ST. CHARLES	IL
WESTERN SPRINGS NB&T	WESTERN SPRINGS	IL
FIRST DUPAGE BANK	WESTMONT	IL
PREMIER BANK	WILMETTE	IL
FIRST STB OF WINCHESTER IL	WINCHESTER	IL
BANK OF COMMERCE	WOOD DALE	IL
FOUNDERS BANK	WORTH	IL
IRWIN UNION BANK FSB	COLUMBUS	IN
IRWIN UNION BANK&TRUST CO	COLUMBUS	IN
INTEGRA BANK NATIONAL ASSN	EVANSVILLE	IN
SHELBY COUNTY BANK	SHELBYVILLE	IN
FIRST NB OF ANTHONY	ANTHONY	KS
HEARTLAND BANK	LEAWOOD	KS
FIRST NATIONAL BANK OF OLA	OLATHE	KS
SECURITY SAVINGS BANK FSB	OLATHE	KS
HILLCREST BANK	OVERLAND PARK	KS
SOLUTIONSBANK	OVERLAND PARK	KS
TEAMBANK NATIONAL ASSN	PAOLA	KS
THUNDER BANK	SYLVAN GROVE	KS
COLUMBIAN BANK&TRUST CO	TOPEKA	KS
STATEWIDE BANK	TERRYTOWN	LA
BUTLER BANK	LOWELL	MA
BAY NATIONAL BANK	BALTIMORE	MD
BRADFORD BANK	BALTIMORE	MD
IDEAL FEDERAL SAVINGS BANK	BALTIMORE	MD
AMERICAN PARTNERS BANK	BETHESDA	MD
BANK OF THE EASTERN SHORE	CAMBRIDGE	MD
SUBURBAN FSB	CROFTON	MD
K BANK	RANDALLSTOWN	MD
HARVEST BANK OF MARYLAND	ROCKVILLE	MD
COMMUNITY BANK OF DEARBORN	DEARBORN	MI
MICHIGAN HERITAGE BANK	FARMINGTON HILLS	MI

Failed Banks with pre-2007 UFIRs 1 and 2

PARAMOUNT BANK	FARMINGTON HILLS	MI
PEOPLES STATE BANK	HAMTRAMCK	MI
COMMUNITY CENTRAL BANK	MOUNT CLEMENS	MI
CITIZENS STATE BANK	NEW BALTIMORE	MI
MAIN STREET BANK	NORTHVILLE	MI
NEW LIBERTY BANK	PLYMOUTH	MI
CITIZENS FIRST SAVINGS BANK	PORT HURON	MI
WARREN BANK	WARREN	MI
1ST REGENTS BANK	ANDOVER	MN
STATE BANK OF AURORA	AURORA	MN
FIRST COMMERCIAL BANK	BLOOMINGTON	MN
NORTHWEST COMMUNITY BANK	CHAMPLIN	MN
MAINSTREET BANK	FOREST LAKE	MN
MARSHALL BANK NATIONAL ASSN	HALLOCK	MN
1ST AMERICAN STB OF MN	HANCOCK	MN
HOME SAVINGS OF AMERICA	LITTLE FALLS	MN
INTER SB FSB D B INTERBANK F	MAPLE GROVE	MN
COMMUNITY SECURITY BANK	NEW PRAGUE	MN
COMMUNITY NATIONAL BANK	NORTH BRANCH	MN
WASHINGTON COUNTY BANK	OAKDALE	MN
RIVERVIEW COMMUNITY BANK	OTSEGO	MN
HORIZON BANK	PINE CITY	MN
ROSEMOUNT NATIONAL BANK	ROSEMOUNT	MN
PINEHURST BANK	SAINT PAUL	MN
JENNINGS STATE BANK	SPRING GROVE	MN
PATRIOT BANK MINNESOTA	WYOMING	MN
RIVERBANK	WYOMING	MN
BC NATIONAL BANKS	BUTLER	MO
SUN SECURITY BANK	ELLINGTON	MO
GLASGOW SAVINGS BANK	GLASGOW	MO
HUME BANK	HUME	MO
PREMIER BANK	JEFFERSON CITY	MO
BANK OF LEETON	LEETON	MO
SOUTHWEST COMMUNITY BANK	OZARK	MO
EXCEL BANK	SEDALIA	MO
TRUMAN BANK	ST. LOUIS	MO
AMERICAN STERLING BANK	SUGAR CREEK	MO
COMMUNITY BANK OF THE OZARKS	SUNRISE BEACH	MO
HERITAGE BANKING GROUP	CARTHAGE	MS
FIRST NATIONAL BANK	ROSEDALE	MS
BANK OF ASHEVILLE	ASHEVILLE	NC
BLUE RIDGE SAVINGS BANK INC	ASHEVILLE	NC
WACCAMAW BANK	WHITEVILLE	NC
CAPE FEAR BANK	WILMINGTON	NC
COOP BANK	WILMINGTON	NC

Failed Banks with pre-2007 UFIRs 1 and 2

TIERONE BANK	LINCOLN	NE
SHERMAN COUNTY BANK	LOUP CITY	NE
MID CITY BANK INC	OMAHA	NE
HIGH DESERT STATE BANK	ALBUQUERQUE	NM
CHARTER BANK	SANTA FE	NM
FIRST COMMUNITY BANK	TAOS	NM
GREAT BASIN BANK OF NEVADA	ELKO	NV
SILVER STATE BANK	HENDERSON	NV
WASHINGTON MUTUAL BANK	HENDERSON	NV
COMMUNITY BANK OF NEVADA	LAS VEGAS	NV
NEVADA COMMERCE BANK	LAS VEGAS	NV
SECURITY SAVINGS BANK	LAS VEGAS	NV
SUN WEST BANK	LAS VEGAS	NV
FIRST NB OF NEVADA	RENO	NV
NEVADA SECURITY BANK	RENO	NV
LIBERTYPOINTE BANK	NEW YORK	NY
OHIO SAVINGS BANK FSB	CLEVELAND	OH
BRAMBLE SAVINGS BANK	MILFORD	OH
AMERICAN NATIONAL BANK	PARMA	OH
FIRST STATE BANK OF ALTUS	ALTUS	OK
HOME NATIONAL BANK	BLACKWELL	OK
FIRST STATE BANK	CAMARGO	OK
FIRST NATIONAL BANK OF DAVIS	DAVIS	OK
FIRST CAPITAL BANK	GUTHRIE	OK
HOME VALLEY BANK	CAVE JUNCTION	OR
LIBERTYBANK	EUGENE	OR
COMMUNITY FIRST BANK	PRINEVILLE	OR
SILVER FALLS BANK	SILVERTON	OR
COLUMBIA RIVER BANK	THE DALLES	OR
ALLEGIANCE BANK OF N AMERICA	BALA CYNWYD	PA
AMERICAN EAGLE SAVINGS BANK	BOOTHWYN	PA
NOVA SAVINGS BANK	PHILADELPHIA	PA
PUBLIC SAVINGS BANK	SOUTHAMPTON	PA
EUROBANK	HATO REY	PR
R-G PREMIER BANK OF RQ	HATO REY	PR
WESTERNBANK PUERTO RICO	MAYAGUEZ	PR
BANKMERIDIAN N A	COLUMBIA	SC
COMMUNITYSOUTH BANK&TRUST	EASLEY	SC
WILLIAMSBURG FIRST NB	KINGSTREE	SC
BEACH FIRST NATIONAL BANK	MYRTLE BEACH	SC
PLANTATION FEDERAL BANK	PAWLEYS ISLAND	SC
FIRST NB OF THE SOUTH	SPARTANBURG	SC
TENNESSEE COMMERCE BANK	FRANKLIN	TN
BANKEAST	KNOXVILLE	TN
FARMERS BANK OF LYNCHBURG	LYNCHBURG	TN

Failed Banks with pre-2007 UFIRs 1 and 2

GUARANTY BANK	AUSTIN	TX
MILLENNIUM STB OF TEXAS	DALLAS	TX
FRANKLIN BANK SSB	HOUSTON	TX
NORTH HOUSTON BANK	HOUSTON	TX
LA COSTE NATIONAL BANK	LA COSTE	TX
MADISONVILLE STATE BANK	MADISONVILLE	TX
FIRST INTERNATIONAL BANK	PLANO	TX
SANDERSON STATE BANK	SANDERSON	TX
CITIZENS NATIONAL BANK	TEAGUE	TX
ADVANTA BANK CORP	DRAPER	UT
BARNES BANKING CO	KAYSVILLE	UT
AMERICA WEST BANK	LAYTON	UT
CENTENNIAL BANK	OGDEN	UT
SUNFIRST BANK	SAINT GEORGE	UT
MAGNETBANK	SALT LAKE CITY	UT
BANK OF THE COMMONWEALTH	NORFOLK	VA
VIRGINIA BUSINESS BANK	RICHMOND	VA
NORTH COUNTY BANK	ARLINGTON	WA
AMERICAN MARINE BANK	BAINBRIDGE ISLAN	WA
HORIZON BANK	BELLINGHAM	WA
WESTSOUND BANK	BREMERTON	WA
BANK OF WHITMAN	COLFAX	WA
FRONTIER BANK	EVERETT	WA
VENTURE BANK	LACEY	WA
COWLITZ BANK	LONGVIEW	WA
CITY BANK	LYNNWOOD	WA
EVERGREEN BANK	SEATTLE	WA
WASHINGTON FIRST INTL BANK	SEATTLE	WA
SHORELINE BANK	SHORELINE	WA
FIRST HERITAGE BANK	SNOHOMISH	WA
PIERCE COMMERCIAL BANK	TACOMA	WA
RAINIER PACIFIC BANK	TACOMA	WA
WESTSIDE COMMUNITY BANK	UNIVERSITY PLACE	WA
BANK OF CLARK COUNTY	VANCOUVER	WA
FIRST BANKING CENTER	BURLINGTON	WI
BADGER STATE BANK	CASSVILLE	WI
LEGACY BANK	MILWAUKEE	WI
BANK OF ELMWOOD	RACINE	WI
EVERGREEN STATE BANK	STOUGHTON	WI
MARITIME SAVINGS BANK	WEST ALLIS	WI
AMERIBANK INC	WELCH	WV
BANK OF WYOMING	THERMOPOLIS	WY

Hearing: "State of Community Banking: Is the Current Regulatory Environment Adversely Affecting Community Financial Institutions?"

March 20, 2013

FDIC OIG Response to the Question for the Record Submitted by Rep. Bill Posey (FL-8)

Question: On page 59 of the FDIC IG report, you note that "historical cost was proving to be a poor measurement approach in inflationary markets." Is it fair to say that impairment accounting and fair value accounting is a poor measurement in bubble markets?

FDIC OIG Response: The referenced statement from our report was an excerpt from a December 2011 Federal Reserve Bank of Boston study, *Evaluating the Impact of Fair Value Accounting on Financial institutions: Implications for Accounting Standards Setting and Bank Supervision*, (Working paper No. QAU 12-01). This study provides background information and a historical context for the development of fair value measurement in accounting standards. Our report focused on the impact of fair value and impairment accounting on insured depository institutions, especially with respect to losses and regulatory action. We did not perform specific work related to the reliability of fair value and impairment accounting measurements in a bubble market.

Our Study notes that loans and leases held-for-investment represent the largest asset class for community banks with assets of less than $1 billion. Loans and leases held-for-investment are recorded at historical cost less an Allowance for Loan and Lease Loss. In this regard, the Financial Accounting Standards Board (FASB) issued for comment a proposed accounting standards update, *Financial Instruments—Credit Losses (Subtopic 825-15), dated December 20, 2012,* to make the credit impairment model more forward looking. Specifically, the FASB proposed to replace the current impairment model, which reflects incurred credit events, with a model that recognizes expected credit risks and would require consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The FASB's main objective in developing this proposal is to provide financial statement users with more decision-useful information about the expected credit losses on financial assets and other commitments to extend credit held by a reporting entity at each reporting date.

Hearing: "State of Community Banking: Is the Current Regulatory Environment Adversely Affecting Community Financial Institutions?"

March 20, 2013

FDIC OIG Responses to Questions for the Record Submitted by Rep. Lynn Westmoreland

Question 1a: In your report you note that charge-off rates peaked at the end of 2009 for insured depository institutions. This decline is illustrated in Figure 3 on page 4 and Figure 8 on page 51. For both graphs, will you please provide a breakdown and corresponding illustrations for net charge-offs for banks under $1 billion and banks over $50 billion?

FDIC OIG Response: Figures 3 and 8 in our report were developed from FDIC-prepared time series supporting schedules that the FDIC publishes along with its *Quarterly Banking Profile* report. Those supporting schedules present quarterly charge-off information by asset type (e.g., Acquisition, Development, and Construction (ADC) loans, 1-4 single family loans), but do not stratify charge-off information by asset size or by individual institution. While providing the information specifically asked for in your question would require a significant audit effort, we offer two items that provide additional perspective on this issue.

First, in Attachment 1, we are providing two figures (A & B) that stratify the average net real estate loan charge-off rate by four asset size segments that correspond with Figure 8 (page 51 of our Study). We also included two figures (C & D) that correspond to Figure 3 (page 4 of our Study), that stratify the net ADC loan category charge-off rate by asset size segment and the 1-4 Family Residential loan category charge-off rate by asset size segment. These two loan categories experienced the greatest rate of loan charge-offs during our period of review.

Second, the publicly available *Quarterly Banking Profile* also stratifies charge-off information by certain bank asset sizes. The *Quarterly Banking Profile* presents average year-to-date information and is a point in time analysis while the time series supporting schedules present quarterly information and are updated for subsequent events such as call report amendments. As such, the *Quarterly Banking Profile* amounts are slightly different than the charge-off rates presented in our report. The *Quarterly Banking Profile* can be found at http://www2.fdic.gov/qbp/.

Question 1b: Will you provide an analysis for charge-offs at banks who did receive Troubled Asset Relief Program (TARP) money and those that did not?

FDIC OIG Response: Because Public Law 112-88 did not require the FDIC OIG to collect information related to TARP funds, we did not collect data which would allow us to distinguish between banks that received TARP funding and banks that did not during this review. Further, as discussed above, information supporting Figures 3 and 8 was not itemized by individual institution. Identifying which institutions received TARP money and determining TARP institutions' net charge-off rates would require a significant audit effort.

Question 2: Page 16 of the report states "over 50% of FDIC-supervised financial institutions with informal or formal actions received material capital injections within the period 2008-2011." Please provide a state-by-state breakdown of these numbers, including the number of banks that raised capital, the number of banks seeking to raise capital but were unsuccessful, and the number of banks not seeking to raise capital.

FDIC OIG Response: The statement on page 16 of our report is from an internal FDIC study. In response to our request for supporting information from the FDIC, FDIC officials agreed to provide formal enforcement action information by state and informal enforcement action information by FDIC region for banks that raised capital. This infomation is contained in Attachment 2. We did not independently validate this information. In providing the informal action information, FDIC officials expressed concern that the informal action information is not public and that, in some states, providing state-by-state information could enable identification of individual institutions. The FDIC does not collect information to distinguish the number of banks that were unsuccessful in their efforts to raise capital or the number of banks that did not attempt to raise capital.

Question 3: The study only looked at formal orders and did not have details on the application of informal orders. How many informal orders were issued over the study period? Was the application of informal orders fair and consistent? Is the FDIC, OCC and Federal Reserve uniform in lifting informal orders?

FDIC OIG Response: Consistent with P.L. 112-88, our report focused solely on formal enforcement actions. We presented very limited summary information about informal enforcement actions on page 111 of our report to provide perspective for the actions placed on 3-rated institutions. However, we did not evaluate the fairness or consistency of informal actions, whether the regulators terminate informal actions uniformly, or the amount of time that banks remain under informal or formal actions. To answer such questions related to informal actions would require a separate lengthy assignment and special privileges to allow our office to gather information from the OCC and FRB, as both regulators are outside our audit jurisdiction.

Question 4: For both informal and formal orders, what is the longest a bank has been under a formal and informal order since 2008? What was the shortest amount of time a bank has been under a formal and informal order since 2008? What is the average amount of time a bank is under a formal and informal order since 2008?

FDIC OIG Response: Consistent with P.L. 112-88, our report focused solely on formal enforcement actions. As such, we do not have data available to respond to the informal action part of the question. Information related to formal enforcement actions based on the information we collected for our report is provided below by regulator.

FDIC Formal Enforcement Actions

Time Action in Place as of 4/30/2012	Days
Longest	1,560
Shortest	50
Average	785

OCC Formal Enforcement Actions

Time Action in Place as of 12/31/2011	Days
Longest	1,437
Shortest	23
Average	549

FRB Formal Enforcement Actions

Time Action in Place as of 12/31/2011	Days
Longest	1,277
Shortest	3*
Average	530

* This Cease and Desist Order was in place for the institution 3 days before failure. There was also a formal Written Agreement in effect for 343 days before failure.

Question 5: Please provide a breakdown of return on investment for Shared Loss Agreements (SLA) from 2008-2011, compared to SLAs in the 1980s and 1990s.

FDIC OIG Response: We are not aware of a return on investment calculation pertaining to SLAs. As discussed in our report, the FDIC is required to pursue the least costly method of resolving a failed bank and maximize recoveries of receivership assets. One measure that the FDIC monitors is the loss rate of failures (i.e., the estimated losses from a failure divided by the failed bank's total assets). A 1998 FDIC publication, *Managing the Crisis: The FDIC and RTC Experience 1980-1994*, included a chapter on loss sharing and reported that loss rates for the 16 purchase and assumption (P&A) agreements with loss sharing during the period 1991-1993 averaged 6 percent of failed bank assets while loss rates for 175 P&As without loss sharing averaged 10.5 percent of total assets during the same period. On page 24 of our report, we note that the FDIC had determined that the average loss rate during the recent crisis for a P&A with loss sharing had been 21.3 percent compared with average loss rates of 26.1 percent for a P&A without loss sharing, and 35.6 percent for a payout.

Question 6: Please provide a geographic breakdown, at the county level, of SLA asset concentrations in Georgia.

FDIC OIG Response: Our study did not collect this level of information specific to individual states, but we were aware that the FDIC did possess such information. At our request, the FDIC prepared a map of Georgia illustrating, by county, the SLA asset concentrations, as of July 2013. This map can be found in Attachment 3. As noted in the map's footnote, the information contained in the map was compiled from loan data supplied by assuming institutions as part of their reporting requirements under their respective SLAs, and has not been subject to audit. We did not independently validate this information.

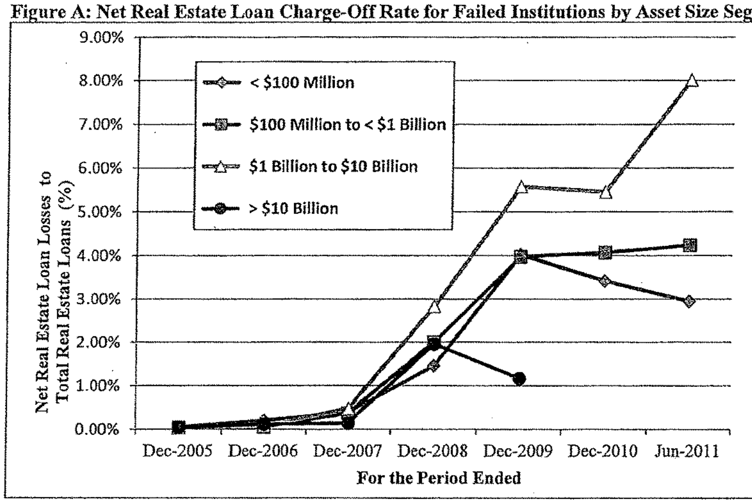
Question 7: On page 64 of the report you cite that nine institutions failed because Fannie Mae and Freddie Mac were put into conservatorship. Please identify those nine banks for the record.

FDIC OIG Response: The nine banks appear in the table below.

Number	Institution Name	City	State
1	Madisonville State Bank	Madisonville	TX
2	North Houston Bank	Houston	TX
3	Citizens National Bank	Teague	TX
4	National Bank of Commerce	Berkeley	IL
5	San Diego National Bank	San Diego	CA
6	Pacific National Bank	San Francisco	CA
7	Park National Bank	Chicago	IL
8	California National Bank	Los Angeles	CA
9	Bank USA, National Association	Phoenix	AZ

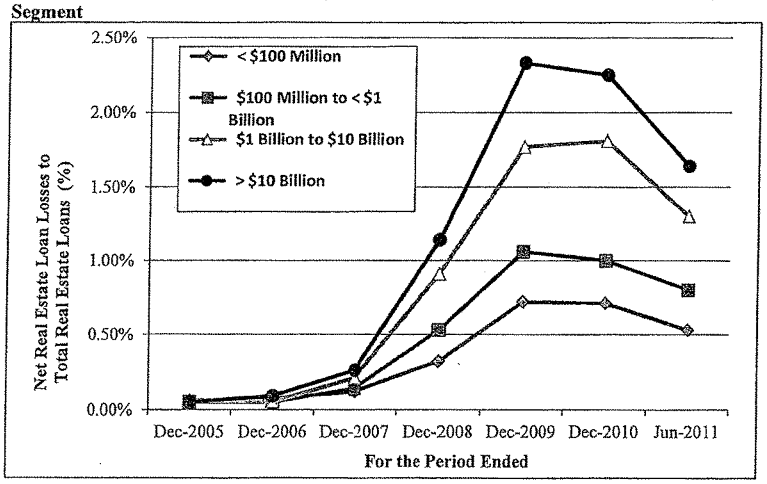
The following two figures correspond to Figure 8 (page 51) of our Study.

Figure A: Net Real Estate Loan Charge-Off Rate for Failed Institutions by Asset Size Segment



Source: OIG analysis of UBPRs for failed financial institutions.

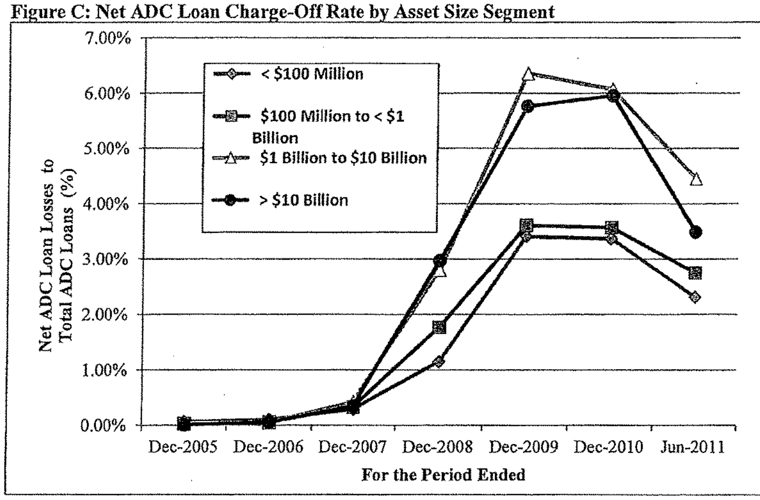
Figure B: Net Real Estate Loan Charge-Off Rate for all FDIC-insured Institutions by Asset Size Segment



Source: OIG analysis of the FDIC's Quarterly Banking Profile reports for all FDIC-insured institutions.

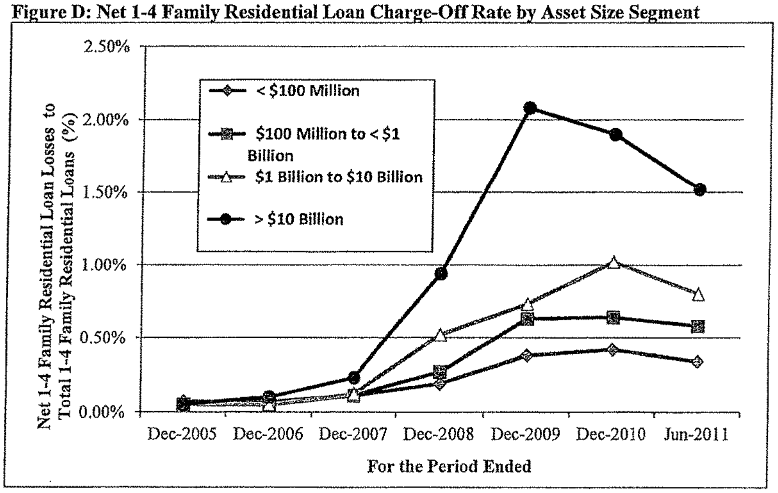
The following two figures correspond to Figure 3 (page 4) of our Study. Loan data is presented for only the ADC and 1-4 Family Residential Loan categories – the two most significant loan categories.

Figure C: Net ADC Loan Charge-Off Rate by Asset Size Segment



Source: OIG analysis of the FDIC's Quarterly Banking Profile reports for all FDIC-insured institutions.

Figure D: Net 1-4 Family Residential Loan Charge-Off Rate by Asset Size Segment



Source: OIG analysis of the FDIC's Quarterly Banking Profile reports for all FDIC-insured institutions.

Attachment 2

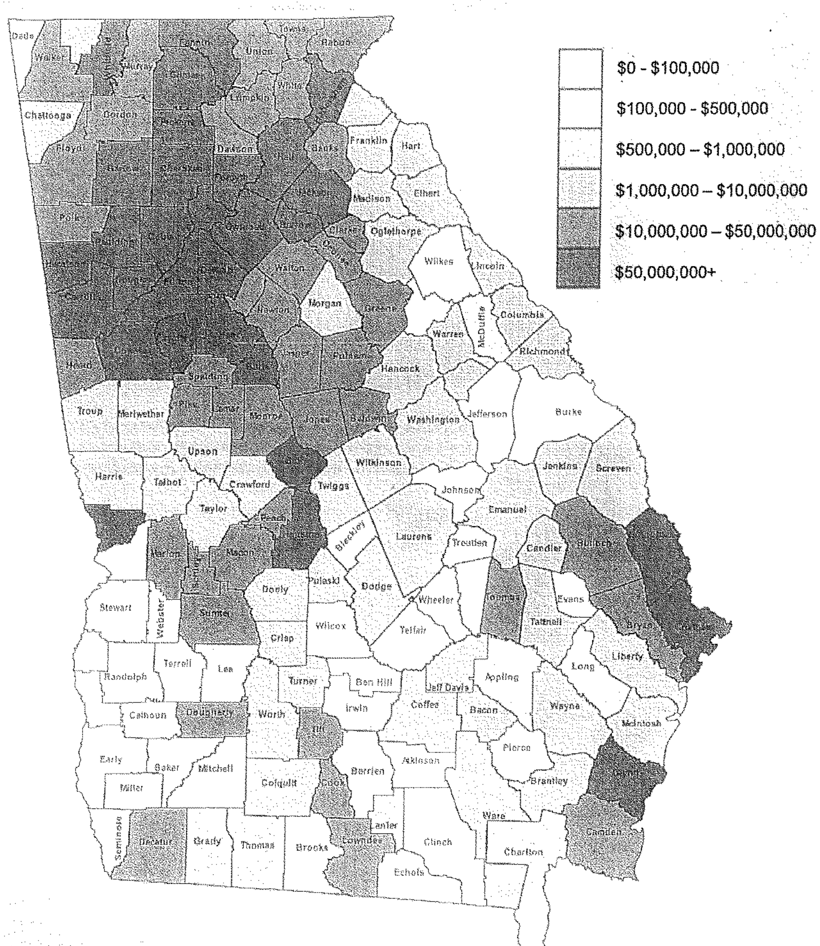
Number of Institutions with FDIC Formal Actions that Received Material Capital Injections	
State	Count of Banks
AL	10
AR	4
AZ	4
CA	25
CO	7
CT	2
DE	1
FL	23
GA	51
HI	3
IA	5
ID	1
IL	27
IN	3
KS	9
KY	4
LA	2
MA	0
MD	2
ME	1
MI	7
MN	32
MO	8
MS	3
MT	4
NC	5
ND	4
NE	3
NJ	2
NM	3
NV	7
NY	3
OH	5
OK	3
OR	4
PA	2
SC	2
SD	3
TN	11
TX	16
UT	9
VA	0
WA	12
WI	12

Attachment 2

Number of Institutions with FDIC Informal Actions that Received Material Capital Injections	
Geographic Region	Count of Banks
ATLANTA	71
CHICAGO	73
DALLAS	64
KANSAS CITY	74
NEW YORK	14
SAN FRANCISCO	50

Attachment 3

Georgia Shared Loss Asset Concentration



Source: FDIC 7/15/2013

The information presented in the map above has been compiled from loan data supplied by Assuming Institutions as part of their reporting requirements under their respective Shared Loss Agreements. This information has not been subject to audit and no representation is made as to the compliance or accuracy of the information.