OVERSIGHT OF THE FDIC APPLICATION PROCESS

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM HOUSE OF REPRESENTATIVES

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OVERSIGHT OF THE FDIC APPLICATION PROCESS

Wednesday, July 13, 2016

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, D.C.

The committee met, pursuant to call, at 10:01 a.m., in Room 2154, Rayburn House Office Building, Hon. Jason Chaffetz [chairman of the committee] presiding.

Present: Representatives Chaffetz, Mica, Duncan, Jordan, Walberg, Amash, DesJarlais, Farenthold, Massie, Meadows, Mulvaney, Buck, Walker, Blum, Hice, Carter, Grothman, Hurd, Palmer, Cummings, Maloney, Clay, Lynch, Kelly, Lawrence, Watson Coleman, Plaskett, DeSaulnier, Welch, and Lujan Grisham.

Chairman CHAFFETZ. The Committee on Oversight and Government Reform will come to order. And without objection, the chair is authorized to declare a recess at any time.

I appreciate you being here. This is an important topic, the role of banking, and what it plays in the American economy cannot be understated.

The FDIC, the Federal Deposit Insurance Corporation, was created by Congress to help maintain stability in the financial sector. Several things are currently happening with the FDIC that raise some concerns. Importantly, since 2013, the FDIC has not had a Senate-confirmed inspector general. I do think that this needs to be put in place sooner than later. That is far, far too long.

In May, the FDIC reported it suffered five—five—major data breaches since October of 2015, all involving taxpayer personal identifying information. In the banking sector, this is particularly of concern, to have it happen five times that we know about.

But today's hearing will highlight an area truly undermining our country's financial future. Our local financial institutions continue to drown in a sea of red tape.

There has to be regulation, don't get me wrong. There need to be rules of the road. But they need to be fairly administered and they need to be predictable so that new entrants can also come into the marketplace.

Since passage of Dodd-Frank and the implementation of additional policies by the FDIC, we haven't seen our financial sector getting stronger. What we have seen is a drastic decrease in the formation of new banks and an increase in bank mergers and acquisitions.

I think, my own personal opinion is the systemic risk is greater, not less.

As of March 2016, the United States had 6,122 banks. This is the lowest number of banks since the Federal regulators began keeping track in 1934. The lowest number. It's a huge drop from 25 years ago when the United States had over 14,000. Some will claim that that was too many. They didn't have the financial strength and the proper deposits in order to cover their potential losses.

But this decrease in banks does matter. Competition fosters innovation, consumer-responsive products, and provides more options for individuals who need access to credits. We've had a growing population in the United States of America, and yet, less institutions in proportion to that population than in the past.

The FDIC is responsible for issuing deposit insurance to new industrial loan companies, or ILCs, or de novo banks outside of the Federal Reserve System. Proof of deposit insurance is a standard requirement for new community banks to receive their State banking charter.

Put in simpler terms, just like the State requires motorists to have car insurance to register a car, you can't run a bank without proof of deposit insurance. But unlike car insurance companies who will compete for your business, the FDIC doesn't appear to want consumers to have any new banks.

The decline in applications for new banks is unsettling. Between 2011 and 2015, the FDIC processed an average of three applications per year—per year. This is a drastic decrease from an average of 219 applications per year between 2004 and 2008.

Using the same car analogy, if States suddenly had no one registering their cars because citizens were unable to obtain car insurance, we would all wonder what was going on with those insurance companies.

Since 2011, the FDIC has only approved three—three, since 2011—de novo bank applications, and no, not one, ILC application. Not one of them has been approved. This stands in stark contrast to even 2008 when the FDIC approved 48 de novo banks.

Further, the banks the FDIC has approved seem only to meet very small niche markets rather than broad community needs. For example, one of the three approved banks—this is a good thing, don't get me wrong, this is a good thing—was located in the heart of the Pennsylvania Amish country, meant to serve only that market instead of creating opportunities for competition in more diverse areas.

Today's hearing is an attempt to understand why this radical decline in new bank formation. I would like to understand if the FDIC is truly open to receiving and accepting applications or if red tape is resulting in interested parties just throwing up their hands and walking away.

I'm sure we can all agree that we want secure and stable banks. Don't get me wrong, we have to have the safety and security of stable banks. But we must be sure that the regulator who's charged with allowing new banks to enter the market is not circumventing the process. This results in weakening the financial sector and limiting options to households in underserved markets across the United States of America.

We thank the witnesses for being here today. Already, the information that was provided in the written testimonies are insightful and very helpful, but we do have some serious questions and look forward to the hearing.

I would like to now recognize the ranking member, the gentleman from Maryland, Mr. Cummings, for his opening statement.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Neighborhood banks are the lifeblood of local communities. They can be a key source of capital for small businesses. They can help working families save for the future.

No one knows this better than my constituents in west Baltimore, where banks are outnumbered by alternative financial services that sometimes offer the most basic products on abusive and extremely predatory terms. The lack of basic banking services is one of the key challenges for families trying to climb out of poverty in this Nation.

A discussion about what more can be done to ensure that all communities are adequately served by community banks is, indeed, long overdue. Some suggest that communities lack banks because the FDIC is inappropriately blocking the approval of new community banks. But this claim does not appear to be supported by the facts.

The Federal Reserve has reported that a key factor explaining a lack of new bank applications is our current low interest financial environment. A bank's income, particularly a new bank without an established lending portfolio, is closely tied to the Federal funds rate, which has been close to zero since the Great Recession. That is why the FDIC received only 10 applications for deposit insurance between 2011 and 2015 compared with more than 1,000 applications between 2004 and 2008, when the financial crisis began.

Our Nation relies on the FDIC to protect the Deposit Insurance Fund, which repays depositors if an insured bank fails. The FDIC approves only those applications that meet strict standards and that are built around realistic business plans that are likely to ensure profitability. That's because if the fund fails, taxpayers will be on the hook to pay for the bank's mistakes.

Many other regulators failed in their duties prior to the Great Recession, but the FDIC's stewardship of the fund before the financial crisis meant that the FDIC did not have to draw on taxpayer funds to repay the customers of failed banks.

These protective measures are not preventing community banks from succeeding. In fact, the net income earned by community banks in the first quarter of 2016 grew by 7 percent over their income in the first quarter of 2015, according to the FDIC's most recent quarterly banking profile.

By comparison, the net income of noncommunity banks actually fell by nearly 3 percent in the first quarter of 2016 compared to the first quarter of 2015.

Yet, the FDIC has reported that over the past 12 months, and I quote, "Almost 62 percent of community banks improved their net income," end of quote. As a result, the percentage of unprofitable community banks fell to its lowest level since 1998.

As our Nation has seen firsthand, without rigorous standards banks could take outsized risks, assuming that the insurance fund would clean up their losses. Sadly, I am concerned that today's hearing is only the latest in a series of efforts by my Republican colleagues to roll back essential safeguards and put the financial system back at risk.

In 2014, the Republican Congress repealed a portion of the Dodd-Frank Act relating to swaps pushouts, allowing large banks to gamble with FDIC-insured funds. Last year, Republicans introduced legislation to repeal the Volcker rule, which stops banks that are too big to fail from trading for their own profit.

And then this year, the Republican chairman of the Financial Services Committee has proposed a bill to prohibit the FDIC from ensuring that large banks do not cause another financial crisis if they fail. Rather, in trying to put the taxpayer back on the hook for risky practices, Congress should be trying to understand why, given that the community banks appear to be thriving, critical and basic banking services are not being provided in some communities, like the one I live in.

I look forward to the testimony, and I thank our witnesses for being here today.

With that, Mr. Chairman, I yield back.

Chairman CHAFFETZ. I want to thank the gentleman.

We'll hold the record open for 5 legislative days for any members who would like to submit a written statement.

We'll now recognize our panel of witnesses.

We are pleased to welcome the Honorable Martin J. Gruenberg, chairman of the United States Federal Deposit Insurance Corporation.

Mr. Matthew Browning, former board member of the National Association of Industrial Bankers. Mr. Browning is testifying on behalf of the National Association of Industrial Bankers and the Utah Bankers Association.

Dr. Simon Johnson is professor of global economics and management at the MIT Sloan School of Management.

And Mr. Guy Williams is the president and chief executive officer of the Gulf Coast Bank and Trust Company. Mr. Williams will be testifying on behalf of the American Bankers Association.

We welcome you all. We thank you for being here.

Pursuant to committee rules, all members are to be sworn before they testify. So if you'll please rise and raise your right hand.

Do you solemnly swear or affirm that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Thank you.

Let the record reflect that all witnesses answered in the affirmative.

We would appreciate it if you limit your oral comments to 5 minutes. We'll give you a little latitude, but try to keep it to 5 minutes. Your entire written statement will be entered into the record.

Chairman, you are now recognized for 5 minutes.

WITNESS STATEMENTS

STATEMENT OF MARTIN J. GRUENBERG

Mr. GRUENBERG. Thank you. Chairman Chaffetz, Ranking Member Cummings, and members of the committee, thank you for the opportunity to testify today on de novo banks and industrial loan companies.

The FDIC encourages the formation of new financial institutions and welcomes applications for deposit insurance. New institutions help preserve the vitality of the community banking sector, fill important gaps in local banking markets, and provide credit services to communities that may be overlooked by other financial institutions.

While we have seen a broad-based improvement in bank financial performance over the past several years, the prolonged period of low interest rates that has followed the financial crisis has narrowed industry net interest margins substantially from precrisis levels.

Margin pressure remains a challenge for existing institutions and new entrants and appears to be the leading factor in the sharp decline in new institutions since the crisis.

As the economy continues to improve and interest rates rise, we anticipate that interest in new charters will increase. Over the past several quarters, the FDIC has seen indications of increased interest from prospective organizing groups.

By statute, any proposed depository institution seeking Federal deposit insurance must file an application with the FDIC. Before filing an application, the FDIC encourages organizing groups to participate in a prefiling meeting. The goal is to inform applicants about the information needed to facilitate the review process.

The FDIC imposes certain standard conditions on all institutions that are granted Federal deposit insurance. These conditions include minimum initial capital, State charter approval, disclosure of insider transactions, financial audit requirements, among others.

The FDIC may also impose nonstandard conditions when additional controls are appropriate or necessary to either mitigate risks that are unique to the proposal or to ensure actions or activities in process at the time of approval are completed before the insurance becomes effective.

In August of 2009, the FDIC extended from 3 to 7 years the period during which de novo State nonmember banks were subject to higher capital maintenance requirements and more frequent examinations. We also require de novo State nonmember banks to obtain prior approval for material changes in business plans.

The FDIC made these changes because the failure rate of de novo institutions chartered between 2000 and 2008 was more than double the failure rate for established small banks. Many of these failures occurred between the fourth and seventh year of the de novo period.

Given the ongoing improvement in post-crisis industry performance, the FDIC recently rescinded this policy, returning to a 3-year de novo period in April of this year.

As State-chartered federally insured institutions, ILCs must meet the same standards as any FDIC-insured bank. Since parent companies of ILCs are not generally subject to Federal banking supervision, the FDIC has included prudential considerations in its supervisory approach designed to ensure the independence of the ILC separate and apart from its parent.

The FDIC has recently announced a number of initiatives to support the efforts of organizing groups to establish new banks. In November of 2014 and again in April of this year, the FDIC issued deposit insurance questions and answers to eight applications in developing proposals to obtain deposit insurance.

In March of last year, the FDIC provided an overview of the deposit insurance application process during a conference of State banks supervisory agencies.

In September of last year, the FDIC also hosted an interagency training conference promoting coordination among State and Federal regulatory agencies in the review of charter and deposit insurance applications. The FDIC is also preparing a practical guide for organizing groups. This resource will address topics such as developing a sound business plan, raising financial resources, and recruiting competent leadership.

We are also planning outreach meetings in several regions around the country to ensure that industry participants are well informed about the FDIC's application review processes and the tools and resources available to assist organizing groups.

Finally, the FDIC is using this period of low application activity as an opportunity to review our current application processes for transparency and timeliness. As this review continues, we will look for opportunities to solicit public comment from the industry and groups interested in organizing a de novo bank about the steps that the FDIC could take to enhance or clarify the application process.

Mr. Chairman, that concludes my opening statement. I'll be glad to respond to questions.

[Prepared statement of Mr. Gruenberg follows:]

STATEMENT OF

MARTIN J. GRUENBERG
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

***DE NOVO* BANKS AND INDUSTRIAL LOAN COMPANIES**

before the

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
U.S. HOUSE OF REPRESENATATIVES

July 13, 2016
2157 Rayburn House Office Building

Chairman Chaffetz, Ranking Member Cummings and members of the Committee, thank you for the opportunity to testify today on *de novo* banks and industrial loan companies (ILCs). My written testimony will begin with an overview of recent banking industry performance and condition. Next I will address trends in *de novo* and ILC formation and the process by which the FDIC reviews applications for deposit insurance. Finally, I will discuss the supervisory process for *de novo* institutions and steps the FDIC is taking to support *de novo* formations.

Banking Industry Performance

The post-crisis period has been marked by a gradual, consistent improvement in banking industry performance, even in the face of some significant headwinds. FDIC-insured institutions posted record earnings of nearly $164 billion in 2015. Almost two-thirds of all institutions reported higher earnings for the year than they did in 2014. Many banks have worked off significant volumes of noncurrent loans during the post-crisis period, and for most banks, this process is largely complete. Only eight institutions failed last year—the lowest number since 2007. By the end of the first quarter of 2016, the number of problem institutions declined to 165, the lowest level since mid-2008.

This recovery in their financial condition has put FDIC-insured institutions in a better position to support economic activity by extending credit to creditworthy borrowers. Loan balances at FDIC-insured institutions at the end of the first quarter were 6.9 percent higher than a year earlier, marking their highest 12-month growth rate since mid-2008.

Community banks have also posted a strong recovery in the post-crisis period that has, in several respects, outpaced the recovery at larger institutions. Loan balances at community banks grew by 8.9 percent in March from a year ago, exceeding the industry average by more than a quarter. Loan growth at community banks was led by an 11.9 percent increase in commercial real estate loans, an 8.6 percent increase in commercial and industrial loans, and a 5 percent increase in 1-to-4 family residential mortgages.

In addition, net income at community banks grew by 7.4 percent in the first quarter of 2016 compared to a year earlier, while industry net income declined slightly. The decline in overall industry earnings was largely attributable to a drop in trading revenue and a sharp increase in reserves to recognize potential losses from noncurrent commercial and industrial loans related to the energy sector. However, neither of these factors had a material impact on community bank performance during the quarter.

While the current seven-year economic expansion has supported a broad-based improvement in bank financial performance, the prolonged period of low interest rates that has followed the financial crisis has narrowed industry net interest margins substantially from pre-crisis levels.

During the 10 years leading up to the crisis, the average net interest margin for community banks was 4.0 percent. By 2015, after seven years of exceptionally low interest rates, the average community bank margin had fallen to 3.57 percent—a decline of 43 basis points. Noncommunity banks saw their margins fall even further, to just 3.0 percent in 2015. Margin pressure is likely to remain a challenge until interest rates rise to levels more in line with historical norms.

Trends in *De Novo* Formation

The FDIC remains supportive of the formation of new financial institutions and welcomes applications for deposit insurance. The entry of new institutions helps to preserve the vitality of the community banking sector, fill important gaps in local banking markets, and provide credit services to communities that may be overlooked by other financial institutions.

Recent FDIC research on new bank formation since 2000 highlights both the economic benefits of *de novo* banks and their vulnerability to economic shocks.[1] Of the more than 1,000 new banks formed between 2000 and 2008, 634 institutions were still operating as of September 2015, holding $214 billion in total loans and leases. FDIC researchers also found that the failure rate of banks established between 2000 and 2008 was more than twice that of small established banks—consistent with previous research that found *de novo* banks to be susceptible to failure under adverse economic conditions. These findings underscore the importance of promoting the formation of new banks and establishing an effective application process and supervisory program that will ensure new banks adopt appropriate risk management practices and enhance their prospects for long-term success.

As shown in the Appendix, from 2000 through 2007—the seven years leading up to the recent financial crisis—the FDIC received more than 1,600 applications for deposit insurance.[2] Of those, 75 percent were approved, 12 percent were returned and 13 percent were withdrawn. Included were 57 applications for deposit insurance for ILCs, 53 of which were acted upon during this period. Just over half were approved, 23 percent were returned and 26 percent were withdrawn.

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[1] Lee, Yan and Chiwon Yom, "The Entry, Performance, and Risk Profile of *De Novo* Banks," FDIC Center for Financial Research Working Paper 2016-03, April 2016.
https://www.fdic.gov/bank/analytical/CFR/2016/WP_2016/WP2016_03.pdf

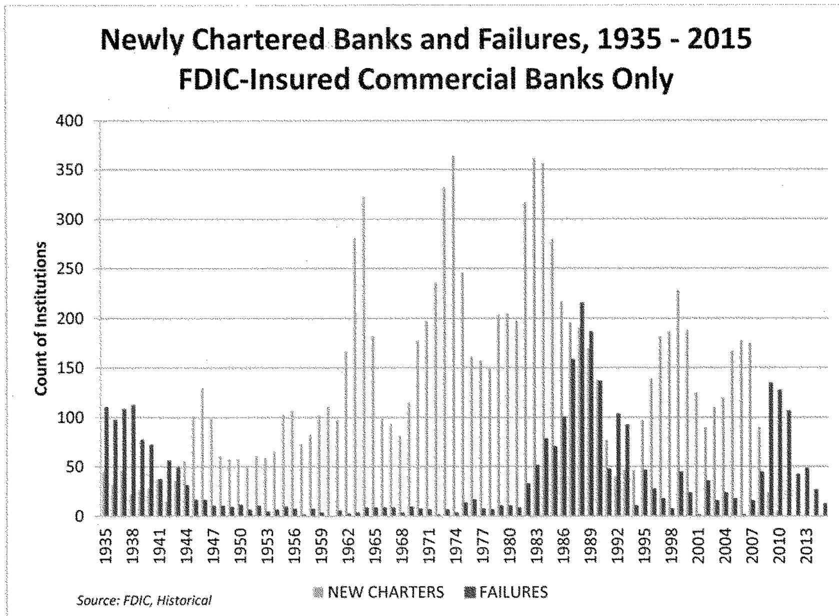
[2] The Appendix provides a chart of applications for deposit insurance for *de novo* institutions received for each year since 2000, along with the disposition of the applications received in that year.

During the crisis from January 2008 through December 2010, the FDIC received 140 applications for deposit insurance (excluding those for the acquisition of failed banks and for the conversion of credit unions), with the number received dropping significantly in each year. Of those applications, approximately 20 percent were approved, 32 percent were returned, 46 percent were withdrawn and one percent are still pending. Included were seven applications for deposit insurance for ILCs with one approved, two returned, two withdrawn and two pending.

The approval rate for applications received during the crisis was less than one-third of the rate of approval during the pre-crisis period. The primary reason for this difference was the challenging economic environment that made it difficult for applicants to demonstrate viable business plans.

De novo formation has always been cyclical as illustrated in Chart 1. De novo activity surged in the economic upswings, such as those of post-World War II, the mid-1990s, and the early 2000s. A significant share of pre-crisis chartering activity occurred in the Southeast and the West, as the economies in those areas rapidly expanded. Of the 899 new institutions chartered from 2002 through 2007, 275 (31 percent) were headquartered in the FDIC's Atlanta region, and 227 (25 percent) were headquartered in the FDIC's San Francisco region. These two regions also led the country in bank failures, as their economies experienced severe downturns during the recession.

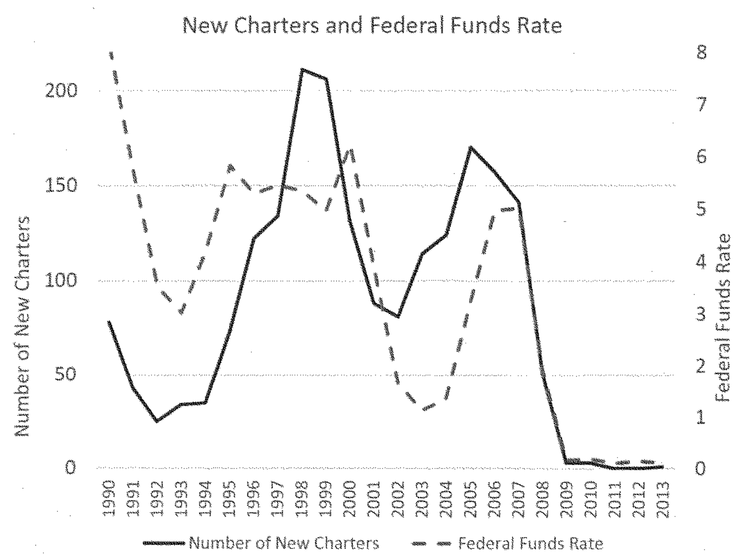
Chart 1



Since January 2011, the FDIC has received only 10 applications for deposit insurance for *de novo* institutions. Of those applications, three have been approved, five have been withdrawn and two remain in process. No new applications for ILCs were received in this period. A drop in *de novo* activity also occurred after the last financial crisis in the 1980s and early 1990s, when *de novo* bank formation declined to historically low levels before recovering as economic conditions improved.

Even with the recovery in community bank earnings following the recent financial crisis, low interest rates and narrow net interest margins have kept bank profitability ratios (return on assets and return on equity) well below pre-crisis levels, making it relatively unattractive to start new banks. Recent research by economists at the Federal Reserve suggests that economic factors alone—including a long period of zero interest rates—explain at least three-quarters of the post-crisis decline in new charters, as illustrated in Chart 2.[3] If this model is accurate, one would expect the rate of new charters to rise as interest rates normalize.

Chart 2



[3] Adams, Robert M. and Jacob P. Gramlich, "Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation," Finance and Economics Discussion Series 2014-113, Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington, D.C. http://www.federalreserve.gov/econresdata/feds/2014/files/2014113pap.pdf

The rate of *de novo* formations can be affected by other factors as well. For example, a Federal Reserve Bank of Kansas City study found that markets with more merger activity experienced higher rates of new bank formation, and that the mergers with the strongest link to new bank formation were those in which small banks were taken over by large banks or local banks taken over by distant banks.[4] These mergers can create gaps in service to small businesses and customers with a strong preference for personal contact and contribute to new bank formation. As a Federal Reserve Bank of Philadelphia study observed, in these markets, *de novos* are also more likely to find a ready supply of skilled, experienced bankers displaced from the merger and acquisition activity.[5]

De novo ILC formations have additionally been affected at various times by moratoria. For example, the state of Utah placed a moratorium on new ILC charters between 1986 and 1997, after several ILCs had experienced significant financial difficulties in the early 1980s.[6] During this period, existing charters could be acquired, but new charters were not issued. Also, in response to requests from Congress amid concerns about the applications filed by WalMart and Home Depot to respectively form and acquire an ILC, the FDIC's Board of Directors imposed a six-month moratorium on deposit insurance applications and change-in-control notices with respect to ILCs beginning July 28, 2006. The FDIC's Board of Directors extended the moratorium for one year on January 31, 2007, with respect to ILCs that would become

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[4] Keeton, William R. "Are Mergers Responsible for the Surge in New Bank Charters?" Federal Reserve Bank of Kansas City. *Economic Review*. First Quarter 2000. https://www.kansascityfed.org/publicat/econrev/PDF/1q00keet.pdf

[5] Collins, Michael E. "Trends in De Novo Formation." Federal Reserve Bank of Philadelphia. *SRC Insights*. Third Quarter 2007. https://www.philadelphiafed.org/bank-resources/publications/src-insights/2007/third-quarter/q3si2_07

[6] Johnson, Christian and George S. Kaufman, "A Bank by Any Other Name." Federal Reserve Bank of Chicago *Economic Perspectives*. 4Q2007. https://www.chicagofed.org/publications/economic-perspectives/2007/4qtr2007-part3-johnson-etal

subsidiaries of companies engaged in nonfinancial activities. Finally, Section 603 of the Dodd-Frank Wall Street Reform and Consumer Protection Act imposed a three-year moratorium on ILCs controlled by commercial firms and prohibited the FDIC from acting favorably on applications for deposit insurance filed by such institutions after November 23, 2009.

De novo activity, however, represents only a portion of total new investment in the banking industry. In many cases, interested applicants have opted to buy a failed bank or problem bank rather than start a *de novo* institution. Acquiring an existing institution, instead of pursuing a *de novo* strategy, has the advantage of providing a core deposit and loan base on which the new investors can build a sustainable franchise.

As the economy continues to improve, we anticipate that interest in new charters will increase. Over the past several quarters, the FDIC has seen indications of increased interest from prospective organizing groups in filing applications for new insured depository institutions.

Application Process for Deposit Insurance

Section 5 of the Federal Deposit Insurance Act (FDI Act) requires any proposed depository institution seeking Federal deposit insurance to file an application with the FDIC. Before filing an application, the FDIC encourages organizing groups for proposed new depository institutions to participate in a pre-filing meeting. This meeting frequently occurs with staff in the FDIC regional office that will receive the application. During a pre-filing meeting, FDIC staff explains the application process, including general timelines for application processing as well as any special information needs and other matters unique to the proposal. The goal is to inform applicants about the necessary information for their filing to facilitate the review process.

Application Requirements

FDIC rules and regulations describe the application requirements in detail.[7] Proposed new depository institutions apply for Federal deposit insurance by filing an *Interagency Charter and Federal Deposit Insurance Application* form (Application) with the appropriate FDIC regional office.[8] The Application collects information that the chartering authority and the FDIC will need to evaluate the charter and insurance applications respectively. The Application requests information on seven main topics: an overview of the proposed institution's operations; its business plan and proposed policies; details on its management team, including its board of directors; a description of the type and amount of capital to be raised, including any plans for employee stock ownership plans or stock incentives; how the institution will meet the convenience and needs of the community to be served; a description of the premises and fixed assets at inception; a description of the information systems to be used by the institution; and any other relevant information.

Applicants must answer all questions in the form and provide supporting information setting forth the basis for the applicant's conclusions. In cases where information is not available at filing time, the FDIC will determine whether the information is necessary to begin the evaluation of the application. If additional information is needed, the FDIC will send the applicant a written request identifying the items needed. If not, the FDIC will deem the application substantially complete and begin its review and evaluation of the proposal.

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[7] The procedures governing the administrative processing of an application for deposit insurance are contained in part 303, subpart B, of the FDIC's rules and regulations (12 CFR part 303).
[8] www.fdic.gov/formsdocuments/InteragencyCharter-InsuranceApplication.doc

Statutory Conditions

Since 1935, governing statutes have required that the FDIC consider specific factors when evaluating applications for deposit insurance. The current statutory factors, set forth in Section 6 of the FDI Act, include:

- The institution's financial history and condition;
- The adequacy of its capital structure;
- Its future earnings prospects;
- The general character and fitness of its management;
- The risk presented by the institution to the Deposit Insurance Fund;
- The convenience and needs of the community to be served by the institution; and
- Whether the institution's corporate powers are consistent with the purposes of the FDI Act.[9]

Evaluation of the Application

While these statutory factors serve as the foundation of the Application, the *FDIC Statement of Policy on Applications for Deposit Insurance* provides guidance to FDIC staff and the industry about the FDIC Board's expectations for staff's evaluation of the statutory factors.[10] Evaluation of the Application is carried out at both the field office level and regional office level, and is coordinated by a regional office case manager, who is assigned responsibility for the ongoing supervision and monitoring of the institution once it opens for business.

At the field office level, an examiner from the local area will review the Application and then meet with the organizers and proposed directors to ascertain their understanding of the

[9] 12 U.S.C. § 1816.
[10] *63 Fed. Reg. 44756, August 20, 1998, effective October 1, 1998; amended at 67 Fed. Reg. 79278, December 27, 2002.*

responsibilities they are taking on as directors, their abilities to execute the business plan, and their commitment to the proposed bank. The examiner documents the findings relative to each of the statutory factors and opines as to whether the criteria under each area has been met. The examiner submits this report to the assigned case manager.

At the regional office level, the case manager reviews the examiner's report for accuracy and consistency with FDIC policy. The case manager prepares a summary of the major findings of the examiner's report as it relates to each of the statutory factors, and concludes with a recommendation for action: conditional approval or denial. The recommendation is considered by regional management in consultation with division management, and it is acted upon by the region, the division or the FDIC Board of Directors, depending upon the application characteristics.[11]

Conditions of Approval

The FDIC imposes certain standard conditions on all institutions that are granted Federal deposit insurance.[12] These conditions include such items as minimum initial capital, minimum ongoing capital requirements for the three-year *de novo* period, minimum fidelity bond insurance coverage, and financial statement audit requirements during the *de novo* period.

The FDIC may also impose non-standard or prudential conditions on a case-by-case basis. Typically, nonstandard conditions are used when the FDIC determines, through the examiner's review and the case manager's summary, that additional controls are appropriate or

[11] For example, authority to act is retained by the FDIC Board of Directors on applications for institutions that are more than 25 percent foreign-owned or controlled, institutions that share common ownership with a foreign institution without a common parent company, institutions organized as industrial loan companies, and institutions that would raise unique or unprecedented policy matters.

[12] These standard conditions are contained in a Resolution of the FDIC Board of Directors dated December 2, 2002, delegating authority for action on certain application matters, including applications for Federal deposit insurance. See https://www.fdic.gov/regulations/laws/matrix/

necessary to either mitigate risks that are unique to the proposal or to ensure that actions or activities in process at the time of approval are completed before insurance becomes effective. The most common nonstandard conditions require FDIC approval of business plan changes, employment agreements and stock options plans, bank policies, and additional directors or officers. In the case of ILCs, additional nonstandard conditions are commonly used to address corporate relationships, management authority and independence, and corporate and operating records.

The majority of nonstandard conditions do not exceed the three-year *de novo* period. However, nonstandard conditions may be imposed for any length of time that is deemed necessary to mitigate the relevant risk. For example, certain monoline institutions are subject to heightened supervisory expectations to mitigate risks associated with engaging in a single line of business.

Supervisory Approach to *De Novos*

The FDIC's *Risk Management Manual of Examination Policies* describes the supervision program for *de novo* institutions. The Manual states that newly chartered and insured institutions are to have a limited scope examination (visitation) within the first six months of operation and a full scope examination within the first twelve months of operation. Subsequent to the first examination and through the third year of operation, at least one examination is to be performed each year. The goal of the close supervisory attention in an institution's formative years is to help ensure its success.

In August 2009, the FDIC imposed nonstandard conditions in extending from three to seven years the period during which *de novo* state nonmember banks were subject to higher capital maintenance requirements and more frequent examinations. The FDIC also required *de novo* state nonmember banks to obtain prior approval from the FDIC for material changes in business plans (FIL 50-2009). These nonstandard conditions were put into place at that time because institutions insured less than seven years were overrepresented among the bank failures that began in 2008, with many of the failures occurring during the fourth through seventh years. Out of 1,042 *de novo* institutions chartered between 2000 and 2008, 133 (12.8 percent) failed, representing more than double the failure rate of 4.9 percent for established small banks.[13] Moreover, a number of *de novo* institutions pursued business plan changes during the first few years that led to increased risk and financial problems while failing to have adequate controls and risk management practices. Given the ongoing improvement in post-crisis industry performance, the FDIC recently rescinded this policy, returning to a three-year *de novo* period in April 2016.

Supervision of ILCs

As state-chartered federally insured institutions, ILCs are supervised by their chartering states and the FDIC, and they must meet the same standards as any FDIC-insured bank.[14] Parent companies of ILCs are subject to regulation or oversight by the state banking agency under which the ILC is chartered. However, parent companies of ILCs are not generally subject to Federal banking supervision and therefore are not generally required to meet regulatory requirements imposed by the Bank Holding Company Act of 1956 (BHCA).[15] Although the FDIC does not have the statutory authority to directly supervise the parent companies of ILCs,,

[13] Lee and Yom. April 2016

[14] ILCs currently operate in California, Hawaii, Minnesota, Nevada and Utah.

[15] Congress enacted the Competitive Equality Banking Act of 1987, which broadened the definition of the term "bank" in the BHCA while specifically excluding ILCs from the new definition of "bank." A parent of an ILC may be subject to Federal banking supervision if it also owns a bank or a savings and loan.

the FDIC does have authority under Section 10(b)(4) of the FDI Act, in examining any insured depository institution, including an ILC, to examine the affairs of any affiliate, including the parent holding company, as may be necessary to disclose fully the relationship between the institution and the affiliate, and to determine the effect of such relationship on the depository institution.

In the early 1990s, the FDIC and the Utah Department of Financial Institutions (DFI) discovered that some ILCs were operated with minimal physical presence, books, records, and on-site management in Utah. The FDIC and the DFI held meetings with ILC industry representatives and developed conditions for state charters and Federal deposit insurance orders to address these concerns. Since that time, the FDIC has included prudential considerations in its supervisory approach, in informal and formal enforcement actions, and in conditions in orders granting Federal deposit insurance to ILCs. This approach is designed to ensure the independence and survival of the insured ILC separate and apart from a parent that may not be subject to the scope of consolidated supervision, consolidated capital requirements, or enforcement actions imposed on parent organizations subject to the provisions of the BHCA.

In 2004, the FDIC took steps to reiterate its supervisory expectations to FDIC examiners and the banking industry. In March 2004, the FDIC issued a memorandum to FDIC regional directors regarding prudential conditions that might be imposed in approving applications for deposit insurance involving insured depository institutions to be owned by or significantly involved in transactions with commercial or financial companies, should the risk characteristics of a given proposal warrant such action. The memorandum included examples of prudential conditions drawn from prior approvals to address the risks associated with the absence of consolidated supervision of the parent organization. The examples address matters such as corporate relationships, management authority and independence, and corporate and operating records. In June 2004, the FDIC published a detailed description of its supervisory approach and possible prudential conditions in its inaugural issue of *Supervisory Insights*, a professional journal to promote sound principles and best practices for bank supervision. The lead article in this issue of *Supervisory Insights* puts ILC supervision strategies in historical context and includes a brief chronology of ILC failures. Subsequent to issuing the 2004 memorandum, the FDIC approved 15 deposit insurance applications proposing to establish an ILC, subject to various standard and nonstandard (prudential) conditions.[16]

Beginning in 2004, the FDIC Office of Inspector General (OIG) conducted two evaluations and the Government Accountability Office (GAO) conducted two studies regarding the FDIC's supervision of ILCs, including its use of prudential conditions.[17] The 2004 OIG evaluation focused on whether ILCs posed greater risk to the deposit insurance fund than other financial institutions and reviewed FDIC's supervisory approach in determining and mitigating material risks posed to those institutions by their parents. A September 2005 GAO study cited several risks posed to banks operating in a holding company structure, including adverse intercompany transactions, operations, and reputation risk. The study also raised concerns about the FDIC's ability to protect an ILC from those risks as effectively as the consolidated supervision approach under the BHCA.

[16] See FDIC Office of Inspector General Evaluation 06-014, *The FDIC's Industrial Loan Company Deposit Insurance Application Process*, https://www.fdicig.gov/reports06/06-014.pdf, dated July 20, 2006. This report provides several charts identifying the standard and non-standard (prudential) conditions imposed on a sample of ILC applications approved after the implementation of the 2004 memorandum.
[17] See OIG Evaluation 04-048, *The Division of Supervision and Consumer Protection's Approach for Supervising Limited-Charter Depository Institutions,* https://www.fdicig.gov/reports04/04-048.pdf; OIG Evaluation 06-014, *The FDIC's Industrial Loan Company Deposit Insurance Application Process,* https://www.fdicig.gov/reports06/06-014.pdf; Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority. GAO-05-621. September 2005.

The reports acknowledged the FDIC's actions to ensure the independence and safety and soundness of commercially owned ILCs. The reports further acknowledged authorities the FDIC possessed and exercised to protect an ILC from the risks posed by the parent and affiliates, including its examination authority; ability to impose conditions on or enter into agreements with an ILC holding company in connection with an application for Federal deposit insurance; ability to terminate an ILC's deposit insurance; ability to enter into agreements during the acquisition of an insured entity; and ability to take enforcement measures. However, these reports reiterated the concern about the risks of the ILC model and the ability of the FDIC to adequately supervise them. In response, the FDIC continued to address capital, liquidity and other matters as appropriate, through the use of written agreements with an ILC and its parent.

The FDIC's approach to ILC supervision was ultimately tested during the recent financial crisis. Despite the failure and bankruptcy of a number of commercial and financial parents of ILCs, as detailed below, only two ILCs failed during the recent crisis, Security Savings Bank, Henderson, Nevada (Security), and Advanta Bank Corp, Draper, Utah (Advanta), a financially owned ILC. Security failed in February 2009 due to ineffective management and rapid growth in high-risk assets. Advanta, which was engaged exclusively in issuing credit cards to small businesses, failed in March 2010, as its clients suffered the effects of the recession.

Many other ILCs' parent companies or affiliates experienced severe stress, but their ILCs did not fail. ILC parents and affiliates that filed for bankruptcy included Lehman Brothers, General Motors, Flying J Inc., Capmark Financial Group Inc., CIT Group Inc., and Residential Capital, LLC.

In 2008, parents of a number of ILCs converted into bank holding companies through expedited conversions permitted by the Federal Reserve due to prevailing emergency conditions in the financial markets. ILC parent companies that undertook expedited conversions to bank holding companies were Morgan Stanley, Morgan Stanley Capital Management LLC, and Morgan Stanley Domestic Holdings, Inc.; Goldman Sachs Group, Inc.; American Express Travel Related Services Company, Inc.; CIT Group Inc.; and GMAC LLC. Also, in 2008, Merrill Lynch, the parent company of an ILC, was sold to Bank of America.

Although the financial crisis was severe, the supervisory approach of the FDIC and chartering states proved to be effective. No ILCs failed during the recent financial crisis because of the failure of a parent, preventing significant additional losses to the Deposit Insurance Fund.

FDIC Actions To Support the Formation of New Institutions

The FDIC continues to monitor developments with respect to the formation of new banking institutions and recently announced a number of initiatives to support the efforts of viable organizing groups. These initiatives, which began in 2014, support the development, submission, and review of proposals to organize new institutions, including industrial loan companies.

In November 2014, the FDIC issued Deposit Insurance "Questions and Answers" (Q&As) to help applicants develop proposals to obtain Federal deposit insurance. In issuing the Q&As, the FDIC addressed concerns raised by commenters through the decennial regulatory review process required by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). The Q&As provide additional transparency to the application process and augment the FDIC's Statement of Policy on Applications for Deposit Insurance. Topics addressed in the Q&As include pre-filing meetings, processing timelines, capitalization, and initial business plans.

In March 2015, the FDIC provided an overview of the deposit insurance application process during a conference of state bank supervisory agencies. This session was followed by an interagency training conference hosted by the FDIC in September 2015 to promote coordination among state and Federal regulatory agencies in the review of charter and deposit insurance applications. Supervisory participants in the conference included the FDIC, state banking agencies, the Federal Reserve System, and the Office of the Comptroller of the Currency.

As mentioned earlier, on April 6, 2016, the FDIC reduced from seven years to three years the period of enhanced supervisory monitoring of newly insured depository institutions. The FDIC had established the seven-year period during the financial crisis in response to the disproportionate number of newly insured institutions that were experiencing difficulties or failing. In the current environment, and in light of strengthened, forward-looking supervision, the FDIC determined it was appropriate to return to the three-year period.

Also, in April 2016, the FDIC supplemented its previously issued Deposit Insurance Q&As to address multiple issues related to business plans. The FDIC intends to issue additional Q&As as needed to help organizing groups understand specific aspects of the deposit insurance application process.

The FDIC is preparing a publication designed to serve as a practical guide for organizing groups from the initial concept through the application process; it also will include post-approval considerations. The publication will focus on those issues that frequently have been identified as obstacles to the FDIC's ability to favorably resolve the statutory factors enumerated in Section 6 of the FDI Act that are applicable to the FDIC's approval of Federal deposit insurance. This resource will address topics such as developing a sound business plan, raising financial resources, and recruiting competent leadership, each of which helps to ensure that every new institution is positioned to succeed. The FDIC plans to have this publication available later this year.

The FDIC has designated professional staff within each regional office to serve as subject matter experts for deposit insurance applications. These individuals are points of contact to FDIC staff, other banking agencies, industry professionals, and prospective organizing groups. They serve as an important industry resource to address the FDIC's processes, generally, and to respond to specific proposals.

Finally, we are planning outreach meetings in several regions around the country to ensure that industry participants are well informed about the FDIC's application review processes and the tools and resources available to assist organizing groups.

Conclusion

In conclusion, the current economic environment with narrow net interest margins and modest overall economic growth remains challenging for U.S. banks and the establishment of *de novo* institutions. The FDIC is committed to working with and providing support to groups with an interest in organizing a bank or an industrial loan company. As outlined earlier, the FDIC continues its efforts to provide interested organizing groups with a clear path to forming a new insured depository institution, regardless of the type of charter pursued by an organizing group.

APPENDIX

De Novo Applications Received by Year, and The Disposition of Those Applications By Number					
Applications Received January 1, 2000, through June 30, 2016*					
Year Received	**Total**	**Approve**	**Return**	**Withdrawn**	**Pending**
2000	205	161	22	22	
2001	156	116	22	18	
2002	147	111	17	19	
2003	161	112	20	29	
2004	214	148	39	27	
2005	299	237	39	23	
2006	232	184	16	32	
2007	223	161	19	43	
2008	101	28	27	45	1
2009	33		17	15	1
2010	6		1	5	
2011	1			1	
2012					
2013	4	1		3	
2014	1	1			
2015	2	1		1	
2016	2				2
Total	**1,787**	**1,261**	**239**	**283**	**4**

De Novo Applications Received by Year, and The Disposition of Those Applications By Percentage					
Applications Received January 1, 2000, through June 30, 2016*					
Year Received	**Count**	**Approve**	**Return**	**Withdrawn**	**Pending**
Total	1,787	70.6	13.4	15.8	0.2
Pre-2008	1,637	75.1	11.9	13.0	0.0
2008-2010	140	20.0	32.1	46.4	1.4
2011-2016	10	30.0	0.0	50.0	20.0

* The above tables do not include: 1) applications filed for the purpose of acquiring failing institutions, or 2) applications filed by existing non-FDIC financial services companies seeking to convert to an FDIC-insured depository institution.

De Novo ILC Applications Received by Year, and The Disposition of Those Applications By Number					
Applications Received January 1, 2000, through June 30, 2016					
Year Received	**Total**	**Approve**	**Return**	**Withdrawn**	**Pending**
2000	5	4		1	
2001	4	2	1	1	
2002	8	6		2	
2003	9	2	2	5	
2004	10	6	2	2	
2005	12	4	5	3	
2006	7	2	3	2	
2007	2	1		1	
2008	4	1		2	1
2009	3		2		1
2010					
2011					
2012					
2013					
2014					
2015					
2016					
Total	**64**	**28**	**15**	**19**	**2**

De Novo ILC Applications Received by Year, and The Disposition of Those Applications By Percentage					
Applications Received January 1, 2000, through June 30, 2016					
Year Received	**Count**	**Approve**	**Return**	**Withdrawn**	**Pending**
Total	64	43.8	23.4	29.7	3.1
Pre-2008	57	47.4	22.8	29.8	0
2008-2010	7	14.3	28.6	28.6	28.6
2011-2016	0	0	0	0	0

Note: Moratoria related to ILCs were in effect during parts of the period. Please see pp. 7-8 of the testimony for details.

Chairman CHAFFETZ. Thank you.

Mr. Browning, you are now recognized for 5 minutes.

STATEMENT OF MATTHEW BROWNING

Mr. BROWNING. Good morning, Chairman Chaffetz and Ranking Member Cummings. My name is Matt Browning, and I'm here on behalf of the National Association of Industrial Bankers and the Utah Bankers Association.

Why are we here today? We are here today because the FDIC is not following its direction from Congress and is preventing the chartering of new banks.

Congress set forth the approval process for new banks in the Federal Deposit Insurance Act. However, the FDIC has unilaterally adopted a no-growth policy of not allowing new bank charters and uses vague nondenial denials as a backdoor means to pursue this policy. In order to avoid the mandates of the Federal Deposit Insurance Act, the FDIC simply avoids calling an application complete and, instead, asks endless open-ended questions and makes vague suggestions of needed changes in a prospective bank's plan.

I would like to share my own experiences with the committee that leads me to conclude the FDIC is blocking the formation of new banks.

In 2012, I led the effort on an application for a new bank's charter and Federal deposit insurance. We modeled our bank on the needs of our clients. It was very similar to the banks owned by our competitors. We were following a proven conservative model with a long history of exceptionally low risk.

Our introductory discussions with local FDIC and State regulatory officials went well. We were then surprised when FDIC's Washington, D.C., staff suggested that serving our client needs and demands for banking services was, in fact, not a sufficient reason to charter a bank. The staff began making vague demands for modifications that would make our bank markedly different and force us outside our areas of expertise.

FDIC officials never mentioned any deficiency in our plan relating to safety and soundness, no deficiency in our compliance, no deficiency in our capital. Our board, management, loan programs, and control systems were never criticized. By all objective measures, our plan met the requirements for approval under the long-articulated statutory requirements.

We were ready to make reasonable changes. But the FDIC imposed novel, unwritten, and unacknowledged standards on us, and these continued to evolve as we progressed.

After 18 months of ongoing discussions, after repeated plan revisions, after spending more than $800,000 in direct expenses and many thousands of hours, we concluded we were engaged in an exercise in futility. We abandoned the process without filing an application.

Sadly, I understand these outlays are modest compared to those of many other applicants who have received similar treatment.

Our plan could not proceed because it was impossible to truly understand the new arbitrary requirements of the FDIC. We experienced denial by attrition. We unwittingly played rope-a-dope with the FDIC, wasting a great deal of time and money in the process.

Earlier this year, Chairman Gruenberg stated, quote, “The FDIC welcomes applications for deposit insurance, and we clearly have a role to play in facilitating the establishment of new institutions,” end quote.

Sadly, the common perception among particular applicants is the FDIC’s claim is mere posturing. The FDIC’s many years of conduct directly contradict its public statements. The actions speak loudly and continue to affirm the widely held industry impression that agency staff in Washington is adversarial, uncooperative, evasive, and at times belligerent. This was certainly my experience, as it has been for many others.

Potential applicants will not commit the substantial time and money needed for an application until the FDIC has really seen to change its unilateral no-growth policy.

The FDIC should rightly have broad discretion on approving new banks; however, it does not have the discretion to arbitrarily shut down the formation of new banks altogether or to covertly use attrition to deny bank applications.

Policymaking should not be done in the dark. Regulators should not create policy without a clear understanding of the effect on the economy and should ensure alignment with Congress. The FDIC must not only tolerate but truly accommodate innovation within the banking sector. This accommodation must extend not only to new products and services in existing banks, but accommodation must also be made for new banks and new bank models designed to serve the evolving needs of American consumers and businesses.

Thank you, and I’m happy to answer your questions.

[Prepared statement of Mr. Browning follows:]

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON OVERSIGHT & GOVERNMENT REFORM

Hearing On

OVERSIGHT OF THE FDIC APPLICATION PROCESS

Wednesday, July 13, 2016

WRITTEN TESTIMONY OF MATT BROWNING

On Behalf of

National Association of Industrial Bankers

Utah Bankers Association

Good morning, Mr. Chairman and Ranking Member Cummings. My name is Matt Browning, and I am appearing before you on behalf of the National Association of Industrial Bankers (NAIB) [1] and the Utah Bankers Association (UBA). [2] I am a former member of the board and executive committee for both organizations.

Thank you, Chairman Chaffetz and Ranking Member Cummings, for holding this important hearing to review the Federal Deposit Insurance Corporation's (FDIC) failure to approve new bank charters, and the impact of that failure to act on the banking system and our nation's economy.

NAIB and UBA believe the lack of new banks is an especially important subject for Congressional review because of its effect on access to a stable supply of credit on fair terms. All providers of credit are important to the economy, but none have been more important to consumers and small businesses than banks and credit unions. Throughout our nation's history, banks and credit unions have proven their ability to operate in all economic conditions, and they are unquestionably the best regulated.

In recent years, however, banks' role as providers of credit has declined, and the absence of new bank approvals is one element of that decline. History suggests that banks have formed a core of credit providers in times of critical need, and we believe that studies would show these depository institutions are still best equipped to provide credit in times of downturn. Our regulatory policies and practices should reflect this central role of banks in our economy.

The David Eccles School of Business at the University of Utah has prepared a series of charts to illustrate this assertion, and those charts are appended to this statement. I believe these will help the Committee's analysis of this important issue. One chart is particularly interesting. It shows a model developed by economists at the Federal Reserve Board of Governors that predicts an average of 30 new banks should have been chartered between 2009-2014.

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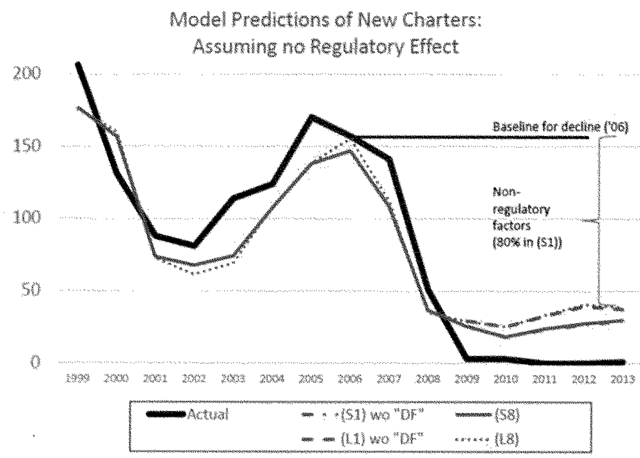
[1] NAIB is the voice of the industrial banking industry, First chartered in 1910, industrial banks operate under a number of titles; industrial loan banks, industrial loan corporations, or thrift and loan companies. These banks engage in consumer and commercial lending on both a secured and unsecured basis. They do not offer demand checking accounts but do accept time deposits, savings deposit money market accounts and NOW accounts. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the US economy.

[2] The Utah Bankers Association is the professional and trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates the interests of its members, enhancing their ability to be preeminent providers of financial services.

Figure 8B



"We use the model to predict the level of new bank formation that would have occurred absent any regulatory changes post-crisis, and compare the model's predicted levels of bank formation to the actual level of bank formation." (Adams and Gramlich, 2014: 4)

A recent article in *The Economist* magazine described the current climate for bank startups as "barren, dry, desolate."[3] This is not dramatic overstatement, but harsh reality. The reality of chartering a bank in today's regulatory environment bears little resemblance to the stated theory of how this process should work.

CHARTERING A NEW BANK: THE THEORY

The Federal Deposit Insurance Corporation, as you may know, does not charter financial institutions. Banks are chartered by the individual states or, in the case of national banks, by the Office of the Comptroller of the Currency (OCC). The FDIC decides whether to grant newly chartered banks federal deposit insurance, a requirement for any institution that collects deposits from individuals. The FDIC also serves as federal regulator for state-chartered banks, exercising further supervisory authority over those institutions.

If the organizers of a new bank choose a state charter, the FDIC is the primary federal regulator responsible for processing the application. If the application is approved, the FDIC shares responsibility with the state regulator for examining the bank and ensuring that it operates in a safe and sound manner, complying with all applicable federal laws and regulations. If the organizers choose a federal charter, the FDIC must still review the application and consult with

[3] "Bank Free or Die; Small Banks in America." *Economist (US)* 25 July 2015: n. pag. Web.

the relevant federal regulator. In all cases, a new bank *cannot* begin operating until the FDIC approves its application or does not object to another federal regulator approving the application.

This approval process for new banks is written into law as Sections 4, 5 and 6 of the Federal Deposit Insurance Act. In these sections, Congress clearly articulated the statutory requirements for applicants and the criteria regulators must consider when considering those applications. The law requires applicants to present a detailed business plan, show financial and staff resources, and demonstrate an ability to operate a profitable and legally compliant institution.

Concerned this process could prevent the timely consideration and approval of new banks, Congress enacted Section 343(a) of the Riegle Community Development and Regulatory Improvement Act of 1994, which "requires" federal banking agencies — including the FDIC — to take action on an application within one year of the day upon which "a complete application is received." According to the FDIC's own *Case Manager Manual*, "it is expected that processing time frames approaching the one-year time limit and/or needing a waiver will occur in rare and unusual circumstances."[4]

Unfortunately, the FDIC ignores both Congress and its own internal processes by using the simple expedient of not finding an application "complete," asking endless questions interspersed with long periods of silence. Potential applicants, even existing banks seeking routine approvals for organizational and operational changes, view the FDIC applications process as a black hole designed to deny changes through inaction in service of a no-growth policy.

I am not here to criticize the practice of requiring an application to be complete before the FDIC acts on it. Our concern is that the FDIC has unilaterally adopted a no-growth policy without acknowledging it, justifying it to Congress, and reviewing it through a healthy public debate.

CHARTERING A NEW BANK: THE REALITY

The reality of the new charter application process was painfully apparent in the case of John Deere, the iconic maker of agricultural machinery, which applied for a bank charter in November 2009. A *Fortune 100* company, Deere has been in business for 172 years and had successfully operated an FDIC-insured federal savings bank since 1999. It sought a new bank charter in order to offer the kinds of loans and services not permitted for a savings bank, which it also believes are unmet needs in places where Deere has a long and substantial retail presence serving America's farmers.

The company sent the entire FDIC board and a number of US Senators a widely circulated letter in November 2012 that described its long history of interactions with the FDIC and submissions in response to numerous requests for additional information. In closing, John Deere wrote that they believed the company had fully complied with all requirements to have its application approved. They asked the FDIC to complete its process, which by then had been pending for nearly three years.

[4] United States. Federal Deposit Insurance Corporation. Case Manager Manual. N.p.: April 2004. Print.

To date, Deere does not have a new charter.

Deere's plight is not unusual. From 2003 to 2007, an average of 126 new banks opened for business each year in the U.S. Since 2008, formation of new banks in the U.S. has virtually stopped. We are aware of only three *de novo* banks formed in the nation since 2009.[5] Given the vital role banks play in our economy and our communities, this situation raises many concerns.

CHARTERING A NEW BANK: A PEEK BEHIND THE CURTAIN

Although I am here to speak for the associations, my own experiences in this area are relevant, and reinforce my personal conclusion that the FDIC is blocking the formation of new banks.

I served as the president of a federally insured industrial bank, and later joined another company where I was to become the chief executive of a new industrial bank. My first duty was to organize the bank, which included preparing the applications for the bank's charter and federal deposit insurance.

The parent company of this proposed bank was a profitable regional retail brokerage and investment banking firm with more than a century of operating history. It wanted to organize a bank in order to offer bank products and services to its brokerage clients and the public generally — in the same manner as many of our competitors.

Ironically, the parent company had a nationally recognized division that offered specialized advisory services for banks analyzing complex areas such as loan loss reserves, capital adequacy, interest rate risk and liquidity needs.

We initially modeled our bank on the needs of our clients and the banks owned by our competitors. We did not plan to do anything out of the ordinary. We were following a proven, conservative model with a long history of exceptionally low risk.

As our application progressed, I found an important difference between the FDIC's Washington DC staff and its regional office in San Francisco. In recent years, the FDIC has consolidated decision-making in Washington, DC. This has blinded the agency to what is going on in the economy at ground level by precluding contributions from expert, experienced regional staff. In my case, the regional office was generally supportive and reasonable. Our treatment changed when Washington staff unveiled previously unknown policy interpretations and tilted the playing field.

[5] Recent studies have reported different numbers of new banks varying between two and seven. Five of those new banks, however, were actually reorganizations of an existing bank, such as converting a charter from one type to another or spinning off from a parent company. The studies agree that between 2009 and today only three d*e novo* banks formed in the entire nation.

Chairman Gruenberg now describes the role of regional offices this way: "We have designated subject matter experts and applications committees in the FDIC regional offices to serve as points of contact for deposit insurance applications."[6] While useful, being a "point of contact" is, in reality, a euphemism for the token role regional officials now play in the process.

After our initial introductory meeting with FDIC and state regulatory officials, we followed the normal practice of regularly discussing the progress of our application with FDIC application specialists. We were surprised when they said our plan needed modifications that would make our bank markedly different from those of our competitors, and force us outside our areas of expertise. We eventually made many changes to our plan to accommodate FDIC demands.

The FDIC officials did not mention any deficiency in our plan relating to safety and soundness or compliance with laws and regulations. They never told us our loan programs were risky or our financial projections were deficient. Our plan used a legally permitted bank charter to engage in sound lending programs that would generate sufficient income to support the bank, in practices similar to many other banks'. Our board, management, facilities, systems, compliance, and internal audit were not criticized. As far as we knew, our plan met all the requirements for approval under the applicable laws and regulations.

Nevertheless, the FDIC kept insisting our bank plan needed to offer additional loan programs that would serve unspecified unmet needs. Our plan, designed to offer loans and other services demanded by our clients, was deemed inadequate because competing banks offered those same products and services. Therefore, the FDIC told us, our bank was not necessary to meet the needs of those consumers – no "community need" existed for this bank. The FDIC officials went on to say that strengthening the parent company's business by deepening its relationship with its current and future customers was not a valid reason to approve a bank. This was both surprising and confusing, since it ignored the benefit to our customers of providing a broader array of products and services at a competitive cost.

Competing for business is the manner in which most banks operate. The unmet needs of our customers and the competitive needs of the parent company drove our plan from the outset. Furthermore, *every* financially sound bank benefits its parent. The only banks that do not benefit their parent *in addition to their customers* are banks that are failing or those that have no parent. Banks that do not benefit their customers cannot remain in business.

Still, we tried to accommodate the FDIC with modifications to our plan. New yet ambiguous demands followed each change. The FDIC suggested that the bank self-originate mortgages, creating inefficient, complex and redundant operations with an existing affiliate, and consider offering SBA loans. These suggestions did not fit our overall business plan and were confusing, because an affiliate already offered mortgages and we saw no demand for SBA loans among our target customers.

[6] See note 18 *infra*

It was also suggested we source less stable deposits through alternate high-cost channels despite an existing program of very low-cost, exceptionally stable deposits that far exceeded the bank's needs. These demands went beyond any requirements imposed on the existing comparable banks that would be our competitors. They baffled us, as they would introduce increased risk and expense into bank operations.

After many months, many modifications to our plans, and expenditures well in excess of $800,000 and countless hours, we concluded we were engaged in an exercise in futility. We halted the effort to get our charter approved.

Our effort failed because the FDIC imposed unwritten and unacknowledged standards on us that changed as we progressed. We were ready and able to make any reasonable changes to our plan to meet the long-articulated FDIC standards and requirements. We failed because we were never able to understand specifically the FDIC's new requirements for approval. We were only told, regularly, that we needed to do more.

Today I strongly believe the FDIC did not want to approve our application regardless of any changes offered, but did not want to deny it on the merits because that would require stating explicit reasons and provide an opportunity to challenge the decisions as arbitrary and capricious. What we experienced was denial by attrition. Put another way, we unwittingly played rope-a-dope with the FDIC and wasted a great deal of time and money in doing so.

As a member of the banking community, I can say without hesitation that experiences such as ours with the applications process have produced a deeply held view that applications for new banks are a waste of time and actively discouraged in practice.

All of this poses a question: Why is the FDIC not approving any charters? Their own answers are unpersuasive.

On several occasions FDIC officials have blamed the dearth of new bank applications on economic conditions, which likely did play a role during the Great Recession. But if that were the only factor we would expect to see new bank applications surging as the economy recovers, and that is not happening. Indeed, studies have shown that in all prior recessions bank applications declined during the downturn, but never went to zero, and quickly returned to normal numbers of applications after the recession ended. The lack of new bank applications, even now, is anomalous and cannot be explained by current economic conditions or increased regulatory costs since 2008. A careful review of the existing data shows that the only credible explanation for the lack of new applications is a *de facto* moratorium imposed by the FDIC.

A paper issued by the Federal Reserve Bank of Richmond in 2015 clearly shows that bank profitability has recovered to near normal levels since the recession, and if we were following historical trends, new banks would have been formed at normal rates for the past few years.[7] Thus, factors other than economic conditions are blocking the organization of new banks. We

[7] McCord, Roisin, and Edward Simpson Prescott. "The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks." *Federal Reserve Bank of Richmond Economic Quarterly* 100.1 (2014): 23-50. Print.

believe the array of new requirements imposed by the FDIC on new bank applicants and the FDIC's stonewalling of pending applications are the real barriers to opening new banks. The chartering of new community banks and specialty banks has always been an engine of innovation in our nation's banking services and credit markets. This engine has stopped.

In 2009, *American Banker* reported:

> *Though the ban is not official, several industry sources said groups looking to start banks in Florida, Georgia, California, Nevada, or Arizona have been told by FDIC officials that applications for deposit insurance will not be considered for up to a year — even if organizers have already raised capital and their charter applications have been approved by their primary regulator.* [8] [9]

In another case, in 2010, a state bank regulator discussed how the FDIC nudged entrepreneurs seeking to start a new bank into buying an existing bank in need of capital. That regulator told a reporter, "They weren't looking for anything but a traditional community bank. Hopefully sometime the FDIC will get back to the business of approving *de novo* applications. There is still interest out there."[10]

The lack of new charters has helped to fuel continued growth among the nation's largest banks. By not allowing a natural renewal through new charters, the FDIC is enshrining a more concentrated, less dynamic banking sector.

Some critics say the FDIC is fixated on risk, and has decided that the best way to minimize risk is to reduce the size of the banking industry and limit new banks, just as auto insurers could reduce their collision-related losses by refusing to cover cars.

Beyond the drive toward consolidation, however, the FDIC has shown a strong hostility to new bank models since 2008. This is short-sighted. Technology has transformed the overall structure of the financial services markets. Technological advances such as ATMs, credit and debit cards, and mobile-based applications have made branches increasingly less important, and changed the basic relationship between banks and many of their customers, especially younger ones, from geographically based to product-based. Banks must become technology leaders if they want to remain in business tomorrow. If the FDIC continues to block change and growth, banks will become increasingly insignificant as suppliers of credit to the economy.

This is unacceptable. A healthy economy requires a healthy banking system. A vibrant and innovative banking system is critical for job growth and economic expansion. It appears that the FDIC has failed to take broader economic needs into account when fashioning new unilateral policies it has followed for the past decade.

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[8] The term "primary regulator" refers to the agency that approves a charter *e.g.*, a state banking department or, in the case of national banks, the Office of the Comptroller of the Currency.

[9] Fajit, Marissa. "FDIC in Unofficial Clampdown; Reluctance Seen to OK Start-ups Insurance." *American Banker* 12 Jan. 2009: 1. Web.

[10] Rehm, Barbara A. "FDIC Set to End De Novo Dry Spell." *American Banker* 2 Dec. 2010. Web.

The nation needs new banks, and the time is overdue to allow banks of every kind to resume playing their natural role in the economy. Given the rapid development of technology, it is also essential for regulators to allow banks to adapt to the changing economy and develop new ways to deliver products and services designed to serve the needs and demands of more tech-savvy generations.

THE FDIC'S CONDUCT SHOWS A PATTERN OF ERECTING ROADBLOCKS TO NEW ENTRANTS

Along with endless processing times, and constantly evolving, ambiguous requirements, FDIC policies designed to block new banks include:

- A new highly constricted, novel definition of "serving public needs and convenience"
- Prohibiting branchless banks
- Prohibiting applications that rely on brokered deposits
- Prohibiting specialty banks, which often have monoline or tailored business plans

The FDIC has unilaterally adopted these new policies, without public notice and request for comment, and has concealed what it was doing to avoid oversight. The FDIC's practice of using "non-denial denials" to avoid oversight and accountability for blocking growth of a vital sector of the economy is improper and dangerous. The agency has adopted these policies without a clear understanding of the needs of the economy, or of its own proper role in facilitating the development of a thriving and stable economy.

WHO GETS HURT?

Outside the FDIC, the need for new bank charters is recognized. North Carolina's banking commissioner, Ray Grace, recently told the North Carolina Bankers Association that regulators "need to shake themselves up" in order to fulfill the industry's potential as a laboratory for change. A news story on Commissioner Grace's remarks noted that **"Obtaining new charters has proven difficult since the financial crisis, as the Federal Deposit Insurance Corp. balks at signing off on new banks."[11]** (emphasis added)

When the FDIC "balks," it particularly affects three types of banks, each of which brings vital economic benefits to the customers they serve:

- Community banks
- Minority banks
- Specialty banks, such as industrial banks

[11] Davis, Paul. "Regulators Need to Approve New Types of Banks: N.C. Banking Commish." American Banker. (11 Mar. 2016 .http://www.americanbanker.com/news/community-banking/regulators-need-to-approve-new-types-of-banks-nc-banking-commish-1079861-1.html.

COMMUNITY BANKS

While community banks are small in relation to total bank assets, they make a disproportionate number of agricultural and small business loans. As Federal Reserve Governor Lael Brainard has noted, "Community banks have long been a primary source of credit for small businesses and today may continue to have the best business model for fulfilling many small business credit needs." She also pointed out that "community banks continue to hold about 50 percent of outstanding small business loans at commercial banks, far in excess of their 20 percent share of commercial banking assets and deposits."[12]

As Governor Brainard explained, community banks "tend to provide different types of loans to different types of [small business] borrowers, using different underwriting methods." While large institutions may have the advantage of access to vast quantities of automated data, she said, "[s]mall banks . . . have advantages in the provision of relationship-based lending — lending based on context-specific or qualitative information, such as the owner's character and reliability and the needs of the community."

While much of the nation has enjoyed an economic recovery since 2008, rural America has not participated. A May 2016 study by the Economic Innovation Group found that only 20 counties generated half the country's net new business startups.[13] None of these 20 counties are in rural areas.

Our national economic recovery will not be complete without small business lending to entrepreneurs in the counties that have been left behind. That capital will have to come from somewhere, and these communities will likely need new banks to help their residents prosper. This cannot happen until the FDIC begins to approve new charters again

As the number of banks declines, it is unlikely that large institutions will fill this void. Community banks compete on service more than on rates. As banks grow, they typically focus more on efficient delivery of a high volume of standardized products and services. This can leave smaller customers and communities by the wayside.

As the Federal Reserve Bank of Richmond points out, the formation of new banks is vitally important to fill the voids created as existing banks grow, merge, and leave their smaller niches unserved. This process is dynamic and dramatic. Between 2007 and 2014, the number of small banks in the U.S. declined by an astonishing 41%. The Richmond Federal Reserve Bank study found this was largely the result of "a striking decline in new bank entry not seen in previous periods. **From 2009 through 2013, entry falls to almost zero."** (emphasis added)

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[12] Brainard, Lael. "Community Banks, Small Business Credit, and Online Lending." Community Banking Research and Policy Conference, Cosponsored by the Federal Reserve System and Conference of State Bank Supervisors, Federal Reserve Bank of St. Louis, St. Louis, Missouri. 30 Sept. 2015. https://www.federalreserve.gov/newsevents/speech/brainard20150930a.htm.

[13] Economic Innovation Group. "The New Map of Economic Growth and Recovery." May 2016

This trend is alarming because community banks disproportionately serve small businesses and rural American communities. In 2011, community banks held the majority of deposits in rural and "micropolitan" counties — areas surrounding an urban center between 10,000 and 50,000 people — according to the FDIC. The FDIC also found that community banks were four times more likely than non-community banks to locate their offices in rural areas. In 2011, the physical banking offices in about 20 percent of American counties – approximately 600 in all — were exclusively owned by community banks.[14]

Earlier, I cited an article from *The Economist* that described the formation of Primary Bank in New Hampshire — only the second of three banks to be chartered in five years. Primary Bank's founder, New Hampshire businessman Bill Greiner, had seen three local banks evaporate. The *Economist* concluded:

> *Such local knowledge does not fit neatly with the impersonal lending procedures used by big banks, which are more geared towards large borrowers which have hard data, such as financial statements and credit ratings. Although new platforms—such as peer-to-peer lenders—are emerging, they are young and limited in size. In the meantime, America's small businesses hope that more will follow in Mr. Greiner's footsteps.*

The dearth of new bank charters has a profound impact on rural America, including a significant decrease in the availability of banking services in U.S. "micropolitans" — the smaller cities and towns that serve regions that account for approximately 25% of the US population.

Agricultural communities are also seeing a marked decline in the availability of banking services. Community banks provide 50% to 77% of agricultural loans. While estimates vary, all agree that community banks are an important source of agricultural finance, and are disappearing in rural America. Some communities have no local financial services, and individuals may have to travel up to two hours to reach a banking location.

This creates "financial deserts" in rural America, exacerbated by the fact that many of these communities lack the Internet services that may offer alternative means of banking. This growing gap in outlying communities' access to vital financial services highlights the profound flaw in the FDIC's unilateral no-growth, no new competition policy. New competition from banks that focus initially on those underserved communities is the best way to fill these gaps.

Community banks also serve small businesses, providing approximately 50% of all small business finance. Some observers suggest the decline in small business formation, especially in small towns and rural areas, is the direct result of the disappearance of community banks.[15]

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[14] Lux, Marshall, and Robert Greene, 2015. "The State and Fate of Community Banking." Mossavar-Rahmani Center for Business and Government Working Paper Number 37, Harvard University.

[15] DeYoung, Robert, et al., "Small Business Lending and Social Capital: Are Rural Relationships Different?" (paper presented at the Community Banking in the 21st Century conference, Federal Reserve System & Conference of State Bank Supervisors, St. Louis, Mo., October 2-3, 2013); Berger, Allen N., Seth D. Bonime, Lawrence G. Goldberg, and Lawrence J. White. "The Dynamics of Market Entry: The Effects of Mergers and Acquisitions on Entry in the Banking Industry." *Journal of Business, University of Chicago* 77.4 (2004): 797-834. Web.; McCord, Roisin,

But rural and exurban areas are not the only markets damaged by the FDIC's failure to act. Minority and urban populations also suffer.

MINORITY BANKS

Of the nation's 6,110 FDIC-insured institutions, only 162 are Minority Depository Institutions (MDIs). In fact, FDIC data show that only 22 MDIs are African American-owned, and only 30 are Hispanic American-owned.[16] These institutions make up less than one percent of the nation's banks.

The FDIC's December 2015 Minority Depository Institutions report explains the need for these banks:

> *Having offices in minority communities is also important to providing access to mainstream financial services. A 2011 FDIC survey shows that 10 million "unbanked" U.S. households did not have bank accounts while another 14 million households could be considered "underbanked."*[17]

That survey found that 21.4% of African American and 20.1% of Hispanic American households were unbanked, compared with 4% of white households. The FDIC noted that "MDIs are important service providers to minority populations, which tend to have higher percentages of unbanked households than other population groups."[18]

Michael A. Grant, president of the National Bankers Association, a Washington, D.C.-based organization of minority- and women-owned banks, has said that he sees a greater need for black-owned and black-run banks now than before the recession. "We've lost as much as 40% or more of the wealth in the black community since the mortgage crisis," he told the NerdWallet blog earlier this year. He said, "Some customers get turned down by mainstream institutions for business loans and mortgages, then come to black banks as a last resort — and get the loan."[19]

Minority banks are, by and large, community banks. The challenges and opportunities that apply to community banks apply to minority banks as well. Community banking has also traditionally served lower income individuals, and low-income communities are often left without any financial services beyond the transactional services provided by ATMs.

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and Edward Simpson Prescott. "The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks." *Federal Reserve Bank of Richmond Economic Quarterly* 100.1 (2014): 23-50. Print.

[16] FDIC Minority Depository Institutions Report, Dec. 2015,https://www.fdic.gov/regulations/resources/minority/mdi.html.

[17] 2011 FDIC National Survey of Unbanked and Underbanked Households, http://www.fdic.gov/householdssurvey/.

[18] United States. Federal Deposit Insurance Corporation. "Minority Depository Institutions: Structure, Performance, and Social Impact." FDIC Quarterly. 3rd ed. Vol. 8. N.p.: n.p., n.d. Print.

[19] Lee, Jeanne. "Black-owned Banks Fight To Bounce Back." NerdWallet. 19 Feb. 2016. https://www.nerdwallet.com/blog/banking/black-owned-banks-fight-to-bounce-back/.

Some observers believe the US is moving to a structure where the lowest 40% of the income distribution will not have access to banking, and will be forced to rely on secondary providers such payday lenders and check cashing services.[20]

FDIC Chairman Martin Gruenberg acknowledged this last month in remarks to the Urban Financial Services Coalition. After noting that "[m]any consumers — minorities in particular — remain unserved by the banking system," he went on to say that "the number of MDIs has declined since the onset of the financial crisis and has continued to decrease in recent years." He made no mention of the obvious solution: chartering new minority banks.

While advocates agree with the need for MDIs, given the FDIC's treatment of a well-capitalized multinational company like Deere, what could a minority entrepreneur expect when planning a start-up?

SPECIALTY BANKS

As in the case of Deere, specialized institutions, such as industrial banks, have long been part of the fabric of the financial system. Industrial banks have existed for more than a century and operate under a number of titles: industrial banks, industrial loan banks, industrial loan corporations, thrift and loan companies, and more recently federal savings banks.

Industrial banks provide a broad array of products and services to customers nationwide, including some of the most under-served segments of the U.S. economy. Banks under this charter serve truckers, taxi drivers and postage buyers, while others use the charter to provide services for some of the largest credit card and commercial finance companies in the nation.

Specialty banks, which might also be called branchless banks, are leaders in the development of new technologies to deliver financial services. This is one of the strongest and clearest trends in banking and financial services today. Younger generations increasingly rely on banking services delivered through their mobile devices. Growing numbers of people no longer visit a bank branch. Instead they bank from home, using online systems that can be accessed from anywhere, which is easier than driving to a branch.

Although the existing specialty banks have been the strongest and safest banks in the nation for many years, the market's widely held perception is that the FDIC will not approve any new application for an industrial bank, or for any other kind of branchless bank that would offer specialized products and services nationwide. This is a dangerous policy, driving innovations crucial to the future of banking to less regulated and less stable providers.

Two states, Nevada and Utah, currently offer these charters. Despite state laws that enable new charters, the FDIC has refused to approve or consider new applications. In fact, the agency actively discourages these applications.

[20] Baradaran, Mehrsa, 2015. How the Other Half Banks: Exclusion, Exploitation, and the Threat to Democracy. Harvard University Press, 2015.

The Nevada and Utah legislatures chose to permit these longstanding charters, and Congress has reaffirmed their authority on three occasions: in 1987 (Competitive Equality Banking Act), 1999 (Graham-Leach-Bliley Act), and 2010 (Dodd-Frank Wall Street Reform and Consumer Protection Act). Now the states — and by extension, Congress — find their public policy preempted, without any legal process, by the unilateral actions of the FDIC.

A GLIMMER OF HOPE?

On April 6, 2016, Chairman Gruenberg announced that the FDIC was rescinding a policy that required heightened scrutiny of *de novo* banks during their first seven years of existence, and was returning to the prior policy, which subjected new banks to regulatory micromanagement for three years.[21] The announcement also stated that "the FDIC welcomes applications for deposit insurance, and we clearly have a role to play in facilitating the establishment of new institutions."

From an applicant perspective, the three-year or seven-year duration of the *de novo* scrutiny is not a determinant in whether to apply. In fact, the common perception among potential applicants is that the FDIC's claim to welcome new applications is mere public relations.

This perception exists because the FDIC's decade-long conduct contradicts this announcement. It has still not acted on the John Deere application, which has languished for years. And it has done nothing to change a common impression that people at the agency in Washington are adversarial, uncooperative, evasive and at times belligerent. Potential applicants will not commit the substantial time and money needed to prepare an application until they see the FDIC changing its practices of enforcing a unilateral no-growth policy while avoiding accountability to Congress.

A recent article in the *National Law Journal* called the dearth of deposit insurance approvals "a self-fulfilling prophecy," as the FDIC's failure to act has suppressed interest in new charters. The author, an attorney, wrote that "[e]xperience has shown us that persons wanting to organize a new insured depository institution have been discouraged by the FDIC's failure to approve more than a small handful of new deposit insurance applications in the past few years (none so far in 2016, two in 2015, none in 2014, three in 2011, and two in 2010, according to the FDIC's website)."[22]

A May 13 letter from Senator Dean Heller, Chairman of the Senate Banking Subcommittee on Economic Policy, told FDIC Chairman Gruenberg that the agency's "record of creating an environment favorable for the establishment of new de novo chartered institutions has been dis-

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[21] Gruenberg, Martin. "Strategies for Long-Term Success." FDIC Community Banking Conference. Arlington, VA. 6 Apr. 2016. Speech.

[22] Horn, Charles M. "FDIC Chairman Gruenberg Announces Initiative to Promote New Bank Charters; New Supplementary Guidance on Deposit Insurance Applications Announced." National Law Journal 6 Apr. 2016: n. pag. Print.

appointing. In Nevada and throughout the country, there is a growing demand for local community banks from individuals, small businesses, ranchers and farmers."[23]

Is the FDIC serious about approving new charters? It seems unlikely. In recent remarks about the impact of post-financial crisis banking reforms on the financial system and the economy, Chairman Gruenberg did not seem aware of any problems. He told Washington, DC's Exchequer Club last month that he believes "the reforms put in place since the crisis have been largely consistent with, and supportive of, the ability of banks to serve the U.S. economy."[24]

He made no mention of new charters or underserved markets.

ONLY CONGRESS SHOULD DECIDE IF THERE ARE ENOUGH BANKS

While the FDIC should have broad discretion over approving new bank applications, it does not have the discretion to shut down the formation of new banks altogether, or to refuse to process applications for types of banks authorized by Congress to access deposit insurance. Congress, which enacted the Federal Deposit Insurance Act and numerous banking bills, did ask for this. The states, which have chartered banks since 1780, are finding their 236 years of prudential regulatory experience ignored. [25]

The Committee should take particular note of the lack of studies or research to justify the FDIC's unilateral no-growth policies. FDIC is not just an insurance company. It is a regulatory agency with basic responsibilities to develop and implement policies designed to support the economy. Through its actions, the FDIC shows no concern or understanding about the needs of the economy.

In evaluating deposit insurance applications, the FDIC should gather and use information that identifies:

- the kinds and amounts of financial services needed to support a thriving and stable economy;
- the best ways to provide these services;
- the optimal numbers and types of banks to support the economy;
- the best regulatory policies to support the development of these banks and other financial services providers; and
- the best regulatory policies to control risks and address potential crises.

We found no studies conducted by the FDIC or any other entity addressing these questions. We found no announcement by the FDIC that it is adopting new standards that would reduce or block new bank applications, no description of studies or reasoning for changes to its

[23] Senator Dean Heller. Letter to The Honorable Martin Gruenberg. 13 May 2016. MS. Washington, DC.
[24] Gruenberg, Martin. "The Impact of Post-Crisis Reforms on the U.S. Financial System and Economy." Exchequer Club; Washington, D.C. 15 June 2016. Speech.
[25] States chartered banks from 1780 until 1933 without the aid of the FDIC.

long-articulated standards for applicants, and no requests for comment or input on these new policies.

WHAT SHOULD THIS COMMITTEE REQUIRE FROM THE FDIC?

We believe that policymaking must be transparent, and that regulators must not create policy without a clear understanding of its effect on the economy, a thorough assessment of the nation's best interests, and an open process seeking input from all interested parties.

To make the FDIC accountable for its failure to charter *de novo* banks, we urge this Committee to require the FDIC to:

1. Outline, with specificity, what it is doing to align its actions with its stated policies and convince potential bank organizers that it will actually process applications promptly and fairly.

2. Designate the specific criteria used to approve a bank charter so that applicants know the rules and can legitimately evaluate their likelihood of success. Any unpublished differences or new creative interpretations from established statutory criteria need to be public and accessible.

3. Provide a plan and timeframe to return to the pre-crisis delegation of authority to the Regional Offices.

4. Describe how the FDIC plans to free states to resume their traditional role as innovators in the banking system, providing our economy with a vibrant, pro-growth banking system that meets the needs of communities and the nation.

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Thank you for the opportunity to share our views. I would be happy to answer any questions you may have.

Chairman CHAFFETZ. Thank you.

Mr. Johnson, you are now recognized.

STATEMENT OF SIMON JOHNSON

Mr. JOHNSON. Thank you very much, Mr. Chairman.

I would like to make three points. The first is to strongly agree with what Mr. Cummings said at the beginning with regards to effective overall interest rates in the U.S. economy on new entries. And I'm afraid—and I think this is absolutely the key fact for this hearing, and I hope we can establish those facts—I'm afraid there is an issue—perhaps it's an issue of omission—in Mr. Browning's testimony. He had some slides prepared by people at the University of Utah, and they seemed to have read a Richmond Fed research paper on this issue of interest rate spreads.

The Richmond Fed paper itself references and is based on a Federal Reserve Board of Governors paper. I have that paper with me, and I have the figure to which they seem to be referring. They say interest rate spreads have remained relatively stable for banks. That statement applies to established banks, Mr. Chairman, not to de novo banks, the point made by Mr. Cummings, because they have a different loan portfolio, they don't inherit loans that already have interest rates at a certain level.

So the evidence is clearly, from the Fed's research, which is being referenced by Mr. Browning, the evidence is clearly that the net interest spread for de novo banks is much lower than it has ever been in recorded U.S. history. That's a major disincentive to create community banks.

The second point I would like to make, Mr. Chairman, builds on what you said at the beginning, which I think is also fundamental to this hearing, which is the FDIC is an insurance company—a strange insurance company, an insurance company chartered by the Federal Government, backed ultimately by the taxpayer. But as you know, Mr. Chairman, if the FDIC faces losses or the deposit fund faces losses, those are covered by premiums paid by other banks.

Now, we can, I think, reasonably look at the FDIC's performance as an insurance company over the past couple of cycles. And what we see, including in the most recent experience, is that the FDIC's deposit fund almost ran out of money.

Now, if you think that the FDIC is being overly cautious over the business cycle, the credit cycle, you'd expect that fund to always be positive, maybe even highly positive. That was not the experience.

If the FDIC was being reckless, and we're asking the FDIC to take bigger risks today—well, you're asking any insurance company to take bigger risks, they're going to have bigger losses over the cycle, you're going to have bigger negatives in that insurance fund—those premiums are not, Mr. Chairman, that deficit is not ultimately going to be paid by the taxpayer. We're the backstop. We're the line of credit through the Treasury. It's the people sitting behind me representing the banking industry who are going to pay a high premium.

So the question, I think, comes down to—and I hope we can get to this—do established bankers want to pay a higher premium to run their existing business? Because that's basically what the ask is today, if you're asking the FDIC to take more risk.

Now, as Chairman Gruenberg said, the FDIC has attempted to move its rules recently, and they have relaxed or reduce the de novo supervision and intensive scrutiny period from 7 years back to 3 years. I think that's a responsible move, and I'm supportive of that. I really do not see a case for asking the FDIC to take greater risks with their deposit fund unless the bankers are all adamant that they want to pay higher insurance fees, because the taxpayer certainly does not want to be on the hook here and will not be on the hook.

The third and final point I would like to make is with regard to what are and are not the big issues here. I think Mr. Cummings put his finger exactly on one of the big issues, which is the lack of affordable, responsibly provided financial services to low-income communities. There's a huge gap in the United States, and many of the alternative financial services that currently exist are, frankly, predatory. If you look at all the different ways that credit is provided to those communities, it's not acceptable. There's big issues there of consumer protection, and I hope we can discuss those to some degree.

But if we're talking about entry and what affects entry and what distorts competition in this market, Mr. Chairman, I think we have to talk about the big banks. We have to talk about the unresolved questions around too big to fail. The very largest banks in this country have an unfair, distortive, implicit subsidy from the taxpayer, because they are not allowed to fail and the creditors would ultimately be protected.

The FDIC is involved in trying to improve that situation, and there is a living wills requirement, as you know, for all these big banks. But, frankly, 6 years after that requirement was created, we have not made enough progress with those living wills.

So, you know, if we want to talk about entry, we should be talking about fintech, we should be talking about new ways that finance is provided in the United States. There's a lot of risk capital going into finance. Yes, it is relatively hard to get insured deposits, but that's because the FDIC has responsibility not to impose bigger effective taxes on the rest of the banking industry.

Where are we on too big to fail, and how can we possibly create a level playing field for community banks before and until we really make sure that no bank and bank holding company in the United States is too big to fail?

Thank you very much.

[Prepared statement of Mr. Johnson follows:]

Testimony submitted to the House Committee on Oversight and Government Reform, hearing on "Oversight of the FDIC Application Process," Wednesday, July 13, 10am (embargoed until the hearing begins).

Submitted by Simon Johnson, Ronald Kurtz Professor of Entrepreneurship, MIT Sloan School of Management; Senior Fellow, Peterson Institute for International Economics; and co-founder of http://BaselineScenario.com.[1]

A. Overview

1) The Federal Deposit Insurance Corporation's Application Process is an important part of how new banks obtain (or do not obtain) charters.[2] Some commentators have expressed concern that the current Process for obtaining federal deposit insurance inappropriately limits the amount of entry into the community banking sector.[3]
2) In April 2016, the FDIC rescinded Financial Institution Letter (FIL) 50-2009, *Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Depository Institutions.* This rule change reduced the "de novo period" for examinations, capital maintenance, and other requirements from seven years to three years.[4] Informal guidance is also reported to have changed, consistent with the goal of encouraging de novo banks to be created.[5]
3) This policy change was welcomed by the Independent Community Bankers of America (ICBA) and the American Bankers' Association (ABA).[6]
4) Community banks play an important role in the U.S. economy and encouraging de novo bank applications is a sensible policy goal. However, under current circumstances and based on

[1] Also a member of the Federal Deposit Insurance Corporation's Systemic Resolution Advisory Committee, the Office of Financial Research's Financial Research Advisory Committee, and the independent Systemic Risk Council (created by Sheila Bair and now chaired by Paul Tucker). All the views expressed here are mine alone. Underlined text indicates links to sources and supplementary material; to see this, please access an electronic version of this document, e.g., at http://BaselineScenario.com. For important disclosures, see http://baselinescenario.com/about/.

[2] The Process is summarized on the FDIC's website, https://www.fdic.gov/regulations/laws/rules/5000-3000.html. Section 6 of the Federal Deposit Insurance Act specifies the seven criteria that the FDIC must take into account in its evaluation. The FDIC does not charter banks – this is done by The Office of the Comptroller of the Currency (OCC) and state authorities.

[3] The FDIC has a broadly sensible and robust definition of community banking and I use that throughout this testimony. See Chapter 1 in the recent (2012) FDIC Community Banking Study, https://www.fdic.gov/regulations/resources/cbi/report/CBSI-1.pdf. Most of these banks are, as the name suggests, deeply rooted in local communities.

[4] In 2009, the de novo period was increased to seven years; it has now been returned to three years. This should be seen in the overall context of stronger FDIC forward-looking supervision. See the press release, https://www.fdic.gov/news/news/press/2016/pr16027.html; also the Supplemental Guidance, https://www.fdic.gov/news/news/financial/2016/fil16024.html and https://www.fdic.gov/news/news/financial/2016/fil16024a.pdf.

[5] This is the publicly expressed view of two law firms active in this area: Bracewell (http://www.bracewelllaw.com/news-publications/updates/fdic-action-encourages-de-novo-bank-charter-applications), and Kennedy Sutherland (http://kslawllp.com/category/financial-institutions/community-banks/de-novo/).

[6] See the ICBA press release, http://www.prweb.com/releases/2016/04/prweb13322093.htm, and the ABA announcement, http://bankingjournal.aba.com/2016/04/fdic-announces-effort-to-encourage-de-novo-applications/.

available data, the case for further changing the FDIC rules regarding the Application Process for de novo banks is not compelling.

5) The broad facts regarding community banks are not in dispute. The total number of commercial banks with FDIC-insured deposits fluctuated around 13,000-14,000 in the decades leading up to 1980. Since that time there has been a steady decline to just over 5,000 (from the latest available data, as of March 2016).[7]
6) Seen over a period of decades, the major policy change that led to the decline in the number of community banks was the phasing out of restrictions on inter-state banking.[8] A large part of the process of consolidation was driven by mergers and acquisitions, i.e., smaller banks had a positive market value on a forward looking basis and were bought by other banks.
7) In addition, the economies of scale in banking likely changed over a long period of time, in part due to the rising importance of information technology in this sector – and this made it harder for the smallest banks to survive as stand-alone entities. Recent evidence on average costs as a function of asset size suggest that these decline from around 9 percent to around 6 percent as assets rise to $100m.[9]
8) When executives at community banks make bad decisions (or are unlucky), the bank goes out of business – typically through an FDIC-managed resolution event. There are no "too big to fail"-type subsidies available from the government; deposit insurance ultimately protects depositors but not shareholders or executives. The failure of community banks is very much related to the overall business and credit cycle, particularly as it affects specific communities.
9) Looking back at the number of failures over the past three decades, the aberration or abnormal period seems to have been the long boom between 1994 and 2007, when very few banks failed. In 1986-1993, the annual rate of failure (as a percent of charters reporting at previous year-end) was 1.6 percent; in 2008-2013, the annual rate of failure was 1.0 percent; in 1994-2007, the annual rate of failure was only 0.05 percent.[10]
10) It seems reasonable to compare the latest credit cycle (with a peak in 2007, driven by residential real estate) with the previous cycle (peak in the late 1980s, driven by commercial

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[7] See Table 1 in the FDIC's latest Quarterly report, https://www.fdic.gov/bank/analytical/quarterly/2016_vol10_2/fdic_v10n2_1q16_quarterly.pdf. This gives the total number of "FDIC-insured institutions" as 6,122; excluding insured U.S. branches of foreign banks. Of the 6,122 institutions, 5,289 are Commercial Banks and 833 are Savings Institutions; see also FDIC Historical Trends, Statistics at a Glance, https://www.fdic.gov/bank/statistical/stats/2016mar/fdic.pdf. The FDIC's detailed Quarterly Banking Profile provides more detail and is available here: https://www.fdic.gov/bank/analytical/qbp/. The longest time series on FDIC-insured banks is available from the FDIC's data page, https://www5.fdic.gov/hsob/HSOBRpt.asp (and select the Commercial Banks option).

[8] See "Community Banks Remain Resilient Amid Industry Consolidation", FDIC Quarterly, 2014, Volume 8, No. 2; https://www.fdic.gov/bank/analytical/quarterly/2014_vol8_2/article.pdf.

[9] Stefan Jacewitz and Paul Kupiec, "Community Bank Efficiency and Economies of Scale", FDIC, December 2012, https://www.fdic.gov/regulations/resources/cbi/report/cbi-eff.pdf. The price level has more than doubled since the early 1980s and this should be taken into account when considering nominal thresholds for bank size over time. At year-end 2013, 68 percent of community bank charters had assets between $100 million and $10 billion (p.37 in "Community Banks Remain Resilient").

[10] See Chart 3 on p.35 of "Community Banks Remain Resilient".

real estate). In both instances some banks went out of business and the number of new charters quickly fell to a very low level.[11]

11) However, compared with the previous cycle, the number of applications for new charters has subsequently stayed very low since 2008.
12) The business model of community banks is primarily to take deposits (from households and small firms) and to make loans. A very low interest rate environment does not make things easy for this model.
13) Researchers at the Federal Reserve have looked carefully at this issue and found a strong correlation between interest rates and new entry into banking over a long period of time. With regard to recent experience, they concluded: "Our results suggest that even without any regulatory changes following the financial crisis, the weak economy and low interest rate environment would have caused 75-80% of the current decline in new charters."[12]
14) This view is consistent with the assessment of James Chessen, chief economist at the American Bankers Association, who wrote recently, "Great investment options don't exist in today's abnormally low-rate environment. But even with more normal rates and a steeper yield curve, can a new bank grow fast enough to cover investor expectations?"[13]
15) Mr. Chessen adds this important point: "Every bank knows the competition is tough among banks but even harder against tax-favored competitors like credit unions and the Farm Credit System, or new online marketplace lenders."
16) In addition, Trust Preferred Securities (TruPS) were an important way that community banks raised capital between 2000 and 2007 – these are a debt-like instrument that the Federal Reserve ruled (in 1996) could be counted as Tier 1 capital. Small TruPS were securitized into collateralized debt obligations (CDOs). These securities did not on the whole perform well during the crisis.[14] Smaller banks will likely find it hard to raise capital in this way.
17) More broadly, there has been dramatic concentration in the provision of credit in the United States since the 1980s – reflecting the advantages and implicit subsidies received by very large "too big to fail" financial institutions. Most of the growth in total assets over the past 30 years has been concentrated in banks with assets over $10 billion. There has been slight growth in the $100m-$10bn segments, and actually a decline in the total assets of banks with less than $100m.[15]

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[11] Chart 4 on p.36 of "Community Banks Remain Resilient". According to the FDIC's Statistics At A Glance, there were no "new reporters" in 2014, only one (a commercial bank) in 2015, and none in the year to date in 2016.

[12] Robert M. Adams and Jacob P. Gramlich, "Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation," Finance and Economics Discussion Series 2014-113, Division of Research & Statistics and Monetary Affairs, Federal Reserve Board of Governors, Washington DC, http://www.federalreserve.gov/econresdata/feds/2014/files/2014113pap.pdf

[13] James Chessen, "The Welcome Sign Is Up for De Novos – But Is It Enough?" ABA Banking Journal, June 24, 2016, http://bankingjournal.aba.com/2016/06/the-welcome-sign-is-up-for-de-novos-but-is-it-enough/.

[14] **"By October 2010, about one-third of the dollar volume of TruPS used to collateralize CDOs had either defaulted or deferred dividend payments", FDIC, Community Banking Study, December 2012, p.6-10.**

[15] A vivid graphic to illustrate this point has been prepared by Thomas Hoenig, vice-chairman of the FDIC: https://www.fdic.gov/about/learn/board/hoenig/creditchannels.pdf. Mr. Hoenig's summary assessment is, "[I]n 1984 the distribution of assets among community, regional, and money center banks was nearly proportional, with more than 15,000 commercial banks serving a variety of borrowers, from consumers and small businesses to global conglomerates. Today, the 20 largest banks by assets control

18) The bigger issues going forward are not the details of how the FDIC treats de novo banks but rather whether legislation and regulation has done enough to create a sufficiently level playing field within banking. The lack of effective living wills for systemically important financial institutions should in this context be seen as a major concern.
19) Section B below discusses the FDIC and de novo banks in more detail. Section C reviews evidence on whether "compliance costs" are deterring entry into finance more broadly.

B. The FDIC And De Novo Banks

De novo banks have a higher failure rate than do established small banks. In a recent FDIC study, staff members conclude, "Consistent with a life-cycle theory of de novos, compared with small established banks, these de novos were financially fragile and took many years to reach maturity, relying more on non-core funding, and failed at higher rates during the recent financial crisis".[16]

Specifically, the authors found that 12.8 percent of banks chartered between 2000 and 2008 subsequently failed. This should be contrasted with a failure rate of established small banks that was only 4.9 percent.[17]

As James Chessen (ABA chief economist) puts it, "Sure, de novos are risky. They have failed at twice the rate of other banks historically. They create losses for the FDIC (which banks fund)." The deposit insurance provided through the FDIC is funded privately (through quarterly assessments on insured banks), but it is a program set up by the government and has a backup line of credit from the U.S. Treasury.

Weak financial regulation was an important contributing factor in the crisis of 2008.[18] While the FDIC did much better than the Office of Thrift Supervision or the Federal Reserve, a significant number of FDIC-insured banks failed and the deposit insurance fund suffered losses. According to the FDIC's statistics, the deposit fund suffered significant losses in 2008 and 2009 – falling from a balance of $52.4 billion in 2007 to $17.3 billion in 2008 to negative $20.9 billion in 2009. The fund has since recovered and now stands at $75.1 billion. In 2008, 25 insured institutions failed – a significant increase relative to experience in previous 15 years. The number of failures rose to 140 in 2009 and peaked at 157 in 2010.

However, helped by the long (if slow) economic recovery, the FDIC now seems to have brought the situation under control – only 8 insured institutions failed in 2015, and the number of "problem institutions" is down to 165 (from a peak of 884 in 2010).

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more than 80 percent of industry assets, and the number of banking firms has declined to less than 6,200. The group of community banks with less than $1 billion of assets, which in 1984 controlled nearly a third of banking assets, today controls less than 10 percent of industry assets." https://www.fdic.gov/news/news/speeches/spapr0616b.html#_ftn1.

[16] See p.2 of "the Entry, Performance, and Risk Profile of Do Novo Banks," by Yan Lee and Chiwom Yom, April 7, 2016, FDIC CFR WP 2016-03 (working paper), https://www.fdic.gov/bank/analytical/CFR/2016/WP_2016/WP2016_03.pdf.

[17] Lee and Yom, 2016.

[18] See Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*, Pantheon, 2010, particularly Chapters 5 and 6.

The FDIC and all regulators face significant pressures to relax standards during relatively good years. But when another downturn arrives, as it surely will, both the macroeconomy and local communities will be stronger if the FDIC has been able to maintain stronger supervisory standards over the cycle.

The costs of the previous crisis were enormous – at least one year's worth of GDP in aggregate, and disproportionately borne by lower income Americans.[19] The FDIC is entirely right to seek a balance between encouraging new entry and ensuring the safety and soundness of banks with federally-insured deposits.

C. Compliance Costs

Is there a broader issue with "compliance costs" in the U.S. financial sector, in the sense that regulation is somehow limiting the availability of credit or other financial sector services?

The FDIC has looked directly at this question for community banks. Its conclusion: "Consistent with the notion that these costs were a normal part of business, the interview participants noted that their overall business model and strategic direction had not changed or been affected by the regulatory compliance cost issues. In addition, the majority of interview participants stated that they had not discontinued offering products or services because of regulatory compliance, with the exception of overdraft protection and certain high-risk mortgage products."[20]

Three pieces of more quantitative evidence suggest that compliance costs are not currently a major brake on banking activity.

First, the latest financial results from community banks continue to show improvement. In the first quarter of 2016, community banks reported $5.2 billion in net income, which was up 7.2 percent year-on-year. Net operating revenue was up 6.9 percent from the first quarter in 2015.

Second, there are definite signs of expansion by existing banks. For example, Canadian banks are reportedly expanding their presence in the U.S. market.[21] Strong regulation in the U.S. is seen as a plus, relative to other potential international destinations.

Third, there is plenty of entry into non-banking parts of finance, for example in what is termed "on-line marketplace lending". This product line is currently quite small but growing fast and, at least until the recent problems at Lending Tree became public, it was relatively easy to raise venture capital in this sector.[22]

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[19] For a recent comprehensive and accurate assessment, see "The Cost of the Crisis: $20 trillion and Counting," a report by Better Markets, July 2015.

[20] https://www.fdic.gov/regulations/resources/cbi/report/cbi-full.pdf.

[21] Jackie Stewart, "What's Next for Canadian Banks Intent on U.S. Expansion" American Banker, July 8, 2016.

[22] The largest lenders originated over $10bn in loans in 2015. Total consumer credit in the US is around $3.5 trillion, which is typically interpreted as room to grow for this sector. See U.S. Treasury, Opportunities and Challenges in Online Marketplace Lending, May 10, 2016.

Chairman CHAFFETZ. Thank you.

Mr. Williams, you're now recognized for 5 minutes.

STATEMENT OF GUY WILLIAMS

Mr. WILLIAMS. Thank you, Chairman Chaffetz and Ranking Member Cummings. My name is Guy Williams. I'm president and CEO of Gulf Coast Bank and Trust Company in New Orleans, Louisiana.

My bank was chartered in 1990, at the beginning of a recession, with $1.5 million in capital. Over the last 25 years, we've grown into a $1.4 billion community bank serving southeast Louisiana. We are the largest small business lender in our State, specializing in helping to establish and grow new businesses, and we are also one of the area's largest mortgage lenders.

ABA appreciates the opportunity to testify on the dearth of new bank charters. New entrants into any industry are a sign of economic vitality. New banks provide more choices of competitive products and services for business and consumers, which translates into greater economic activity and growth in local communities.

The lack of de novo banks is strong evidence that the economics of new community banks don't work. Investors have options. If the impediments to starting a new bank are too great, they will invest elsewhere.

Sadly, the forces that have acted to stop new bank charters are the same ones that have led to a dramatic consolidation in the banking industry: excessive and complex regulations that are not tailored to the risk of specific institutions. This, not economic conditions, is often the tipping point that drives small banks to merge with banks typically many times larger and is a barrier to entry for new banks.

There are only seven de novos in the last 5 years. More troubling is that there are 1,500 fewer community banks than 5 years ago, a trend that will continue until changes are made that will provide relief tor America's banks.

In April, the FDIC announced some welcome but small supervisory changes to help prospective de novos through the process. Unfortunately, they do not address the underlying barriers to entry: capital hurdles, unreasonable regulatory expectations on directors, funding constraints, and inflexible regulatory infrastructure, and tax-favored competition from credit unions and Farm Credit System.

If it does not make economic sense, no one will start a new bank. Look no further than the lack of new charters for proof that something is seriously wrong. When you fix the underlying problem, new charters will result.

Gulf Coast Bank started with $1.5 million of investor capital, 4.4 million in today's dollars, and proceeded to create an institution that's helped our community thrive for more than 25 years. The current requirement is that it would take $20 to $30 million to start a bank. That's many multiples beyond what successful banks needed in the past. It's doubtful that a new bank today could earn enough to cover the cost of that capital.

There are many banks like mine that pooled local investment dollars to start a bank and built it into a strong community partner. I doubt seriously that my bank would be granted a charter today due to the capital requirements, the constraint on assets, the restrictions on funding. Couple these factors with a suffocating regulatory blanket, and I doubt that our investors would have made the investment.

To ensure the broadest possible range of financial options to our communities, we must think creatively to find solutions that simulate new bank entrants. The changes that FDIC has made are a good beginning, but much more can and needs to be done. It's time to think differently—to encourage new banks by requiring less capital, reducing regulatory burden, permitting greater flexibility in business plans, and lifting funding restrictions.

Each and every bank in this country has a direct impact on job creation, economic growth, and prosperity. Our slow recovery from the recession is partly a result of the shrinking pool of community banks. We urge Congress to act now and pass legislation to help turn the tide of community bank consolidation, create an economic environment that encourages new bank charters, and protect communities from losing a key partner supporting economic growth.

Thank you. I'll be happy to answer questions.

[Prepared statement of Mr. Williams follows:]

July 13, 2016

Testimony of

Guy T. Williams

On behalf of the

American Bankers Association

before the

Oversight and Reform Committee

United States House of Representatives

American Bankers Association

July 13, 2016

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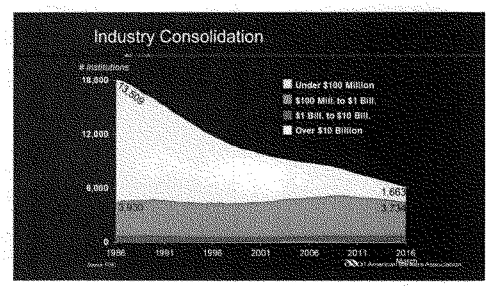
Chairman Chaffetz and Ranking Member Cummings, my name is Guy Williams and I am the President and Chief Executive Officer of Gulf Coast Bank and Trust Company in New Orleans, Louisiana. I appreciate the opportunity to be here to present the views of the American Bankers Association (ABA) regarding regulatory relief for small financial institutions. The ABA is the voice of the nation's $14 trillion banking industry, which is composed of small, mid-size, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans.

Gulf Coast Bank was chartered in 1990—at the beginning of a recession—with $1.5 million in capital. Over the last 25 years, we have used that capital to grow our company into a $1.45 billion community bank, serving southeast Louisiana. We are the largest small business lender in our state, specializing in helping to establish and grow new businesses. Gulf Coast Bank is also one of the largest New Orleans metro area mortgage lenders, making roughly $500 million in residential mortgage loans each year.

ABA appreciates the opportunity to testify on the nearly complete lack of new bank start-ups (de novo banks). New entrants into any industry are a sign of growth potential and economic opportunity. New banks help fill gaps in the provision of banking services, increase competition, and ultimately strengthen the community banking sector. New banks mean consumers and businesses have more choices of competitive products and services which translates into greater economic activity and growth in local communities.

The lack of de novo activity is concerning to our industry and sadly reflects the same forces that are driving consolidation—excessive and complex regulations that are not tailored to the risks of specific institutions. This—not the local economic conditions—is often the tipping point that drives small banks to merge with banks typically many times larger. It is also a barrier to entry for new banks. The fact remains that there are only seven de novos in the last 5 years. Even more troubling, there are 1,500 fewer community banks today than 5 years ago—a trend that will continue until rational changes are made to provide some relief to America's banks.



The FDIC has acknowledged both the vital importance of community banks as well as the need for changes to encourage de novo formations. Community banks account for 44 percent of small business loans. According to a 2012 FDIC report, there are 600 rural or micropolitan counties where a community bank is the only financial institution. If that bank disappears, there is no incentive for investors to start a new bank to serve that community (and any economic vitality will quickly disappear).

In April, the FDIC announced welcome supervisory changes, including community outreach, establishing a team of people to help prospective de novos through every stage of the process, refreshing its answers to key questions, and developing a guide to the deposit insurance application process to increase transparency. In addition, the period of heightened de novo supervision and strict adherence to the bank's original business plan—what some have referred to as the "penalty box"—was shortened from seven years to three years.

Addressing gaps in knowledge and resources is very important, but it doesn't address the underlying issues that create the barriers to entry: capital hurdles, unreasonable regulatory expectations on directors, funding constraints, an inflexible regulatory infrastructure, technology investments, and tax-favored competition from credit unions and the Farm Credit System. The 3-year penalty box, while better, still acts as a deterrent. If it does not make economic sense, no one will start a new bank. Look no further than the lack of new charters for proof of this. Fix the underlying problems and new charters will result.

Certainly the extraordinarily low interest rates over such a long period have narrowed spreads and created considerable economic stress for any existing bank or prospective de novo. But this is only part of the story. Community banks are resilient. We have found ways to meet our customers' needs despite the ups and downs of the economy, but that job has become much more difficult due to the avalanche of new rules, new guidances and the seemingly ever-changing expectations of the regulators. Let me repeat: Fix the underlying problems and you help both existing banks and encourage new bank charters as well.

Each and every bank in this country helps fuel the U.S. economy. Each has a direct impact on job creation, economic growth and prosperity. Community banks have always prided themselves on being flexible in order to meet the unique circumstances of each customer. This is why it is imperative that Congress take steps to ensure and enhance the banking industry's capacity to serve their customers, thereby facilitating job creation and economic growth.

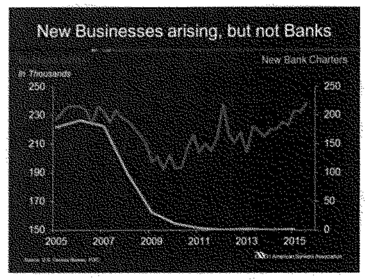
We thank House Financial Services Committee Chairman Hensarling and the members of the Committee that have worked to provide some regulatory relief. We urge members of Congress to work together— Senate and House—to pass legislation that will enhance the ability of community banks to serve our customers and help grow our economy.

In the remainder of my testimony, I would like to focus on the follow key points:

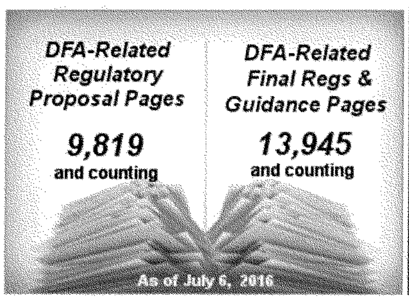
- The lack of de novos has its roots in excessive regulation,
- The constraints on assets, liabilities and capital all conspire to make new charters uneconomical, and
- In order to insure the broadest possible financial options for our communities, we must think creatively to find solutions that will stimulate new bank entrants.

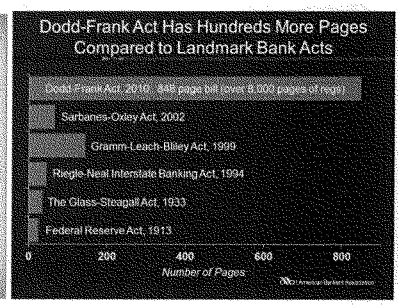
1. The Lack of De Novo Banks Has Its Roots in Excessive Regulation

In these economic times, the forces that challenge banks every day are the same as those that make starting a new bank nearly impossible. Certainly, economic conditions have had an impact. The Federal Reserve did admirable work during the recession, but quantitative easing and the zero-interest-rate policies have had real, lasting consequences. The first consequence is that we as a nation now favor borrowers and penalize savers. Great if you have good credit and want a home loan; horrible if you are a saver or retiree and need to live on your interest income. For banks, quantitative easing has compressed margins and forced longer-term lending which has raised concerns by regulators about interest rate risk. The near zero-interest-rate policy is challenging enough for existing banks, but as I detail later, it makes starting a new bank much more difficult.



A common belief is that the economic cycle is the primary obstacle for new banks. This is untrue. When Gulf Coast Bank was started in 1990, it was in the middle of the so-called "S&L Crisis" and the beginning of a recession. Despite these severe conditions, there were 193 de novos that year. ***Over the next 10 years, 1,500 new banks started***! While our bank was started during a recession—in many ways not dissimilar to the Great Recession—there were opportunities and investors who were willing to risk their own money to capitalize a new bank. Contrast that with the latest cycle: it started similarly with 181 new charters in 2007 (the start of the recession) but fell off very quickly over the next two years. Since the Dodd-Frank Act was enacted in 2010, there have only been 7 de novos with three of those started only to facilitate an acquisition of a failed bank and another for a credit union to convert to a bank. ***That means only 3 real new banks in the last 5 years***. Even more stark is the contrast between the lack of de novo bank formations and the recovery of new business formations across all industries since the recession.





Not only have regulation been piled on, even more telling is the regulatory approach that a bank should never fail. This is not only an impossible standard, it is also too risk averse. It limits new activities and growth. The first chapter in every book on entrepreneurship or economics says that capitalism is built on investors putting ideas and money to work, and accepting the very real risk that they will fail in the process.

There is no question that de novos, like all new businesses, are riskier than existing institutions. They have failed at twice the rate of other banks historically. They create losses for the FDIC (which banks fund). But most bankers believe that failures are part of any dynamic industry and de novos are where new ideas are born.

When Gulf Coast Bank and Trust Company was started, we used the capital we had to buy two failing savings and loan institutions, and quickly boosted capital from the initial $1.5 million to $3 million and proceeded to create an institution that has helped our community thrive for more than 25 years. Other de novos may not have fared so well, but without the risk taking by investors, none of this would have been possible. I doubt seriously that our bank would be granted a charter today due to the capital requirements, the constraints on assets, and the restrictions on funding. Couple those factors with a suffocating regulatory blanket, and I doubt that our investors would have made the investment.

2. **Constraints on Assets, Liabilities and Capital All Conspire to Make New Charters Uneconomical**

On both sides of the balance sheet—assets on one side and liability plus capital on the other—there are constraints that limit the economic potential of any new bank. These are detailed below:

Earning Assets are Under Stress

Community banks typically have four broad categories of assets: cash and investments, consumer loans, mortgage loans and business loans. Each of these types is under stress. For consumer lending (non-real estate), competition from lightly regulated, untaxed credit unions combined with an overwhelming and constantly increasing regulatory burden has made these loans marginally profitable at best, if not actual loss leaders. For residential mortgage and home equity lending, new requirements from the Consumer Financial Protection Bureau with help from the other regulators has made this type of lending more risky. The risk comes from an aggressive compliance culture that attempts to criminalize minor regulatory violations, combined with an inflexible definition of qualified mortgages. This means fewer banks will offer these loans, limiting choices and options for consumers.

As I mentioned, Gulf Coast Bank is one of the largest residential mortgage lenders in our state. After the new TRID rules, we found that all of the mortgage service providers raised their costs.

The closings now take longer, and because of the TRID mandated closing resets, realtors encourage home owners to only take cash offers or offers from borrowers who have locked in financing to avoid closing delays. As a result, consumers now pay more, wait longer, and have incentives not to shop among lenders because of the delays these things are likely to create. The result is fewer options for consumers as many community banks abandon mortgage lending altogether due to the added risks and costs that make it uneconomical.

The last area of profitability for consumer banks is small business lending. This continues to be profitable, but it is now under assault from the tax-free credit unions and Fintech non-bank lenders who make loans without the same regulatory costs as community banks to remain in the business.

Every earning asset held by community banks is now less profitable than it was in years past. Some of this erosion is caused by regulations, some by the interest rate environment, some by unregulated competitors, and some by untaxed and lightly supervised competitors.

For those considering starting a new bank, these stresses combine to limit potential profitability and discourage any investment. Banks compete with all other capital options, and if returns from making good asset decisions are not sufficient to generate a reasonable return, money flows elsewhere.

Funding Constraints Limit Asset Growth

Even when there are good opportunities to lend, funding those loans is the perhaps the biggest hurdle for potential de novos. Banks are funded with deposits. Recent regulations aimed at the largest banks, which take a narrow view of "stable" funding, coupled with the FDIC's aggressive definition of what constitutes a brokered deposit, have steered the industry into insured retail and small business deposits. While these deposits offer low cost funding, this narrow view of stable funding constrains banks, which incur a regulatory cost as compared to other types of funding. The limited array of acceptable funding sources hits de novo banks acutely because it takes time to build the customer relationships necessary to gather these deposits – and de novos can't compete on convenience (with few branch locations) or pay high rates.

There are many other sources of funding available that have proven to be stable and cost effective. For example, as de novo institutions build their deposit base, they may need to look for funding outside of their local market by using internet-based deposit services or partnering with a third party to help market their products and generate deposits. Unfortunately, all these are considered "brokered" by the FDIC and, as such are unlikely to be approved in the de novo's new business plan. The bottom line is that unlike most new businesses that can work every available option to gain customers and gain market share, new banks are extremely limited in their funding and product options, further detracting from the desirability of a new bank charter.

Capital Thresholds are Too High

As I mentioned, Gulf Coast Bank started with $1.5 million of investor capital—$4.4 million in today's dollars—and quickly doubled that as part of our two acquisitions. The expectation now in banking circles is that it would take $20-$30 million to start a bank. This is many multiples beyond what ***successful*** banks needed in the past. Can a bank today earn enough to cover the cost of that capital? Great investment options don't exist in today's abnormally low-rate environment. But even with more normal rates and a steeper yield curve, a new bank probably cannot grow fast enough to cover investor expectations.

The key point is that investors cannot justify illiquid investments at low yields. If de novos were a good investment that made economic sense, today there would be a lot more new banks started. Besides the enormous regulatory infrastructure that must be covered by capital (with no return, of course), the technology investment required in today's banking world is also large. Moreover, while a strong business plan for the new bank is required, there is strong resistance by the regulators to any change in that plan. A new business must adjust quickly to the rapidly changing reality of its market. But unlike most new businesses, a de novo bank must jump through regulatory hoops to chart a new course. With the 3-year penalty box and strong resistance by the regulators to any change in the business plans of a new bank, it can be nearly impossible to make the necessary adjustments quickly enough to be successful. For investors, it raises questions about success and the likelihood and timing of their potential returns.

The pressure to increase capital levels—including requirements of the Basel Capital Standards—increases the hurdle rate for any return to investors. A well-capitalized bank used to operate with 6% leverage capital. Now are being pushed to maintain 9% capital. The simple math is that earnings must increase by 50% to maintain the same return on equity. These high capital requirements mean that new banks are unlikely to make a reasonable return on equity in any reasonable time frame.

So we are back to the beginning. If investors can't see a way to make a reasonable return on investment, they won't invest. No investment means fewer new banks and slower growth for the U. S. economy.

Unreasonable Regulatory Expectations for Directors is Also an Impediment

Typically investors in a de novo institution become the first directors of the newly formed bank. This is because the capital often comes from pooled funding from leaders in the community that see a niche that could be filled by the new bank.

The significant regulatory requirements of directors in banks today—which can impose personal legal liabilities for them—make it difficult for any bank to find a good director and near-impossible for new bank. Directors are now expected to know more than can be reasonably expected, including maturity matching, hedging strategies, derivative accounting, complex asset-liability strategies, and cybersecurity risks and mitigations, to name just a few. They must then tell management how to address each of these things. Given the potential liability, the lawyers to these investors most certainly would advise against being a bank director.

3. A Creative Approach is Needed to Encourage New Bank Formations

The changes the FDIC has made are a start, but more can and needs to be done. It's time to think differently to encourage new banks—by requiring less capital, reducing the regulatory burden, permitting greater flexibility in business plans, and lifting funding restrictions. Some ideas to consider include:

- Create a fast track for new banks.
- Reduce the minimum initial capital level (e.g., to \$10 million) and reduce the required capital ratio for the first three years (e.g., to 6%). The goal is enable the new bank to generate earnings and grow quickly enough to become profitable and sustainable.
- Further reduce the "penalty box" and enable changes in the bank's business plan.

- Allow a new bank to fund itself in the least-cost most efficient way without regard to the source.

- Define any mortgage loan held by the bank on its own balance sheet as a "Qualified Mortgage."

- Address the unfair competition from tax-favored providers such as credit unions and the Farm Credit System.

Simply put, Congress can help by eliminating unnecessary impediments which negatively impact every community across the United States. This will help stem the tide of community bank consolidation and create an environment conducive to new bank charters. The key to changing the consolidation trend is to stop treating all banks as if they were large and complex institutions. All too often, regulations intended for the largest institutions become the standard that is applied to every bank—Basel III capital requirements being the most egregious. (The Europeans who designed the Basel Accords are shocked that the U.S. regulators chose to apply them to community banks.) Such an approach only layers on unnecessary requirements that add little to improve safety and soundness, but add much to the cost of providing services—a cost which customers ultimately bear. A better approach to regulation is ***tailored*** bank supervision that is responsive to the charter, business model, and scope of each bank's operations. This would ensure that regulations and the exam process add value for banks of all sizes and types. By facilitating new bank charters, new capital will flow into the entire banking system as it would signal the potential for growth and success.

Conclusion

New entrants into any market reflect the promise of a better tomorrow. For banks, new entrants bring new ideas and technologies, expand the financial choices and opportunities of businesses and consumers, and fill gaps where banking services may not have fully met the needs.

The lack of de novos banks is strong evidence that the economics no longer work. Investors have plenty of choices about where to invest, and if the impediments to starting a new bank are too great, they will quickly move their money to opportunities with greater promise. The forces that have acted to stop de novos are the same ones that have led to the dramatic consolidation of the banking industry. Fix the underlying problems and the future will be brighter for both new and existing banks.

Community banks—whether new ones or old—have a personal stake in the economic growth, health, and vitality of nearly every community. A bank's presence is a symbol of hope, a vote of confidence in a town's future. When a bank sets down roots, communities thrive. We urge Congress to act now and pass legislation to help turn the tide of community bank consolidation, create an economic environment that encourages new bank charters, and protect communities from losing a key partner supporting economic growth.

Chairman CHAFFETZ. Thank you. Thank you, all.

We'll now recognize myself for 5 minutes.

Chairman Gruenberg, on page 1 of your testimony, you say that FDIC institutions are posting record profits, and yet, on page 6 you say that the profitability ratios are below pre-crisis levels, making it unattractive to start a new bank. Which one is it?

Mr. GRUENBERG. It's actually both. The industry, as a whole, as we've documented over the past several years, has been gradually but steadily recovering from the financial crisis. So on most of the major metrics of performance—net income, credit quality, and loan balances—the industry has been getting better.

But it's something of a tribute to the industry that they have been able to do that in an economic environment of very low, historically low interest rates, and low net interest margins. So that the margins they are able to generate on their loans are narrow, but they have actually been able to compensate for it. And this is particularly true of community banks by expanding lending activity.

Chairman CHAFFETZ. I just think it's inconsistent for you to suggest that there is not—that the profitability ratios are so low that it's unattractive to file an application at the same time you say that there are record profits. People do want to get into this business and service the need and the demand that's in the economy.

Ninety-four percent of all bank applications since 2009 have not been approved—94 percent. Do you really believe that all those bank applications don't meet the needs of the communities? I mean, are we really supposed to believe that 94 percent of the applications were insufficient?

Mr. GRUENBERG. If I may say, Mr. Chairman, 2009 was the second year of the financial crisis, probably the most severe financial crisis at least since the Great Depression.

In 2009, we had——

Chairman CHAFFETZ. I know, but to date.

Mr. GRUENBERG. No, but I'm just—I'm saying——

Chairman CHAFFETZ. How many have you approved to date since 2009?

Mr. GRUENBERG. What I can say is, between 2000 and 2007 we——

Chairman CHAFFETZ. That's not what I'm asking you.

Mr. GRUENBERG. No, but my point is, Mr. Chairman, if I may just respond, we've had a post-crisis environment really since 2009 which is in some measure unprecedented. We had the most—severest financial crisis——

Chairman CHAFFETZ. You're not answering my question here.

Mr. GRUENBERG. Well, I'm trying to explain that we've had the longest prolonged period of near-zero interest rates in our country's history.

Chairman CHAFFETZ. At the same time you're posting record profits.

Mr. GRUENBERG. Yeah.

Chairman CHAFFETZ. And you're not approving any applications. That's the problem.

Mr. GRUENBERG. We're not—if I may explain—we're not receiving applications. And the reason for that is——

Chairman CHAFFETZ. Ninety-four percent of the ones you did were not approved. You only approved three.

Mr. GRUENBERG. Well, you have to—we've had a small number of applications, as you know, and we have an environment in which it's difficult for an institution to demonstrate a viable business plan.

We've had established institutions coping with the challenging environment by generating larger volumes of loans to generate revenue.

Chairman CHAFFETZ. You're not answering my question.

Mr. GRUENBERG. Well, I'm trying to.

Chairman CHAFFETZ. I know, but you're not. That's what I'm explaining to you. You may be trying, but you're not answering the fundamental question.

Mr. GRUENBERG. For new institutions to get over the hurdle they not only have to be able to generate revenue, but they also have to get over the fixed cost of establishing the institution. And in a near-zero interest rate environment, that becomes particularly challenging.

Chairman CHAFFETZ. But they're posting record profits. So you can't have it both ways. And my fundamental challenge is that you've only approved three, and that's highly suspicious in a—I think there's more systemic risk, because the cruel irony of all this is there are fewer institutions that have more leverage, more of the play.

And so you have very large institutions out there that are trying to get into this business. You have applications that are pending for a long period of time. One application has been pending since 2008. Another application is showing pending since 2009.

I mean, how long does it take to go through these applications? You and I have talked about this in my office, and I still don't understand—that's why we're having the hearing—I still don't understand why it takes so long.

Mr. GRUENBERG. Well, I think for the—without speaking to a specific application, I think—as you know, the ones that are pending relate to investor loan companies. There was a more than 3-year moratorium period and an additional moratorium period, I think, during——

Chairman CHAFFETZ. Is that still in place?

Mr. GRUENBERG. No, it expired in 2013.

Chairman CHAFFETZ. And have you approved any since then?

Mr. GRUENBERG. And I believe the applications you are referring to have not really been pursued by the applicants since that time.

Chairman CHAFFETZ. But they're still pending?

Mr. GRUENBERG. They're still pending.

Chairman CHAFFETZ. What are they supposed to do? I mean, they're pending. Do they have to come and say, "Will you please continue to do your work?"

I mean, these institutions, they've spent seven figures putting these things together. Why aren't you—if they're still pending, why aren't you taking action on them?

Mr. GRUENBERG. The applications, as they currently stand, Mr. Chairman, I don't think would meet the standards, and the institutions have not pursued them.

Chairman CHAFFETZ. They have pursued them. They're pending before your body.

Mr. GRUENBERG. But they're no longer actively engaging with us on the application, I believe, Mr. Chairman.

Chairman CHAFFETZ. So they submit the application, they've done everything they're supposed to do, and it's still pending, and they need to show activity?

You state that you're going to put out some guidance, right? When is that going to happen?

Mr. GRUENBERG. I think we're going to do it, I think, before—over the course of this year.

Chairman CHAFFETZ. No, no, no. Give me—come on. Give me a date.

Mr. GRUENBERG. Assuming before the end——

Chairman CHAFFETZ. How long have you been working on it?

Mr. GRUENBERG. As I indicated——

Chairman CHAFFETZ. When did you start the process of coming up with the guidance?

Mr. GRUENBERG. We've already issued guidance, as I mentioned, in 2014 and 2016——

Chairman CHAFFETZ. No, no, no. You're not answering the question. I'm sorry I'm going over time here. But this is a very simple question. You put it in your opening statement, okay?

Mr. GRUENBERG. Yeah.

Chairman CHAFFETZ. When will you actually complete this exercise? When did you start it and when are you going to publish it?

Mr. GRUENBERG. I believe we began it earlier this year, and I believe we'll publish it before the end of the year, Mr. Chairman. And if you like, I'll come back to you with a specific timeframe for doing that.

Chairman CHAFFETZ. That would be great.

I've gone past my time. Let me now recognize the gentleman from Maryland, Mr. Cummings.

Mr. CUMMINGS. Let's start. Let me make this clear.

Mr. Browning, what do you think—why do you think people are holding up your application? Let me get down to the nitty-gritty. Because apparently, I mean——

Chairman CHAFFETZ. I don't think he necessarily said that.

Mr. CUMMINGS. Well, he's here testifying. He's upset.

Are you not?

Mr. BROWNING. I am.

Mr. CUMMINGS. What do you think is the motive? Why would they deny your application? I mean, do you think they just don't like you? I'm serious. I mean, what is it? And I'm not trying to be smart. I'm just trying to figure out—I'm trying to get to the bottom of this.

Mr. BROWNING. No, I don't think it's personal.

Mr. CUMMINGS. Then what do you think it is? Do you think it's competition, they're trying to protect competition?

Mr. BROWNING. I believe the FDIC has yet to come out of crisis mode. I believe it's acting much more as an insurance company and less as a regulator governing safe and sound institutions. I think it is some lingering shell shock from the crisis and it is loath to accommodate new banks, which, historically, new banks are a bit riskier. But in terms of true risk to the Deposit Insurance Fund, it's de minimis. In terms of risk to the system, it's de minimis.

And, in my example, we came forward with $30 million in capital. Our business plan showed profitability at the end of year 1. And we were effectively stonewalled for an extended period of time.

Mr. CUMMINGS. So you think they're being too careful, basically? Is that what you are saying?

Mr. BROWNING. Yes, sir.

Mr. CUMMINGS. All right.

Now, Mr. Chairman, how did the insurance fund fare during the financial crisis?

Mr. GRUENBERG. Well, as you——

Mr. CUMMINGS. I can't hear you.

Mr. GRUENBERG. As you know, Congressman, over 500 institutions failed since 2008. The Deposit Insurance Fund was actually depleted during the course of the crisis and as a result of the failures.

At the low point, the Deposit Insurance Fund was actually $20 billion in the red, and we were placed in the position of having, first, to impose a special assessment on the industry to bring in liquidity to manage all of the bank failures and then had to impose a prepaid assessment on the industry to bring in further liquidity to manage the failures and support the fund.

Since the crisis, we've been able to rebuild the fund and——

Mr. CUMMINGS. Okay. I've got. I only have limited time here. I just wanted to get that. You told me what happened.

The number of new bank charters is significantly lower in the years since the financial crisis than in the years before the crisis. Professor Johnson, what do you believe accounts for the decline in the number of new bank charters?

Mr. JOHNSON. The primary explanation, Congressman, is the low interest rates. And I think the reconciliation of the points Mr. Chaffetz was making earlier is, for existing banks, if you have existing loans at relatively fixed rates, yes, there's some return to profitability.

But if you're a de novo bank that doesn't inherit these loans, that actually holds a lot more in Federal funds, for example—this is all in the Fed paper Mr. Browning was trying to cite—it's all there. It's all clearly documented. The profitability for a de novo on a forward-looking, prospective basis, as being valued by the FDIC, is very low. In fact, it's lower than it's ever been in recorded data.

Mr. CUMMINGS. In an article published on June 24, 2016, by the American Bankers Association, the ABA's chief economist, James Chessen, wrote, and I quote, "Great investment options don't exist in today's abnormally low rate environment," end of quote. Mr. Williams reiterated that today in his written testimony.

Professor Johnson, do you agree with the concerns expressed by Mr. Williams and the American Bankers Association's chief economist?

Mr. JOHNSON. Yeah. I think Mr. Chessen's article was spot on in that regard. Low interest rate environment, very hard for investors to make money. And if you're the insurance company—remember, the FDIC is not chartering any banks at all, none. The FDIC provides—agrees to provide you with deposit insurance or not.

So from an insurance company perspective, evaluating the risks, if they can't make any money, if they're not going to be profitable because of this low interest rate environment, that's substantially higher risk, and you should, therefore, on a prudent basis be less willing to provide them with insurance.

Mr. CUMMINGS. Mr. Williams also stated in his written testimony that he started his bank in 1990, quote, in the middle of a so-called S&L crisis and the beginning of a recession; despite these severe conditions, there were 193 de novos that year, end of quote. He compares that with the current business cycle.

Professor Johnson, are there differences between that business cycle and this one? And how do interest rates compare?

Mr. JOHNSON. There are huge differences, Congressman. Mr. Williams' achievement is impressive, let me be clear, but there was a very different interest rate environment. Interest rates did not fall anywhere near the level that they are today or they've been since the financial crisis. For the past 8 years almost we've had extremely low interest rates. There's a very, very different world than anything we have ever seen in the United States.

Mr. CUMMINGS. The American Bankers Association chief economist also wrote this quote, "Sure, de novos are risky. They failed at twice the rate of other banks, historically. They create losses for the FDIC," end of quote.

Professor Johnson, is Mr. Chessen right? Is that correct?

Mr. JOHNSON. Yes, I think Mr. Chessen is actually citing the same Federal Reserve research that I was talking about. That's what they've documented very clearly in the data, a failure rate of de novo banks two times established banks. And as Mr. Gruenberg already said, there's a lot of failures between years 3 and 7 in that, which is why they heightened or extended the de novo scrutiny period in 2009.

Mr. CUMMINGS. What trends were observed regarding the failure rates of new banks during the crisis? Were adequate safeguards in place prior to the financial crisis to ensure that risky new banks were not approved?

Mr. JOHNSON. Well, the FDIC has looked at this carefully, and I cite the research in my paper. I think it's good research. They found a lot of de novos failed, including this recent episode.

Now, the FDIC is not charged with making sure that zero banks fail. It's an insurance company, so some failure is acceptable, as long as it's covered by the premium.

Another key issue is, over the cycle, what happens to deposit funds. That's a really tangible, you know, hard-to-argue-with measure of how this insurance company did. And as Mr. Gruenberg said, they were negative $20 billion. So they were on the side slightly of allowing too many banks with not very good prospects over the business cycle to enter.

You know, I think, looking back and seeing how they managed to build it up, it's hard to complain too much. I don't think the FDIC did a bad job on financial regulation. But there's no way that they were shutting out the banks or preventing them from entering, and I don't think that's the business they're in today.

Mr. CUMMINGS. My last question. Professor Johnson, if the FDIC were to weaken its regulations in an effort to jump-start applications, would that help or harm the insurance fund?

Mr. JOHNSON. It would create greater risk for the insurance fund, and over the cycle you would have bigger losses. Those losses would be covered by larger assessments, both on an income statement basis and on a cash basis, from the industry. The taxpayer is exposed to some risk. Deposit funds have failed in other situations, in other countries, at other moments of U.S. history. I don't think FDIC would fail. I think it's the bankers and the banking industry that would ultimately pay. And I don't think that's what the industry wants, and I don't think that's what the economy needs.

Mr. CUMMINGS. Thank you.

Chairman CHAFFETZ. We now recognize the gentleman from Ohio, Mr. Jordan, for 5 minutes.

Mr. JORDAN. Mr. Johnson, so what's going to happen when we go to negative interest rates? We're not going to have anyone apply, anyone be approved. Is that right? If the argument is that the Fed keeping low interest rates, we're not getting any more banks, what happens when we go negative? Which my understanding is some European countries have already done that.

Mr. JOHNSON. Well, it's a fascinating hypothetical, Mr. Jordan. Certainly——

Mr. JORDAN. I don't know if it's all that fascinating. It seems like it's pretty realistic right now based on what I'm reading.

Mr. JOHNSON. Well, it certainly has happened in Europe. I don't think we're—that's an imminent development in the United States. But, yes, to your point, if interest rates are negative, that is going to squeeze the net interest margin further.

Mr. JORDAN. Hurts competition, hurts the consumer, right?

Mr. JOHNSON. Well, in terms of net interest margin, it's certainly going to be difficult for de novo community banks.

Mr. JORDAN. Well, all I'm hearing is about community consolidating, and you're telling me no new ones are going to be created because the FDIC is not going to give them insurance because the rates so low and the chances of them making a profit is so low. Then, if we go negative, it's going to be even worse, further hurting competition, therefore hurting the consumer, all because the Fed—I mean——

Mr. JOHNSON. Well, look, if you want to talk about the consumer, we should be talking more broadly about all of finance and entry into the financial sector, including the impact of fintech, which, as you know, is substantial and growing.

So that conversation about the consumer is not only about community banks. But to the extent we're focused on de novo community banks, it's certainly not going to be helpful to the issues that the chairman has put before us today.

Mr. JORDAN. Exactly.

Let me switch gears. I wasn't planning on asking that, but you've got me thinking.

Mr. Gruenberg, you ever hear of Operation Choke Point?

Mr. GRUENBERG. Yes, Congressman.

Mr. JORDAN. You ever, at FDIC, ever have any interaction with the folks over at Justice Department regarding Operation Choke Point?

Mr. GRUENBERG. As you know, Congressman, our inspector general did a review of that, and the finding of the inspector general's report was that the FDIC played an inconsequential role.

Mr. JORDAN. That's not what I asked. Did you have interaction with the Justice Department regarding Operation Choke Point?

Mr. GRUENBERG. I think the IG report found that there was some legal staff level——

Mr. JORDAN. Did some of your lawyers talk to some lawyers at Justice about Operation Choke Point?

Mr. GRUENBERG. No, I think it was about specific institution that the Justice Department had questions on.

Mr. JORDAN. You send out financial institution letters, right?

Mr. GRUENBERG. Yes, sir.

Mr. JORDAN. Is there, like, a formal letter that goes out to banking institutions? Am I getting this right? And it's viewed as formal guidance documents, right? The banks take these things seriously?

Mr. GRUENBERG. I think that's fair to say.

Mr. JORDAN. All right. And you said your outreach with Justice Department and your working with Justice Department on Operation Choke Point was rather limited, even though your lawyers talked to them about it. But I look at this letter that you sent back in January of 2012, managing risk and third-party payment processor relationships. Do you remember this letter?

Mr. GRUENBERG. I don't know specifically what you're referring to, but——

Mr. JORDAN. Page 8 of this letter you talk about high-risk activity, and you give a list—ammunition sales, firearm sales, payday loans, travel clubs, to name a few. Do you remember this letter?

Mr. GRUENBERG. Yes, sir.

Mr. JORDAN. Yeah. First time I've seen the list. The list looks very familiar to the same kind of institutions the Justice Department targeted in Operation Choke Point. Would you agree with that statement, Mr. Gruenberg?

Mr. GRUENBERG. I really can't speak to what the Justice Department program was, since we were not a participant in it. What I can say is that back in 2011 there was an article published in a Supervisory Insights Journal that the FDIC produces on managing third-party——

Mr. JORDAN. Well, it sure looks very similar to me what Operation Choke Point was doing, going after the same kind of businesses and telling banks, hey, you want to steer clear of these. I've talked to folks who say, you know what, the folks we were doing business with, our bank, said, we've got this notice, and our bank said, we no longer want to do business with you; even though you're in a legitimate business selling firearms or in a legitimate business providing payday lending, we're no longer going to do business with you because you're now viewed as high risk and we're getting all kinds of pressure, even though we may have done business with you 20, 25 years.

Mr. GRUENBERG. All I can say is our inspector general did look at that issue——

Mr. JORDAN. And all I can say is, here's the list, and the list looks very familiar.

Mr. GRUENBERG. I understand. And because of the——

Mr. JORDAN. And then we have this. I guess, here's—I've got just a few seconds. But we just heard from the chairman you're not approving anybody. We've got the interest rate issue as the reason you're citing. But the fact is, you're not approving anybody and it's different than it's historically been.

Then we see this list of folks. I'll tell you what this looks like, Mr. Chairman, it looks—because we've dealt with this issue a lot in this committee—it looks exactly like what the Internal Revenue Service did. They said to folks who were at that applying for tax-exempt status, no, we're going to harass you, you've got to fill out a bunch of forms, we're going to keep asking a bunch of questions, we're not going to approve you.

And they targeted them, just like this list seems to be targeting certain types of businesses that you don't like, and obviously the Justice Department didn't like, as evidenced by Operation Choke Point. That's what it looks like.

Mr. GRUENBERG. Candidly, Congressman, I don't believe that was the case. And I think the IG——

Mr. JORDAN. But do you see the similarities?

Mr. GRUENBERG. Sir, I can't speak to that. All I can say——

Mr. JORDAN. Well, I can, and I do.

Mr. GRUENBERG. Our inspector general reviewed this particular issue and didn't find any support for that, I believe.

Mr. JORDAN. Mr. Chairman, I yield back.

Chairman CHAFFETZ. I thank the gentleman.

We now recognize the gentlewoman from New Jersey, Ms. Watson Coleman, for 5 minutes.

Mrs. WATSON COLEMAN. Thank you, Mr. Chairman.

Chairman Gruenberg—is that correct?

Mr. GRUENBERG. Yes.

Mrs. WATSON COLEMAN. Yes, thank you. I want to follow up on a question the chairman asked. There are a couple applications you said that are pending for de novo banks, but you said that there's been no action on them. So are they considered dead file? Because "pending" suggests to me that something is happening with those applications or with whatever is before you.

Mr. GRUENBERG. No, there are a couple of active applications by parties interested in establishing de novo banks that are under active consideration. I think the chairman was referring to applications that were actually filed several years ago, prior to the crisis.

Mrs. WATSON COLEMAN. Before. Right. And so those applications, are they pending or are they dead?

Mr. GRUENBERG. They're technically still pending, but they're not active because the applicants really haven't been pursuing them since the crisis.

Mrs. WATSON COLEMAN. Well, pending suggests to me that something——

Mr. GRUENBERG. Yeah.

Mrs. WATSON COLEMAN. Pending suggests that there's something that is expected of them or is expected of you to tell them what they need to do in order to move through the process. And so that's confusing to me.

Mr. GRUENBERG. No, I think you raise a fair point. And as I indicated, we're going undertake a review or undertaking a review of our application process and procedures. And I think we need to resolve that issue so that an application shouldn't be outstanding for that period of time.

Mrs. WATSON COLEMAN. Right. It shouldn't be pending and be dead at the same time, right.

Mr. GRUENBERG. Right.

Mrs. WATSON COLEMAN. According to reports issued by the FDIC in 2013, nearly 8 percent of households in the United States were, quote, "unbanked," meaning that they did not have bank accounts. One of five households was, quote, "underbanked," meaning that the household had at least one bank account but also used alternative financial services, with the most common sources for alternative sources being grocery, liquor, convenience, or drugstores, or even, I guess, check-cashing stores.

Dr. Johnson, what challenges do consumers face in obtaining basic banking services from these institutions, these alternative institutions?

Mr. JOHNSON. Well, Congresswoman, as you know, these alternative financial institutions charge very high rates of interest. The terms and conditions they provide are not always fully transparent. There are many instances of, frankly, predatory behavior in that industry.

And, partly, I think it's about the consumers not understanding what they're getting into, not realizing how expensive this is. But as Mr. Cummings already said, there is an issue of how readily available are reasonable financial—affordable financial services in that community, and that that's clearly a big problem.

Mrs. WATSON COLEMAN. Thank you, Dr. Johnson.

Mr. Gruenberg, FDIC, you indicated you're committed to increasing participation of unbanked and underbanked households in the financial mainstream. What does that mean? What are you doing or what do you propose to do and what is the timeframe for doing those things?

Mr. GRUENBERG. As you indicated, Congresswoman, that's a significant issue in our financial system. We, the FDIC, actually partnered with the Census Bureau on the first survey ever done on who's unbanked and underbanked, and we've been focusing on trying to respond to this issue over the last several years. Among a number of things we've done, we've developed so-called model transaction accounts, which are low-cost account-based debit card accounts with no overdraft fees as a condition of the account.

And as a result of our work, a number of major financial institutions across the country are now offering these low-cost threshold accounts that really reduce the barriers to entry and expand the ability of people to get into the banking system, and we think that's actually a very, very important objective to pursue.

Mrs. WATSON COLEMAN. Thank you.

In a lot of communities, the impact of the Great Recession is still very profound, and many individuals are continuing to suffer from it, entrances and exits from the banking system.

Mr. Williams, what steps has your bank taken to reduce the number of unbanked and underbanked in Louisiana?

Mr. WHITE. Our bank is a blue collar as opposed to a blue blood bank. We operate in a number of parishes from Baton Rouge down to St. Bernard, and we provide free checking. So it doesn't get better than that. We advertise it, promote it, we also provide debit cards and payment cards that you can use. But the essential service that we provide is free checking.

Mrs. WATSON COLEMAN. Thank you very much.

Thank you, Mr. Chairman. I yield back.

Chairman CHAFFETZ. Thank you. I now recognize the gentleman from Michigan, Mr. Walberg for 5 minutes.

Mr. WALBERG. Thank you, Mr. Chairman, and thanks to the panel for being here. Reading information in preparation for this hearing and seeing the fact that we have the lowest number of banks in the United States, since records being kept to 1934, is a concern. I mean, the reason why this country, as I recollect, is the greatest country in the world based upon only a short period of time of being alive as a country, 240 years, is because we had the ability to take risk and develop reward to get capital into the marketplace, into the hands of people who can generate opportunity for people.

So to hear concerns fostered in the last 8 years about trying to protect us against what has really made us great and oversee in such a way that we hold back the genius of what compounded interest, capital being freely and relatively easy to gain if you have the process in place that says will you take that risk on me is a concern.

Mr. Browning, your testimony says that constantly evolving and ambiguous requirements at the FDIC are putting up roadblocks to new entrance. Could you expand and describe the situation in a little more detail?

Mr. BROWNING. Certainly. Congressman, thank you.

As we engaged in our process, we put forward a plan with great detail on our loan programs tapping into an existing client base. We brought $30 million in capital, showed profitability in our first year. We had an exceptionally stable low cost deposit base built into the program and a variety of other things. There were vague suggestions that our deposit program was inadequate even though we had ready available deposits well in excess of four to five times what the bank would need in its first 3 years of life.

There were additional suggestions of entering new lines of business such as SBA lending. And SBA lending is a great program, for sure, but it is not something we contemplated it with outside our expertise. We didn't have the infrastructure staff to originate such loans to service them, to sell them.

Mr. WALBERG. And yet you are not a novice in the field?

Mr. BROWNING. Not at all, sir. And so it was expanding infrastructure, expanding processes in ways that were outside of our core plan, outside of our profile, and to us, introduced increased risk and increased cost, and were certainly not part of the statutory requirements of chartering a new bank.

Mr. WALBERG. Which is not the reason why you're getting into that line of work. You need to develop the risk as you determine as best to meet your agenda, which is, I would assume, to succeed and succeed for the people that use your resources.

Mr. Williams, in your written testimony you mention that regulations are more detrimental to a bank's profitability than low interest rates. Why is that?

Mr. WILLIAMS. Regulations cost time and money and hurt both the bank and the consumer when they are overburdensome. And a good example is the new TRID regulation. We are one of the largest mortgage lenders in southeast Louisiana.

When TRID came in, all of the service providers raised their cost because, under TRID, if there is a change in cost, you have to redisclose and it resets the time period, so every cost went up. When TRID went in, the closings were delayed, and when TRID went in, the realtors, in particular we have some markets in New Orleans right now, Uptown and the Marigny, where they are very active markets. Realtors would say to consumers, if you don't have your financing either all cash or locked in, we're going to tell the seller not to take your offer because the TRID delays are just too cumbersome. So it's a triple play.

The consumer now has a slower closing, pays more, and has less ability to shop. But when CFPB harms the consumer like that, there's nowhere to go because there is no oversight of CFPB. So that's a regulation that cost us money, cost the consumer money, and hurts everybody.

Mr. WALBERG. It takes the natural rhythm that would be in place in those types of dealings and puts it on its ear, doesn't it?

Mr. WILLIAMS. It does. And I mean, it's counterproductive. It doesn't help the consumer, it doesn't help the bank, it was—and it's unfortunate, but that's an example of an overburdensome regulation that's unhelpful.

Mr. WALBERG. And you truly believe that if all of this was in place when you started back in 1990, that you probably wouldn't have started up the bank?

Mr. WILLIAMS. Well, I was a little scared listening to Mr. Browning talk about spending so much money to apply. We put up all the money we had, which was a million five. We couldn't have afforded all the consultants that were necessary, and it just wouldn't be possible.

And I think of what would be missed. You know, there is a charter school in New Orleans that funds—that has students that are all inner city, but yet all 400 students graduate and go to college. When that charter school started, they went around the city looking for a line of credit. We were the only bank that would provide it. They think that they wouldn't be open absent our bank. I'm an honorary member of the Warren Easton Hall of Fame because of that.

Well, how do you measure the things that don't occur when you don't charter banks? We're missing an awful lot of success because we want to prevent a small potential failure.

Mr. WALBERG. Thanks for your service. I yield back.

Chairman CHAFFETZ. I thank the gentleman. I now recognize the gentlewoman from Michigan, Mrs. Lawrence for 5 minutes.

Mrs. LAWRENCE. Thank you, Mr. Chairman.

I understand that part of the application process, there is numerous conversations typically occur between the applicant and the FDIC before a formal application is filed. Chairman Gruenberg, what types of conversations occur?

Mr. GRUENBERG. We actually encourage what are called prefiling meetings with interested groups looking to establish a new institution to walk them through the application and the requirements, to answer questions, and to give them the sense of what's involved in the undertaking. And actually, we may engage in multiple meetings as the group tries to inform itself about the requirements and what would be expected.

Mrs. LAWRENCE. Is this before—is this an interest in an application or there is an official application filed and then you start having these pre-conversations?

Mr. GRUENBERG. Actually both. Oftentimes we encourage groups, before they actually submit the application, to come in and have what we call a prefiling meeting so that we can establish up front what the requirements are and sort of walk them through the process. And then once the application is actually submitted, we'll then follow up with them in terms of trying to fulfill all of the requirements.

Mrs. LAWRENCE. Mr. Browning, you have had some concerns. Would you say this has been your reality?

Mr. BROWNING. I certainly appreciate the intent of the chairman and believe that to be very genuine, but I think the reality is quite different. We went through many months of conversations with regional staff, and that went well, regional FDIC and State regulatory staff.

Mrs. LAWRENCE. Okay.

Mr. BROWNING. Once we engage in our prefiling meeting, that formal presentation the chairman referenced, things turned very differently from there forward. The process was taken from San Francisco, the regional office that had jurisdiction, taken back to Washington, and that's when very unusual questions, very novel criterion suggestions began to be made.

Mrs. LAWRENCE. So if I could try to interpret your comments. There were conversations, but you felt that they were not productive and the type——

Mr. Chairman, you've heard that comment. Do additional discussions occur between the applicant and the FDIC, after the application is filed, and where do you think the breakdown is, at least for Mr. Browning?

Mr. GRUENBERG. You know, I can't speak——

Mrs. LAWRENCE. You need to turn on your mike.

Mr. GRUENBERG. Sorry. I can't speak to the specific case of Mr. Browning. I do think the application process is generally a very hands-on process with applicants.

Mrs. LAWRENCE. Yeah.

Mr. GRUENBERG. And we do go to great lengths to work with applicants. I can tell you that in terms of the general experience from 2000 through today, applications are generally processed and decided on in a 4- to 6-month period. That's the overall experience. Obviously there are going to be instances where that may not be the case. That may be the instance with Mr. Browning, but I couldn't speak to that specific circumstance.

Mrs. LAWRENCE. Mr. Chairman, can you tell me what have you done? What can you state that you've done to welcome new applicants?

Mr. GRUENBERG. We are very much focused on this, and we've done a number of things, as I indicated in my testimony. We brought together—you know, in any application process, it's not just the FDIC, but the chartering agency, whether the State or Federal agency has to participate, so we brought the other chartering agencies together with us to work through the application process.

We are going to be holding outreach meetings in regions across the country where we are going to meet with interested parties in the industry to talk about the application process and how we can work with them if they're interested in applying. We are developing a manual which will really provide specific guidance on how to go through the application process.

So, you know, we are prepared to do everything we can to lower the process procedure hurdle of getting through the application. But——

Mrs. LAWRENCE. Chairman, I just want to say, on the record, I would like to hear this from you. Do you identify that there has been a high rate of denials of new applications and that you are implementing new practices, or are you stating that the history of the applicants not being approved had nothing to do with your process?

Mr. GRUENBERG. I think what we're seeing, in the period before the financial crisis, 2000 to 2007 where there were over 1,000——

Mrs. LAWRENCE. Yes, I understand.

Mr. GRUENBERG. There was a 75 percent approval rate.

Mrs. LAWRENCE. Okay.

Mr. GRUENBERG. So there's a high level of approval. It's really this post-crisis environment in which both, there was a severe economic downturn and a historically long period of almost zero interest rates.

Mrs. LAWRENCE. So are you doing new innovative things recognizing that has happened?

Mr. GRUENBERG. You know, we can't change the economics in terms of what interest rates are. We are trying to do everything we can within our own process to make it as responsive as we can to applicants and to at least lower the barrier of the application process itself.

Mrs. LAWRENCE. Mr. Chairman, I yield back.

Chairman CHAFFETZ. I thank the gentlelady. Now recognize the gentleman from North Carolina, Mr. Meadows for 5 minutes.

Mr. MEADOWS. Thank you, Mr. Chairman.

Mr. Gruenberg, how will you rate the FDIC on a scale of 1 to 10 with 10 being the highest as a user-friendly organization as it relates to the application process?

Mr. GRUENBERG. It's probably not for me to judge. I would like to think——

Mr. MEADOWS. Well, I'll judge it if you don't, so go ahead and give me a number.

Mr. GRUENBERG. I think we do a pretty good job between 5, 7, 8, but I think we can do better, and I think that's going to be a priority.

Mr. MEADOWS. Okay. Let me tell you the reason why I ask that, Mr. Gruenberg, because there is a belief that you have a retaliatory environment in the FDIC. And I'm here to tell you that the reason why I'm not going to give you real examples by banks is because they're afraid that you will come after them. And I'm here to tell you that I'm not going to allow that to happen.

So let me give you some real examples, since you're talking hypothetically, let me give you some real examples. You've heard from Mr. Browning and Mr. Williams. Is there any reason why you would only have a 4 percent approval rating, in an environment that's encouraging new banks, other than low interest rates, because you're looking at a business model, and I was a business guy, and actually—you know, Mr. Johnson actually was in North Carolina.

I knew Mr. Fuqua of which the school of where he practiced, I knew him personally. And so here's what I'm saying is, this retaliatory environment is very concerning. So how do you respond to that? Do you retaliate or do you not?

Mr. GRUENBERG. I do not believe we do, Congressman.

Mr. MEADOWS. Okay. Well, I'm aware of some communications, from your FDIC personnel from here in D.C., that says we're going to teach them a lesson, we're going to go after them, we're going to make them sweat. Would you like copies of those emails in—because let me tell you where I have—from a regulations and a regulatory standpoint, that is inexcusable. Wouldn't you agree with that?

Mr. GRUENBERG. I would.

Mr. MEADOWS. All right. So if that happened and you're going after people, what are the consequences for those that have that kind of environment and have been sending out those kinds of emails? Will you fire them?

Mr. GRUENBERG. Congressman, you know, I'd be reluctant to speak in the general on something like that. You have to look at the specific situation and the facts.

Mr. MEADOWS. But if they retaliated against somebody, will you get rid of them?

Mr. GRUENBERG. Congressman, I would want to be very careful to look at the facts of a particular situation.

Mr. MEADOWS. All right. Well, I'm going the give you the facts because let me tell you what I've got concerns about. Is I've got regulators that come in, and what they do is they say: Well, we need to make more loans to people that are underserved. And you tell that same bank: Well, you need to watch your aging process because it's going 30, 90 days. And when the banker tells your regulators that those are two conflicting issues, you know what your regulator said? True statement. You're the banker. You figure it out.

Now, that is deplorable. Wouldn't you agree?

Mr. GRUENBERG. The way you describe it, sir, I wouldn't—I'm not taking issue.

Mr. MEADOWS. Okay. I'm going to give you the benefit of the doubt to believe that somewhere in your organization these kinds of things are just not rising to your level. But here's where I'm going to tell you, I'm going to work with the chairman to make sure that you understand that we are not going to tolerate this kind of chilling effect on this industry, because what it does is it affects not the—it doesn't affect the high income folks.

It affects the places that Mr. Williams serves. It affects Baltimore. It affects many of the places that, quite frankly, they need banks. And Mr. Johnson is talking about too big to fail. Well, this whole process will create where we only have a few big banks because you're not going to approve the community banks. Do you agree with that?

Mr. GRUENBERG. Congressman, candidly, we had a process that's—same set of standards from 2000 to 2007, which large numbers and percentage of applications were approved.

Mr. MEADOWS. I'm talking about after that, Mr. Gruenberg. You keep going back. The pendulum was you approved 75 percent. Now you come in to approve 4 percent. Somewhere in the middle is where we need to be. Wouldn't you agree?

Mr. GRUENBERG. Very much so, Congressman.

Mr. MEADOWS. So when is the pendulum going to swing back and you're going to start to approve some of these things?

Mr. GRUENBERG. All I can say, Congressman, is the institutions—and we have to function in the economic environment in which we live, and right now that's a pretty challenging one to——

Mr. MEADOWS. Well, here's what I want. As this hearing, I want whistleblowers, in the industry, to let us know—and we're going to give them the same protection because we're not going to give you the names of those—and when we get the emails, do I have your commitment that heads are going to roll if they continue this kind of process?

Mr. GRUENBERG. What I can say, if you get emails reporting incidents, we'll be glad to look into them.

Mr. MEADOWS. All right. I've got one in terms of some lawsuits that you've got going on right now in discovery, and I found some stuff that's not even from my State. Are you willing to look into that as well? Because you're going after it in a real draconian way to try to prove something that, quite frankly, doesn't serve the American people and it doesn't serve the banking institute. Do I have your commitment to look into that?

Mr. GRUENBERG. I'll certainly take a look at it.

Mr. MEADOWS. I yield back.

Chairman CHAFFETZ. The gentleman yields back. Now recognize Mr. Cummings.

Mr. CUMMINGS. Yeah. I want us to be most effective and efficient. You just made some statements about—and I'm sure you have the evidence to prove it. I know—I know—and I'm not knocking it. I'm just trying to make sure we get to the bottom that there is some kind of retaliation and there may be some whistleblowers.

And I just want to know what is your plan to get the information to the chairman so we can effectively deal with these issues? Wait, wait, let me finish. May I.

Mr. MEADOWS. Sure.

Mr. CUMMINGS. I just want to finish. Because all of us take a very strict position with regard to whistleblowers. We want to protect them, and at the same time we want to accomplish what you want to accomplish, that is, to address whatever that issue is that they may be, rightfully so, complaining about. I just want to know what your plan was? That's all.

Mr. MEADOWS. Well, and I thank the ranking member, and you have my commitment. I'll clear my calendar this afternoon, tomorrow, I will stay in August if you want to address this, but here's what we need to do. Is we need to take these real examples, and we can just take a random sample of all the ones that have been denied or inaction, and there is a problem is it's not even that there's action.

It's just that they're out there in this holding pattern with you not making the decision and not making decisions on behalf of it. I'm willing to work with the ranking member in a real transparent way to address this problem.

Mr. CUMMINGS. Thank you.

Mr. MEADOWS. I yield back.

Mr. CUMMINGS. Thank you, Mr. Chairman.

Chairman CHAFFETZ. Thank you. I now recognize the gentleman from Missouri, Mr. Clay for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman. Let me thank the witnesses for being here.

The FDIC is not subject to annual congressional appropriations process. Instead, the FDIC receives its funding from, quote, "premiums that banks and thrift institutions pay for deposit insurance coverage and from earnings on investments in U.S. Treasury securities."

Some of my Republican colleagues have proposed legislation that would subject all financial regulators to congressional appropriations, including the FDIC.

Professor Johnson, what risk to the financial system do you foresee if the FDIC were to be placed at the whim of congressional appropriations?

Mr. JOHNSON. Well, Mr. Clay, this is a very serious issue. Indeed, the FDIC, since it was created in the 1930s, has been the gold standard for independent regulation, not just in the United States but around the world. So you have 80 years of success, and of course, there's a lot of pressures on all kinds of regulators, including through various kinds of revolving doors and other mechanisms that we've seen operate all too well.

Mr. CLAY. Right.

Mr. JOHNSON. The FDIC has stood under that pressure over decades, and I'm afraid we can't say the same for other banking regulators. So I think it would be extremely unwise to change the funding basis of the FDIC and to bring it closer to Congress. We've had some very unfortunate experiences with regulators that are funded through the annual appropriation process, and I think it would be extremely bad for the banking industry, as well as for the economy, if the FDIC were to be moved in that direction.

Mr. CLAY. So if all financial regulators were subject to the appropriations process like, for instance, the CFPB, what kind of results do you think we would get from that?

Mr. JOHNSON. Well, I think you would get much less effective regulation. I think it's much harder to have predictable regulatory environment when the funding is uncertain, and as various kinds of activities increase, this has been a big issue, for example, around derivative transactions, for example. We didn't increase the amount of scrutiny of that, in part, because of the constraints of the appropriation process, and you can get very large industries developing with almost no regulatory scrutiny, and of course, that hurt us very badly in 2008.

Mr. CLAY. It certainly did. And Chairman Gruenberg, how are the FDIC's annual expenditures approved?

Mr. GRUENBERG. By our board.

Mr. CLAY. By your board. And how does the FDIC ensure it does not overspend in its activities?

Mr. GRUENBERG. We have a pretty rigorous budget process that's overseen by our board, which is made up of 5 members, and as you know, politically diverse as well, and the—it is acted on in a board meeting, a public board meeting, and all of the budget, of course, is a matter of public record.

And actually, since the crisis, we've been reducing our annual budget as we've been winding down from the build up to respond to the crisis.

Mr. CLAY. And isn't it true that even without being subject to the appropriations process, Congress still maintains meaningful oversight of the FDIC's operations. Is that correct?

Mr. GRUENBERG. I would say that's fair to say, Congressman.

Mr. CLAY. Kind of like this hearing today, and we're in the Oversight Committee, and so—and which I find it interesting because you usually come before the Financial Services Committee, and for whatever reason, you have shown up here today. But I appreciate that, Mr. Chair, and I will yield back the balance of my time.

Mr. MEADOWS. [presiding.] I thank the gentleman from Missouri. The chair recognizes the gentleman from Georgia, Mr. Hice for 5 minutes.

Mr. HICE. Thank you, Mr. Chairman.

Mr. Gruenberg, let me ask you, your opinion and that overall of the FDIC, should banks be national? Or is there a need for local community banks?

Mr. GRUENBERG. Oh, I think community banks play a critical function in our financial system and economy, Congressman.

Mr. HICE. I do, too, and yet they're closing all over the place and they're not being approved all over the place. Do you believe that there are too many banks in this country?

Mr. GRUENBERG. Certainly not too many community banks, and we could use more community banks.

Mr. HICE. What about banks as a whole?

Mr. GRUENBERG. No, we have a strong banking system in the United States.

Mr. HICE. Are there too many?

Mr. GRUENBERG. No, I don't think so.

Mr. HICE. Does the FDIC in any way have a strategy, a plan, a policy for consolidation in the banking sector?

Mr. GRUENBERG. No, sir.

Mr. HICE. And yet banks are being swallowed up by bigger banks?

Mr. GRUENBERG. You know, there has been a——

Mr. GRUENBERG. Are you saying that's all coincidental?

Mr. GRUENBERG. There has been a 30-year process in the United States of gradual consolidation within the banking industry, both at the large institutions as well as at the community banks.

Mr. HICE. Does the FDIC have any role in that either through policies, or in any way would you think FDIC is responsible or has a role in that consolidation?

Mr. GRUENBERG. I think deposit insurance is something that's viewed as actually supportive and beneficial for community banks. And going back to 1933, when the FDIC was created, the strongest advocates for deposit insurance were by community banks to put them in a stronger position to compete with the larger institutions.

Mr. HICE. Do you believe that competition in the market is important?

Mr. GRUENBERG. Critical, yes, sir.

Mr. HICE. Should consumers have options when it comes to banks?

Mr. GRUENBERG. Yes.

Mr. HICE. They're getting fewer and fewer options. We're all certainly watching that.

Let me for a quick moment, Mr. Browning, let me go to you. Your written testimony estimates that it costs nearly a million dollars for the application process. How much would this have cost, do you think, had you gone the entire way through the process?

Mr. BROWNING. Congressman, I think that is an unanswerable question, unfortunately. We went through a very protracted process, spending a great deal of time and money. As I mentioned, we spent nearly a million dollars. We had $30 million in capital to put into the bank showing a plan that was profitable in year one, but we came to a conclusion that we could not actually achieve the end of the process.

If we saw a light at the end of the tunnel, we stood ready to make reasonable changes, but we felt like we were shadowboxing and could not get clarity on what was actually required and did not want to pour good money after bad——

Mr. HICE. So your experience is that the cost involved certainly affected not only you, but other interested candidates out there would struggle over the cost of the process?

Mr. BROWNING. Certainly the cost of the process, but perhaps, more importantly, the ambiguity and indeterminate process. There wasn't a clear——

Mr. HICE. No light at the end of the tunnel, as you describe.

Your written testimony also mentions that the FDIC felt like there was no community need for your bank. Do you have any idea what the definition is of a community need?

Mr. BROWNING. Well, I certainly know the historical application of that, and it's spelled out in the statutory requirements within the Federal Deposit Insurance Act. And for our application, our community were clients, retail clients coast to coast, that needed basic banking services in conjunction with their brokerage accounts. This was a built-in customer base, and these are just momand-pop retail investors. That was our community. The new interpretations or new suggestions were unknown to us.

Mr. HICE. Did the FDIC explain to you what their interpretation of "community need" was?

Mr. BROWNING. No. They did not give an explicit interpretation of what it was. What they suggested what it was not. They suggested that our existing customer base was not adequate, that serving consumer demand for banking services that we had a personal relationship with was not a sufficient justification to charter a bank.

Mr. HICE. Who's best to make that determination, the FDIC or those in the local community as to what the community need is for a bank?

Mr. BROWNING. I think those in the local community, and I would also look at some of the regional offices of FDIC who have experienced expert staff, on the ground, in the local real economies, that they have a very good grasp where I think it's much more difficult to regulate strictly from Washington, but certainly local business people enmeshed in the community are certainly the best testament to what those community needs are.

Mr. HICE. Thank you, Mr. Chairman. I yield back.

Mr. MEADOWS. I thank the gentleman.

The chair recognizes the gentlewoman from the Virgin Islands, Ms. Plaskett.

Ms. PLASKETT. Thank you, Mr. Chairman, and thank you, gentlemen, for being here this morning. I wanted to ask about several policies related to keeping the financial system safe.

Professor Johnson, in 2011, you published an article in the New York Times leading up to the financial crisis. Some bankers, and I quote, you wrote, understood, to a large degree, what they and their companies were doing, and they kept it up until the last minute and in some cases beyond because of the incentives they might receive.

Could you explain what you meant by this?

Mr. JOHNSON. I don't recall that precise article. I have written on that topic many, many times. The general point is that when you provide incentives, with some sort of downside protection, so too big to fail would be the most notable version of this, but also it comes up, by the way, in a lot of the conservative commentary about deposit insurance over long periods of time.

If you're protecting people from downside risk, and on the upside, they do very well, then they are naturally, just as a matter of arithmetic applied to incentives, they are naturally going the take more risk.

Now, sometimes you might feel that you can contain that. That has been the experience with deposit insurance in the U.S. over the years, but unfortunately, with regard to larger financial institutions and some of the largest and they run up to 2008, the risk that they took was so big that they ended up having a devastating effect on the real economy. That's why we had this massive recession.

Ms. PLASKETT. So those risks that they took at the largest financial institutions that you're speaking about, and the bank executives of those institutions, are they still incentivized in the same manner that they were at that time, and what is their incentives today to act in the best interest of the Nation?

Mr. JOHNSON. I'm afraid that the largest, what are now, bank holding companies, they still have an enormous amount of effective downside protection provided by the Federal authorities, both the Federal Reserve and other parts of the U.S. Government, and we have not ended the problems associated with these too-big-to-fail financial institutions. So that's a distortion of their incentives.

And as the chairman, Chairman Chaffetz opened the hearing, argued that systemic risk is going up. I think he's right but for a different reason, which is it's the effects of these very large financial institutions and the distorted incentives. Systemic risk is hardly affected at all by the margin of de novo community banks. That's just a matter, again, of arithmetic. They are very small relative to GDP. The largest financial institutions are huge. The largest single bank in the country, JP Morgan Chase has a systemic footprint, which the Fed calculates to be about 40 percent of U.S. GDP, four-zero percent, so dwarfs anything that we've been discussing so far this morning.

Ms. PLASKETT. So those systemic issues that you're discussing and the risks that banks are willing to take, and particularly, the bank executives in making those risks, do you believe that the FDIC should look at compensation and the compensation models that these banks have in their application process to determine what potential risk that the bank and its executives might make in their decisionmaking because of the compensation that they receive based upon those risks?

Mr. JOHNSON. Yeah. It's certainly how you compensate your executives is a very important part of the risk profile that your bank or any firm adopts. And as I read the FDIC criteria, which frankly, I find to be pretty transparent, well explained, and I like the Q&As as well, as I read them, that is one of the criteria. There is other criteria as specified by Congress, but yes, from a point of view, deposit just the narrow deposit insurance, I think the FDIC does take that into account.

Of course, the FDIC also has additional responsibilities created by Dodd-Frank with regards to some of the largest financial institutions, including with regard to living wills, and that, may also be a consideration that although, frankly, there's less transparency on that process.

Ms. PLASKETT. As a lawyer, I guess the living will piece sounds really interesting to me.

But Chairman Gruenberg, could you explain to me how the compensation models might play and how you evaluate that in determining the applications of banks in terms of would the compensation model show that an executive would be willing to take on more risk because the output to them, in terms of compensation, would be greater if there is a greater risk?

Mr. GRUENBERG. In reviewing an application for deposit insurance, just to be clear, our responsibility goes to deposit insurance, not to the charter for the institution. But certainly one of the key components of it would be the management plan and the proposed executive leadership of the institution, both management and——

Ms. PLASKETT. Sure, but you're determining that. You're determining the insurance deposit would let us know that, hey, they need greater insurance because you view them at a greater risk than others would.

Mr. GRUENBERG. And in an appropriate compensation scheme for the institution, with not undue incentivizing of risk, would be part of the things we look at in terms of reviewing the application.

Ms. PLASKETT. So because it's my belief that the compensation models must be—and I'm glad to understand, in consideration by the FDIC in terms of how much deposit do you believe that they should have or what is the insurance compensation that's needed, and I'm thankful for the information that you've given us.

Thank you, Mr. Chairman. I've run out of time. I yield back.

Mr. MEADOWS. I thank the gentlewoman. The chair recognizes the gentleman from North Carolina, Mr. Walker for 5 minutes.

Mr. WALKER. Thank you, Mr. Chairman. Thank you, Panel, for being here today. Being from North Carolina, I am concerned that over the last 7 years we've lost 40 percent of our charters with no new banks being chartered during that time. Bank closures and consolidations account for most of the loss, but this is still a dramatic trend in banking and threatens the future of community banking as a business model.

And over this time, a new bank has not been chartered in North Carolina since 2009, 7 years. The cost of the application and the regulatory compliance are cited as early obstacles to profitability as everyone testifies today, at least from what I've heard, seems to agree that community financial institutions have an important role in our economy.

What has the FDIC, Chairman Gruenberg, done or considered, to lower the barriers to entry for these new bank charters?

Mr. GRUENBERG. I think what we have under control, Congressman, is the application process itself, in trying to make that as user friendly and responsive as possible, and fair to say, a significant aspect, particularly for smaller groups trying to set up a smaller institution, are legal and consulting fees to support the application process. To the extent that we, in the course of working with an applicant can help defray those costs, provide them the information and support and organizing group needs, our goal would be to try to contain that cost.

Mr. WALKER. When you say your goal is to contain the cost, is that something you're regularly looking at, reviewing, discussing, talking about, and is there any action steps or is it just something that's laid out there as a goal somewhere in the future?

Mr. GRUENBERG. No, as I indicated and as I outline in my testimony, we are pursuing a number of steps to try to promote new applications, including holding meetings in regions around the country for interested parties and industry groups to walk them through and explain the application process and encourage them to engage with us, as well as working with the State and Federal agencies who are responsible for chartering new banks and who are partners in terms of entry to the system.

Mr. WALKER. And I appreciate that. Just curious as to maybe for me, maybe for the public, what would be the cost or capital needed to charter a bank today, and what are the factors that would affect the amount of capital required to grant this charter?

Mr. GRUENBERG. It's hard to generalize. I think that the capital required of the institution would be related to its business model and risk associated with it. It's generally a minimum of $2 million, but I think in practice it's more $10 to $20 million of capital is probably the more general experience. And I think in terms of a startup cost for just putting the application together, it probably runs close to a million dollars.

Mr. WALKER. In these meetings and discussions to work for—on the cost and some of the startup fees, has the FDIC considered streamlining the business plan for a de novo bank applicant?

Mr. GRUENBERG. I think we'd like to make it as simple and fast as we can. You know, we have a balance to strike. That's really what—we want to facilitate the entry. At the same time we have to ensure that the institution that's going to be established is going to benefit from Federal deposit insurance, and so we have to be sure both that the process is as user friendly as we can but also ensure that the new institution established can meet the standard so it can be set up.

Mr. WALKER. Sure. And with the de novo banks, one of the major costs is hiring the regulatory attorney. The question is, as this is incredibly expensive, could this process be streamlined so that no regulatory attorney is necessary?

Mr. GRUENBERG. I don't know that I could say or advise a group not to have legal counsel. To the extent we can simplify and work with the institution to reduce that cost, that would be an objective.

Mr. WALKER. And what considerations or accommodations is extended to new charters in the area of regulatory oversight?

Mr. GRUENBERG. I think it's important in the initial 3 years of the establishment of the institution. You can look at it both ways. You want to have careful oversight in the initial period as they get themselves started up. That's a period of risk for a new entity. And I would view we have more attentive supervision, and I would view that as actually supportive of the long-term success of the institution.

Mr. WALKER. And if I have time, maybe to expound on this last question. In North Carolina we have seen successful nontraditional creative bank structures like Square One Bank in Durham and then Live Oak Bank in Wilmington. Will nontraditional charter applicants still receive favorable conditions from the FDIC, assuming all of the boxes are checked, capital management, et cetera?

Mr. GRUENBERG. We'll work with any group that has an interest, Congressman.

Mr. WALKER. My concern, from what I'm hearing over in the hour or so of testimony today, is that—let me ask you this. How long have you been chairman of the FDIC?

Mr. GRUENBERG. I've been—became—I was confirmed as chairman in November of 2012.

Mr. WALKER. Okay. So we're coming up on 4 years. I hear a lot about, hey, these are our goals, this is something we're looking into, we're having meetings, we're checking into this, even some of the questions earlier about any kind of pushback on some of the whistleblowers. I hope that some of that is actually being processed and some of those goals are being met in the days ahead. I have a couple more. My time is expired, so I yield back to the chairman. Thank you.

Mr. MEADOWS. I thank the gentleman. The chair recognizes the gentlewoman from Illinois, my good friend, Ms. Kelly.

Ms. KELLY. Thank you, Mr. Chair. I would like to address two issues affecting the ability of the FDIC to keep the financial system safe.

First I'd like to ask about the FDIC's orderly liquidation authority. The Dodd-Frank Act permits large and complex financial institutions that are failing to be resolved through a process known as "orderly liquidation." Mr. Chairman, can you please explain what that is and how is it different than bankruptcy

Mr. GRUENBERG. Thank you, Congresswoman. Just to put it in context. Prior to the crisis, the FDIC's resolution authorities, or authorities to manage the failure of a financial institution, was limited just to the insured institution, the insured bank itself. What we saw during the crisis that it wasn't just the insured bank but actually the parent company and the consolidated financial company these very large institutions that got into difficulty as well in some cases nonbank financial companies, Lehman Brothers is perhaps the most striking example. And the FDIC had no authority to place either the consolidated complex financial institution or a nonbank financial company into a public receivership

The orderly liquidation authority that you mention actually provides us those authorities. So it's really a threshold capability if we were going to try to actually manage an orderly failure of a systemic institution like this. It was a authority we didn't have in 2008 and it was—it is an authority we have today

Ms. KELLY. If another financial crisis were to occur today, we hope not, could a failing financial institution be resolved through bankruptcy?

Mr. GRUENBERG. I believe we have the authority and capabilities today that we didn't have in 2008. I would just say, though, until we actually do it, and then I would be, you know, a little modest about making heroic assertions, but I do think we are in a very different place today than we were back in 2008.

Ms. KELLY. Professor Johnson, do you agree with that? Is bankruptcy a feasible way to resolve a failing institution at this point?

Mr. JOHNSON. Well, I want to make sure I understand the question, and the wording is really important. Bankruptcy generally, refers to the process where the FDIC is not involved, you go to the courts, and it's administered as a court run process. That's the standard, obviously, for nonfinancial companies.

We have attempted that. Sometimes financial companies, for smaller relatively simple financial companies, yes, bankruptcy does work. For any kind of large complex financial institution, bankruptcy didn't work in the past, would not work today. It would be a catastrophe. You'd be back to Lehman Brothers. That's why we have the OLA, that's why we have the potential for the FDIC resolution process. I think that could be helpful under some circumstances, but I think that the large complex institutions are still a bit too big and too complex and that none of them have produced living wills, to the best of my knowledge, that really would assure us that they could be resolved in an FDIC run process without major negative effects on the financial system and on the economy.

Ms. KELLY. Our chair of Financial Services has recently proposed legislation to rescind the FDIC's orderly liquidation authority.

Professor Johnson, are you familiar with that?

Mr. JOHNSON. Yes, I am

Ms. KELLY. And what would be the effects?

Mr. JOHNSON. I think it would be a disaster. I think that we experienced vivid and horrible detail in 2008 what happens when you say large financial institution is failing, let's have it sorted out by bankruptcy. Lehman went bankrupt. Let's be clear. Lehman went through the bankruptcy process, and I don't think any of us enjoyed the consequences, and I really don't think we want to go back there.

Ms. KELLY. The chairman also has the CHOICE Act, which will require FDIC to calculate and weigh the costs and benefits of new regulations.

Professor Johnson, again, in the financial services arena, how credible are quantitative cost benefit analysis?

Mr. JOHNSON. Look, if you're talking about the full costs and benefits of financial regulation, including avoiding a massive recession with millions of jobs lost, the loss of at least 1 year's GDP, low growth for 8 years, if that's in the cost benefit analysis, then I'm in favor, but unfortunately, that's not what is put in even the legislative language or in the standards of protection of cost benefit analysis. They use a much narrower definition. That frankly is deeply, deeply misleading with regard to why we have financial regulation, how financial regulation works, and what happens when it fails

Ms. KELLY. Thank you. Chairman, I won't you to ask you to comment on that, but can you tell us if the FDIC currently conduct any analysis of proposed regulations, benefits, and costs?

Mr. GRUENBERG. Actually we do, Congresswoman, and as you may know, we're in a process required by Federal statute called EGRPRA, which requires the Federal banking agencies every 10 years to review all the rules and regulations that we've issued and determine whether any of them are no longer necessary or should be modified, and we're actually working on that process now.

We're require to issue a report by the end of this year, and I think we'll be—we've already made some changes, and we'll be proposing additional changes in an effort to reduce regulatory burden and the costs associated with them.

Ms. KELLY. From a nuts-and-bolts perspective, how would a quantitative cost benefit analysis affect the FDIC's ability to put forward new rules, especially in the midst of a financial crisis?

Mr. GRUENBERG. It would really determine on how—as Professor Johnson indicated, how it was run, and since I'm not really familiar with the legislative proposal, I'd rather not comment on that.

Ms. KELLY. Yes, sir.

Mr. MEADOWS. I believe the gentlewoman's time is expired, but—it didn't inspire 5 minutes and 48 seconds ago, but I think we are 48 seconds into expiration.

Ms. KELLY. I was wondering. Okay. Thank you

Mr. MEADOWS. The gentleman from Tennessee is recognized

Mr. DUNCAN. Well, thank you very much, Mr. Chairman.

Mr. Gruenberg, I have a letter from the Tennessee Bankers Association which says: Among the key factors that are both restricting new banks and driving consolidation are the ability to attract the very high levels of capital required to start a new bank, and for that matter, the high levels of capital required after imposition of the Dodd-Frank Act and the new Basel 3 requirements.

And secondly, the regulatory burden imposed by the Dodd-Frank act, which requires significant resources to be directed simply toward compliance issues. And I really heard that second matter for many bankers, but you talk about these high capital requirements.

I heard Mr. Browning say that his people had $30 million they were planning to put into this bank, and I'm wondering, can you give me a rough guess? I've been provided by staff saying that there was only one new bank approved in 2013 and one in 2015.

In the last 3 years, let's say, or 3 or 4 years, how much capital have these new banks that—two or three new banks that have been approved, how much capital have they come up with?

Mr. GRUENBERG. I couldn't tell you that offhand, Congressman. We'd be glad to check on that and come back to you, if that would be okay.

Mr. GRUENBERG. I think in regard to the application standard, the capital requirement today is the same capital requirement that's been in place really since 1992. So we do require higher capital for startups for that first 3-year period, and the reason for that is in the startup phase of an institution, one, it's going to be a growth period so they need the capital to support the growth; two, startups generally experience higher rates of loss as they get their business going; and three, they need the initial capital just to get the operation——

Mr. DUNCAN. Well, how much capital do you require just generally?

Mr. GRUENBERG. It's an 8 percent minimum requirement.

Mr. DUNCAN. Eight percent of what?

Mr. GRUENBERG. It's an 8 percent leverage capital requirement related to the total assets of the institution, and that's been the minimum requirement since 1992. And you can argue that it's too—some people argue that it's too high. Others have argued, because of the failure experience during the crisis, it should have been even higher.

We think it's a reasonable basis to assure a significant probability of success as the institution gets started and tries to get through the initial startup period.

Mr. DUNCAN. Well, you may need to take another look at it if nobody's applying for new banks anymore or they're not getting any approved.

Let me ask another question real quick before my time goes out. I know when they passed the Dodd-Frank law, and I was here then, the people who supported it said they were doing it to get back at the big banks and Wall Street firms that led us into the recession. Yet 2 years ago, George Mason University released a report that said that since the financial crisis, U.S. banking assets and deposits have continued to consolidate in a handful of large banks. The five largest banks now hold 44 percent of U.S. banking assets compared to 23-and-a-half percent in early 2000.

And I'm wondering, Mr. Williams, have you seen that as the—are the total deposits continuing to just go to the big giants? And is it possible for a small bank—I've heard one banker say that it's not possible for a bank under a billion dollars in assets to even survive today.

And have you seen more of your time and expenses being devoted to compliance costs as compared to say when you started in the banking business?

Mr. WILLIAMS. Oh, my goodness, yes. When we started the bank, we actually didn't have a compliance officer, and we treated the consumer better than we do today. Now we have a number of compliance officers, we have an unbelievable regulatory burden, and essentially all of that cost has to be passed onto the consumer, it's passed onto the investors, but it's not a productive cost.

The fundamental factor about compliance is complexity favors the large. I'm going to say that again because it's important. Complexity favors the large. The regulations from Dodd-Frank would fill several phone books. Just paying an attorney to read them is a significant expense. That's not a problem for Bank of America, but for Gulf Coast Bank, it is a big deal

Mr. DUNCAN. What are your total assets? What size is your bank?

Mr. WILLIAMS. A billion 450.

Mr. DUNCAN. Is it possible for a small bank to survive today, or it's certainly becoming much harder, isn't it?

Mr. WILLIAMS. It is, but it's more difficult. It's a challenge, and the more regulation you have, the larger you have to be to succeed. And we've raised the level of complexity to the point that it's very challenging for the very small banks, the 100- to 200- million to make money. And unfortunately, we don't go back and relook at the regulations.

We say that we will, but we add 16,000 bricks to the wagon, we take away three, and as a banking industry, we're supposed to applaud that effort. The regulations never decrease. They only increase.

Mr. DUNCAN. The more any industry becomes Federally regulated, the more regulated it becomes, the more it ends up in the hands of a few big giants. Thank you, Mr. Chairman

Mr. MEADOWS. I thank the gentleman. The chair recognizes the gentleman from Massachusetts, Mr. Lynch for 5 minutes

Mr. LYNCH. Thank you, Mr. Chairman. Look, I actually love my community banks. Those are the banks that are making the loans, doing the mortgages, helping folks out in my community, and I actually have sponsored a regulatory relief bill for community banks because they are making the loans and out doing all those crazy stuff with derivatives. They've got adequate capital, and they are engaged as traditional banks.

But I do want to look at the data here, because I don't think there's a conspiracy within the FDIC to basically, you know, manipulate the application process to stop banks from coming into existence, and that seems to be the suggestion here today.

If you look at the data, in 1985 we had 18,000 banks. Today, we've got a little over 6,000. It's almost a two-thirds decline, but if you look at what happened, about 85 percent of those banks went out of business because they merged with other banks and they became bigger and bigger. As a matter of fact, as my colleague just pointed out, the 10 biggest banks back in 1985, they had 19 percent of industry assets, but today, they're closing in on 60 percent. Those 10 banks control almost 60 percent of industry assets.

So we've got these huge whales out there that are basically gobbling up these other banks, and that's not healthy. But it is not the application process that is causing that. At the same time, we've got a very, very low interest rate environment. We've got very, very low margins here. Between—you know, if you take deposits, and you know, you're getting very low interest on that and you have to lend out your money at a very low interest rate to be competitive, there's a very low margin of interest for banks, so it's tough to operate in this environment.

So I don't think there's any secret plot out there. It's just a tough environment, and that's why, not surprisingly, de novo bank applications are down. They're—it's just a tough time to try to get into the business.

And I do want to say that, you know, that idea of reducing the regulatory burden for community banks is a good one, and I know that Tom Hennig from—he's on the board, right, on your board, Mr. Chairman? He's got some good ideas. He actually sat down with a number of the members on both sides of the aisle here, and we think that we can come up with a good regulatory relief bill for community banks that are doing the right thing and just trying to help local small businesses, and that's the direction we should be going in.

But let me ask Mr. Johnson, is there something I am missing here? Apart from what I laid out in terms of the consolidation going on, the small number of banks that are in existence today and the pressures, or do you really think there is this conspiracy out there or some type of nefarious plot to, you know, to stop banks from coming into existence?

Mr. JOHNSON. Mr. Lynch, I don't think there's any kind of conspiracy. There's a longstanding process of consolidation in the industry, which was prompted by Congress, by the way, when it repealed the restrictions on interstate banking. So that's what happened, historically, and as banks were able to spread across States, you got the prospect of consolidation. The one big thing we haven't talked about today, perhaps, is economies of scale in banking due to technology.

So the fact you have pretty demanding information technology requirements is another squeeze on the banks under $100 million, and this has been looked at carefully by the FDIC, among others. Economies of scale, so in terms of what your costs are relative to your assets, they come down quite quickly until you get down to about $100 million, in assets, and then it flattens out.

So this is more pressure on that lower—the smaller banks, historically, they were more important than they are today. And from a de novo bank, it raises the amount of capital that you need up front because you've got to get to that economies of scale. That just reinforces what you're saying, Mr. Lynch.

Mr. LYNCH. Okay. So we have a list that the FDIC looks at when somebody applies to get a charter. The financial history and condition of the depository institution, adequacy of capital, future earnings prospects, general character of fitness of the management, risk presented by depository institutions to the deposit insurance fund, convenience, needs of the community, and whether its corporate powers are consistent with the purpose of the act.

Do we think any of those are inappropriate that we might be able to reduce the number of factors, or do we think those are all sound?

Mr. GRUENBERG. I think our experience is those are pretty much basic considerations for a bank application.

Mr. LYNCH. Okay. My friends at the American Bank Association, any of those factors you think are overbearing or——

Mr. WILLIAMS. The factors have been the same factors for a number of years. The dilemma is the application where at one time it was relatively easy to start a new bank. Now it is incredibly difficult, and I think we've use the pendulum example. It's gone too far. If you prevent a single bank failure, you'll also prevent an awful lot of success. You know, in my other life I'm a pilot, and I fly medical patients to get treatment. Well, over the 20 years I've done this, we've noticed a significant improvement in cancer treatment. It's because they've tried a lot of things that didn't work.

Well, new banks will fail, but they present a trivial risk to the system in the fund. But if you stop new banks from failing, you also stop banks from succeeding, and a bank like mine doesn't exist, the community is weaker. And in a small town, if you don't have a hometown bank, you really don't have a vital economy.

Mr. LYNCH. Right, right, right. So you're looking to strike that balance.

Mr. WILLIAMS. Yeah, and I think we've struck—we've gone too far the direction of no failure.

Mr. LYNCH. Okay. I've abused my time. I want to thank the gentleman for his courtesy.

Mr. MEADOWS. I thank the gentleman. The chair recognizes the gentleman from Georgia, Mr. Carter for 5 minutes.

Mr. CARTER. Thank you, Mr. Chairman. I thank all of you for being here. I would certainly be remiss if I didn't comment on what—on one of the comments that was just made about the mergers that have taken place in the banking industry here in recent years. Let's keep in mind, a lot of those mergers weren't necessarily wanted. A lot of them were fire sales, a bank selling to bigger banks before they went into business.

You know, full disclosure here. First of all, I've served on community bank boards. Full disclosure, I'm a small businessman. If it weren't for a community bank, I would not have been able to start my small business. I went into business November 21stof 1988, and it was because a small community bank was willing to extend me credit to open up my business, so I am a big community bank fan.

And I will tell you, Mr. Williams, I couldn't agree with you more. When I was serving on the bank board previously to becoming a member of Congress 18 months ago, the only new hires we were making were compliance officers. That was all we could do was every time we'd make some money, we'd hire a new compliance officer. That was the only thing we could do.

Mr. Gruenberg, I want to ask you: Do you know what bank deserts are? What are bank deserts? Can you just briefly tell me.

Mr. GRUENBERG. I'm not—I'm sorry I'm not familiar with the term.

Mr. CARTER. When I would refer—it was a term we kind of used in Georgia. You're aware of what's happened in Georgia?

Mr. GRUENBERG. Yes, sir.

Mr. CARTER. I believe Georgia leads the Nation in the number of banks that have closed since all this started. You know, and listen, I've listened to all of you during the day, and I know you all agree that community banks are important and they're necessary and we've got to have them, but bank deserts exist in both rural and urban areas, particularly in rural areas.

In the State of Georgia we have 159 counties. We've got 48 counties that don't have a locally chartered bank. That would be referred to as a bank desert. Nationwide, there are 654 bank deserts in rural communities and 351 in urban areas. What we don't have a locally chartered bank.

Chairman Gruenberg, can you tell me, it sounds like what you have articulated here today that you're concerned, that the FDIC is concerned about these bank deserts and the need for community banks. But I'm still not clear, when we talk about the convenience and need to the community, what you mean by that?

Mr. GRUENBERG. Well, first of all, Congressman. You're correct. I think we're very concerned about it. Community banks play a critical role, but large institutions really cannot fail for exactly the point that you were making.

Community banks do relationship lending, particularly with small business. That is very hands on, and that is not the kind of business large institutions are interested in. So they really fill a critical—let me just come to your—so your question is, if you could just——

Mr. CARTER. So you acknowledge that. Tell me what you're doing about it.

Mr. GRUENBERG. Oh, look, the—we want to do everything we can to——

Mr. CARTER. I know there's a different in want and in doing. Tell me what you're doing about it.

Mr. GRUENBERG. Well, so we can't change the interest rate environment. That's not under our authority. What we can try to do that's within our authority is at least to try to make the application process, the groups interested in forming a bank, as user friendly and reduce the cost, and to the extent we can, reduce the reliance on what can be expensive consultants for a group to put together a new financial institution. I think that's a contribution we can make, and we are looking at ways to do that.

Mr. CARTER. Okay. I've got very limited time, and I've got to—let me ask you, Chairman Gruenberg, how many bank charters were approved last year? How many new bank charters were approved last year?

Mr. GRUENBERG. I believe just one, Congressman.

Mr. CARTER. One?

Mr. GRUENBERG. Yes.

Mr. CARTER. Did you say one?

Mr. GRUENBERG. Yes. No, we—at the end of my testimony, we provide a chart listing all the new charters, and what we've really had is an unprecedented experience in the period since the financial crisis. We really have not seen—we haven't—we've only a handful of new charters and only a handful of applications, because we have an economic environment that's extraordinarily challenging to start a new institution. I think that's the point that was made earlier.

Mr. CARTER. But how are you going to help? I mean, you know, we need to help these people.

Mr. GRUENBERG. I agree, but we can't——

Mr. CARTER. We've got 48 out of 159 counties in the State of Georgia that do not have a locally chartered bank. If small community banks go away, small business goes away.

Mr. GRUENBERG. I couldn't agree more, Congressman. We don't—community banks in particular——

Mr. CARTER. But what I'm hearing—I'm sorry, but what I'm hearing is that that is the problem. There's no transparency, that the process is difficult, it's hard it navigate.

Mr. GRUENBERG. If you look at our Web site, and our application and the requirements are there for everyone to see, which I think is the bottom line, and we do work actively with any groups, we are prepared, and we'll look at our procedures for deposit insurance applications and try to make them as user friendly as we can.

Mr. CARTER. Okay. Well, my time has expired. But I've got to tell you, small business is what made America.

Mr. GRUENBERG. I agree.

Mr. CARTER. And this is killing us. We have got to have it. And we need help. We need to make it easier.

Now, we need to make sure these de novo banks, we need to make sure these community banks survive. If they don't survive, small business is not going to survive.

Thank you, Mr. Chairman. I yield back.

Chairman CHAFFETZ. I thank the gentleman.

I'll now recognize the gentlewoman from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you very much.

And I would like to discuss the too big to fail and living wills for large financial institutions. Professor Johnson mentioned earlier in testimony, when we had the crisis that cost this Nation $15 to $18 trillion in lost homes, lost jobs, the worst—and it was caused by mismanagement, the first major financial crisis in our history that could have been prevented with better regulation and management of banks. And he alluded to the problem that we faced: We could either let it fail, like we did with Lehman, or we could bail it out, like we did with AIG. Neither response was a good one.

So in Dodd-Frank, we came forward, saying that the largest financial institutions would be required to submit to regulators, including the FDIC, a resolution plan to be implemented in the case that they failed, and these plans were called the living wills. And if a bank consistently fails to provide credible plans, Dodd-Frank permits regulators to increase the bank's capital, liquidity, and leverage ratio requirements, or even to require the bank to divest certain assets or operations.

So, Professor Johnson, could you please explain why Dodd-Frank permits these penalties?

Mr. JOHNSON. Yes, Congresswoman. The point, very simply, is exactly what you are referring to, which is we would like every firm in this country to be able to go bankrupt, potentially, without any kind of government intervention. I think that's a completely shared goal.

And that is the case of the nonfinancial sector. It is not the case, as we learned vividly in 2008, for the financial sector.

So the living wills are supposed to be a documentation provided to the regulators that demonstrates beyond a reasonable doubt, presumably, that these large financial firms can fail without the FDIC or anyone else being involved. So that's Title I of Dodd-Frank.

Title II, ordered liquidation authority, is a backup in case the bankruptcy process doesn't work. But the FDIC and the Federal Reserve are supposed to be completely confident, by reviewing the living wills, that these banks can fail without any kind of government involvement or government financial assistance or temporary loan or anything. So that's, I think, a completely reasonable goal that should be shared across the political spectrum.

Mrs. MALONEY. Okay. These penalties are really sticks to encourage banks to file credible plans, but they are effective only if banks know regulators will use them. And since 2013, banks have had four chances to get this right, but regulators say that most of the plans still have shortcomings. This year, the FDIC found the plans of five banks are not credible, and these five banks must resubmit their plans by October 1.

So, Chairman Gruenberg, if the living wills continue to be deficient in October, you have the authority to impose penalties at that time in order to protect the taxpayers. Is that right?

Mr. GRUENBERG. Yes, Congresswoman.

Mrs. MALONEY. And the plans being submitted this October, in some cases the fifth attempts by some of the largest banks to have credible plans, and the banks have shown that their resolution plans are due since the Dodd-Frank—they've known that they have to do this since 2010, yet five banks are still not getting it right. And no penalties have been imposed for their failures to produce credible resolution plans.

So my question, Professor Johnson, how can the public and the banks be sure that the FDIC is serious about obtaining credible living wills if they are not, you know, putting these penalties forward? And then I'd also like the chairman to answer.

So, Professor Johnson.

Mr. JOHNSON. Yes, Congresswoman, I think it's a very big question. And, of course, it's not just the FDIC. It's the FDIC and the Board of Governors of the Federal Reserve System. They act together in this. And I'm afraid, for precisely the reason that you identified, because we haven't seen any of these remedial actions required, I'm afraid that public confidence in the FDIC and the Fed with regards to having viable living wills that really would keep the taxpayers off the hook and give us much broader financial system stability, I'm afraid confidence in that is low, and I would presume it will decline further.

Mrs. MALONEY. Chairman.

Mr. GRUENBERG. Yeah, Congresswoman. So, as you know, the eight most systemically important financial institutions submitted resolution plans, living wills, last year, and those plans were reviewed jointly by the FDIC and the Fed. And we've recently issued evaluations of those plans. And of the eight, the Federal Reserve and the FDIC jointly found five of them to be noncredible. That's the standard under the statute. And the statute provides that if we make that joint determination, we, together, have to issue a notice of deficiencies laying out the inadequacies of the plan, which we did. And all of that was made public in the course of releasing these evaluations.

And as you indicated, we gave those institutions until October 1 to submit plans addressing those deficiencies, and we'll then be at the point of having to evaluate their responsiveness. And as you indicated, the law provides this authority, that if the plans don't address the deficiencies, we have the authority to impose additional prudential requirements relating to capital liquidity leverage, as well as constraints on activities. And that's a decision we're going to have to make once those submissions are made October 1.

Mrs. MALONEY. Mr. Chairman, may I do a follow-up question to his answer?

You've had four times to have an evaluation. This is the fifth time, correct?

Mr. GRUENBERG. Yes.

Mrs. MALONEY. And the other four times that you've had an evaluation, you haven't come in with the penalties that Dodd-Frank gives you. And so when my—you know, I was one of the participants in the conference committee on Dodd-Frank, as you know, and I support it. But how do we know—and I think people that are critical have a right to be somewhat critical—that it's going to be implemented if you're not implementing it? What's different this time? Are we going to be going to plan 6, 7, 8, 9, 10?

Mr. GRUENBERG. As you may know, Congresswoman, it requires a joint determination.

Mrs. MALONEY. Yeah, joint, I know, realize.

Mr. GRUENBERG. And the FDIC in a previous round had failed the institutions, but we didn't reach joint agreement. I do think what's important is that in this round we did reach a joint agreement on five of the plans, and we're now in a position to see the institutions, presumably, address these deficiencies, or if not, then, you know, there are authorities under the law that would be available to us.

Chairman CHAFFETZ. I thank the gentlewoman.

Mrs. MALONEY. Could I just ask him to submit to you what your outcome is, since we are distracted?

Chairman CHAFFETZ. Sure. That would be good.

Mrs. MALONEY. This is a very important financial security, safety, and soundness issue, and I think to present your findings, since we are—they are not coming to us, they are coming to you. So I think to give us those—that information would be helpful.

Mr. GRUENBERG. Okay.

Mrs. MALONEY. Thank you.

Mr. GRUENBERG. Sure.

Chairman CHAFFETZ. When will we have those?

Mr. GRUENBERG. Well, I'm assuming relating to the evaluations that were made?

Mrs. MALONEY. Yes.

Mr. GRUENBERG. And that's a matter of public record, and we'd be glad to provide that to the committee.

Chairman CHAFFETZ. We now recognize the gentleman from Wisconsin, Mr. Grothman, for 5 minutes.

Mr. GROTHMAN. Thank you, Mr. Chairman.

We've had several questions before, but when I talk to my smaller banks, going back to what Congresswoman Carter said, all they're doing is hiring compliance officers, which, obviously, is in some cases just is squeezing, you know, the amounts you've got to in deposits or whatever. In other cases, it's causing a lot of buyouts, because these smaller banks, they just can't afford to operate and they allow themselves to be bought out and that sort of thing.

Have you kept track of the huge cost to the banking system of the additional compliance? Do you have a dollar figure you can put on that?

Mr. GRUENBERG. You know, we've actually—it's tough to quantify. Clearly, it's meaningful, particularly for the 4,000 institutions in the United States with assets under $250 million. I think for those institutions the cost of regulatory compliance is significant. As a technical matter, it's tough to quantify, but there's no doubt that it's meaningful.

And, look, I think, from the standpoint of the bank regulators, we want to find ways to reduce regulatory burden and cost. We have been undertaking a review as required by the law. I think there are areas we can address, including simplifying capital, risk-based capital compliance, appraisal thresholds. These community banks have raised particular concerns about call report burden.

I think there are a number of areas where we can and are planning to take steps that will actually reduce burden and cost, and I think, to the extent we can, we really should do that.

Mr. GROTHMAN. Thank you.

Mr. JOHNSON. Congressman, I have some data. Can I give you the data on this? It's actually from Mr. Browning's testimony. This is drawing from the Richmond Fed's research and the Fed's research, and it's consistent with what the FDIC has also published.

Now, I'm not trying to trivialize these expenses and costs at all, including for certain segments of the market, but if you take on average what Mr. Browning's testimony says, he's quoting these academics, the increase is relatively small and, more importantly, the size of the expense is just too small to have a big effect on bank profitability.

Mr. GROTHMAN. Like too many professors, you've got to get out of the university and spend more time talking to small bankers.

Mr. JOHNSON. I'm sorry, this is the data, Congressman, this is the data, and I do spend a lot of time working with the private sector, with all due respect, in my university——

Mr. GROTHMAN. That's okay. We have 5 minutes, and I intended to talk to Chairman Gruenberg here.

There's been a huge drop in the number of banks. Do you consider that a bad thing? I mean, you know, a lot of local people say, and maybe it's consistent with my experience, you get better service from the small local bank. Do you view that as a bad thing that we have such a huge drop in the number of banks we've had since a few years ago.

Mr. GRUENBERG. I don't view it as a good thing. No, I don't, Congressman.

Mr. GROTHMAN. Are you doing anything to make sure that these smaller banks are able to keep going? Do you view this as a fundamental problem. I realize it's not all yours. I mean, obviously, the people who voted for Dodd-Frank wanted to finish off a lot of these small banks too. But what are you doing to make sure that we keep these small banks going and they aren't forced to be bought out?

Mr. GRUENBERG. Well, I think it is part of our responsibility. A strong community banking sector has enormous value for the financial system and the economy.

I think we want to find ways to reduce regulatory burden and costs. I think that's one way we can do it. We have tried to make our supervision of institutions risk-based and appropriate to the nature of the institution. So for a smaller, simpler bank, we're able to do exams less frequently and try to do it in a way that's really appropriate to the model of the institution.

So both in terms of trying to reduce regulatory burden and doing our supervision in a way that's responsive to the business of the bank, those are the two things we can do.

Mr. GROTHMAN. Okay. Now, I get a concern, the Consumer Financial Protection Bureau, okay, that insofar as they get involved here, standards that were meant for bigger banks are kind of seeping down to the smaller banks. Is there anything you can do about that to make sure this doesn't happen anymore?

Mr. GRUENBERG. I think this so-called trickle-down issue is certainly one of the things we hear about from the bankers. And we work pretty hard to make clear that whatever obligations are imposed on the larger institutions are not expected of the smaller institutions, and we try to make that very clear in our supervisory program.

Mr. GROTHMAN. Okay. I can see, and Mr. Williams wants to speak down here, just one second. Would you, Mr. Williams?

Mr. WILLIAMS. Sure. Yeah. I mean, will all respect, the unfortunate consequence of the trickle down is that the regulations like Basel that were intended for the most complex banks are pushed down to community banks like ours. And then you have the pernicious effect of best practices. It becomes a best practice, and then we have to do it.

So it may not be a regulation, but then it becomes a best practice, and then it gets pushed down to a billion-dollar bank, then to a 500 billion, and then things that don't make economic sense and weren't intended for banks like ours become realities.

Mr. GROTHMAN. Okay. Chairman Gruenberg, could you do something in which you can have a hard rule to make sure this stuff doesn't become best practice or doesn't affect people?

Mr. GRUENBERG. I think we have a pretty clear policy. I mean, I'll glad to come back to you on that. But we have to try to make it very clear in all of our guidance that expectations for large institutions are not imposed on smaller institutions.

Mr. GROTHMAN. Well, my experience, talking to my bankers, is the same as Mr. Williams. I mean, your expectations aren't being realized. And there's a lot of fear out there on that.

I guess I've used up my time, but thanks.

I really hope—you know, maybe people are afraid to talk to you. But when I talk to my small banks, well, I think over time your people become friendlier. We, right now, there's a perception we hate small banks in this country. It's not entirely your fault. It's also the fault of the people who put together that Dodd-Frank bill.

But I wish we'd get back to the days in which we have more small banks and they aren't being forced into being merged.

Thanks much.

Chairman CHAFFETZ. I thank the gentleman.

We now recognize the gentleman from Alabama, Mr. Palmer, for 5 minutes.

Mr. PALMER. Thank you, Mr. Chairman.

I just want to point out, in regard to the impact of Dodd-Frank on small banks, that Harvard found that small banks lost 6 percent of their share of industry assets during the financial crisis, but since Dodd-Frank they've lost 12 percent. So I do think that validates that we're losing community banks as a result of Dodd-Frank. I think Frank Keating, the president of the American Bankers Association, said we're losing one bank a day, 7 days a week.

So it is a problem, and particularly in context to the answer you gave Mr. Carter about how many new banks the FDIC approved last year. Did you say one?

Mr. GRUENBERG. Yes, sir.

Mr. PALMER. That is problematic for a lot of us who represent rural counties, and I think practically all of us in Congress have some rural counties. I grew up in a rural community, and our community bank was extremely important to us.

Let me ask you this. Why have you been able to approve—why have you been unable to approve the creation of more community banks? What's the holdup?

Mr. GRUENBERG. This has been a subject of discussion during the course of the hearing, but at least it's—as far as we can tell, we've had an extraordinarily, nearly unprecedented economic environment, really, in the aftermath of the financial crisis and recession. It's been the longest prolonged period of near-zero interest rates, really, in our country's history. And community banks make money by making loans and charging interest. So when you have a very low or zero interest rate environment, it becomes a significant obstacle to establishing a new institution.

We think that's the core issue. As the economy can continue to progress and we see some rise in interest rates, we're expecting to see some increased activity. What is under our control is the process and procedures for submitting an application and working through an application process, and that may be the area where we can make a contribution to facilitating those institutions.

Mr. PALMER. I don't disagree that the economic conditions are a part of the problem. But I think one of the reasons that our economy—for instance, our economy has grown 1.55 percent over the last 8 years. The 70-year average is 3 percent. You want to talk about something that's unprecedented.

And I think a large part of that is due to the regulatory environment. We've seen record numbers of proposed rules. I think 2011 was somewhere north of 84,000. That record was broken in 2015. I think we'll probably break that record again this year. I think we're on pace for that, maybe. And as has been pointed out already, I think the biggest uptick in hiring in banks has been people to comply with regulations.

And one of the things that we've got to do in this, I think, in trying to help our banks, but also to help the economy, is untangle them from all these regulations.

Let me ask you this. If the FDIC is open to accepting new bank applications, where in the field is the breakdown occurring? And are your field examiners or other senior staff meeting with potential applicants expressing other concerns?

Mr. GRUENBERG. No. Look, I think our people are ready and available, and we certainly work closely with the groups that have an interest. I can only say that it's—I think the economic environment remains a challenging one, that's why we're actually seeing, at least thus far, only a handful of applications.

Mr. PALMER. Well, one of the things that interests me in this. FDIC routinely uses financial institutional letters to announce changes for de novo banks. Stakeholders are unable to comment on these. And why does the FDIC choose to utilize a financial institutional letter and then not give stakeholders the opportunity to come in? You know, that might be a way to improve the application process.

Mr. GRUENBERG. You know, we have just put out our application—existing application for public comment to take comments from industry and participants on how we can improve it and simplify it. So we do seek public comment. Financial institution letters are a means we used to communicate with the industry and to provide guidance to them.

Mr. PALMER. Don't you think more participation by the folks who are interested in starting a bank would be helpful?

Mr. Browning, if I may, I'd like to ask you a question. Did you participate in any meetings prior to your filing with the FDIC, and would a meeting like that have been helpful?

Mr. BROWNING. Well, thank you, Congressman. We engaged in a long series of conversations before our prefiling meeting. We held that prefiling meeting jointly with the San Francisco FDIC as well, as Washington, D.C., FDIC. From that prefiling meeting is when things got a little curious for us.

Mr. PALMER. Did you receive any communications from the FDIC, you know, on why they would not accept your application?

Mr. BROWNING. So we never actually formally filed an application, because we could never gain clarity on what was actually required to submit an application that would be deemed complete.

We held a series of conversations for many, many months but could never gain that clarity.

Mr. PALMER. So you had trouble getting any clear communications that would have helped you in your process?

Mr. BROWNING. Yes, Congressman. And the statutory requirements that have been longstanding are themselves clear and, I believe, adequate. What is different today, as Mr. Williams explained, the pendulum has swung, is the interpretation and application of those requirements and the authenticity that they're applied within certain segments of the FDIC.

Mr. PALMER. If I may, Mr. Chairman, just one more question.

It's my understanding the FDIC does not track prefile meetings because these are optional. Is that correct?

Mr. GRUENBERG. Yeah, I believe that's——

Mr. PALMER. And if it is, why aren't you documenting this?

Mr. GRUENBERG. I don't think we have a problem with doing them. They are voluntarily. Some applicants utilize them. We encourage them. But since it's an informal prefiling process, it's not something we would track as part of the application process. We certainly can do that, and as I indicated, at the outset, we're undertaking a review of our procedures relating to deposit insurance applications. So that's certainly something we can consider.

Mr. PALMER. I hope you will. I hope you will implement that.

Thank you, Mr. Chairman. I yield back.

Chairman CHAFFETZ. I thank the gentleman.

We now recognize the gentleman from South Carolina, Mr. Mulvaney.

Mr. MULVANEY. Staying right there, Mr. Gruenberg, on the prefiling of meetings, can you do that on your own initiative or would it help if we made the formal request?

Mr. GRUENBERG. We can certainly do that on your own initiative, Congressman.

Mr. MULVANEY. Got you.

Here's why I think you are hearing so many of us pound on this lack of new entry into the market.

And, Mr. Johnson, it's good to see you, again.

Mr. Johnson and I have talked several times over in the House Financial Services Committee. While he and I don't agree on many things, what we probably will agree on, that if you see an industry that is seeing increasing in profits—and certainly one of the criticisms of the financial services industry is they are actually making money—typically, Dr. Johnson, what we would see is a flow of new entries. New capital will go into someplace that's actually making money. So there's a disconnect here.

And I hear what you're saying about the environment being tough for new entrants because of low interest rates, but, clearly, somebody is making money. And I don't have a problem with that.

Yes, Mr. Johnson, I will, I promise, I'm last, so they will probably give me a little bit more time. But I want to stay on this a second.

Let me ask you. Let's drill down a little bit more. You don't track your prefile meetings, how many applications did you actually formally begin, say, last year? You said you approved one. How many actually formally started the process?

Mr. GRUENBERG. I was corrected by our staff. For what it's worth, there were two applications approved last year.

Mr. MULVANEY. How many actually got started?

Mr. GRUENBERG. And two—yeah, two applications were received.

Mr. MULVANEY. So you approved two of two? That's fascinating.

Mr. GRUENBERG. I'm sorry. One of those was received in 2014.

Mr. MULVANEY. Okay. I'm sorry, how long?

Mr. GRUENBERG. No, one of the applications was received in 2014.

Mr. MULVANEY. How long is it supposed to take to get your bank approved?

Mr. GRUENBERG. As I indicated, the average period from 2000 till today for approving applications tends to be 4 to 6 months, but it can take longer in individual cases.

Mr. MULVANEY. Out of the two that you approved last year, how long did each one of those take?

Mr. GRUENBERG. Apparently, within that timeframe, Congressman.

Mr. MULVANEY. Maybe I misunderstood. I thought I heard—again, we're talking over each other a little bit—that one of the applications that was approved this year was received in 2014. Is that not right?

Mr. GRUENBERG. Let us come back to be clear. But I believe it was received in 2014 and approved in 2015.

Mr. MULVANEY. Okay.

Mr. GRUENBERG. But let us come back to you to get it right.

Mr. MULVANEY. Let me ask this. Mr. Browning, you said that there are some statutory requirements on how long is this supposed to take? Did I hear that correctly?

Mr. BROWNING. Well, there is clear criteria on how to evaluate—on what basis to evaluate an application, and the FDIC's internal guidelines suggest that an application review process should be expeditious. Its track record, as the chairman has stated, is typically in the 3- to 6-month range. But it says only in unique or extenuating circumstances should it take longer and certainly no more than a year.

Mr. MULVANEY. I won't ask the question about whether or not everybody believes that new entry into the market is healthy, because I think other folks have asked you that question. And everybody, universally, has said that it is, whether you are running the Deposit Insurance Corporation or you're an academic or actually in the business, that new entrance is helpful.

Mr. Gruenberg, you said you were doing some things to help encourage that, and said you were trying to reduce—you said regulatory burden can act as a barrier to entry.

By the way, off the top of your head, do you know of any portions of Dodd-Frank that, perhaps, shouldn't be applied to community banks?

Mr. GRUENBERG. We—I don't know about—I don't know that I have a comment on that, Congressman, off the top.

Mr. MULVANEY. Well, if you wouldn't, who would? I mean, I think we all admit that Dodd-Frank, even those of us who oppose it—I wasn't here at the time—was designed to supposedly prevent another meltdown with the large financial institutions. It was not intended to deal with, necessarily, the community banks that weren't at all involved during the financial meltdown. In fact, some places were actually profitable during that time.

You've heard testimony that said there is a trickle-down theory. So my question to you is, have you seen the trickle-down theory, and can you name any portions of Dodd-Frank that were never intended for, perhaps, smaller financial institutions but that have ultimately impacted them?

Mr. GRUENBERG. One area we've tried to be clear about is that, you know, Dodd-Frank does require stress tests for institutions over $10 billion.

Mr. MULVANEY. Right.

Mr. GRUENBERG. And I think there was a concern that relates to this trickle-down issue that we were effectively subjecting the smaller institutions to the stress test requirements.

Mr. MULVANEY. What about the Volcker rule, do you think that should apply to small banks?

Mr. GRUENBERG. The Volcker rule as finally approved, actually, for small—if a small bank does not engage in the activities relating to the Volcker rule, there's no compliance.

Mr. MULVANEY. You're absolutely right, except they have a regulatory burden to prove that they don't participate, don't they?

Mr. GRUENBERG. Only if—they simply have to have a policy statement stating that. And even if they do engage in it, all that's required of them, as I understand it, is a policy statement as to how they engage the activity.

Mr. MULVANEY. You mentioned in response, I think, to Mr. Carter that you had taken steps to reduce the regulatory burden on small banks. By the way, did I hear you correctly say it costs about a million dollars to do this?

Mr. GRUENBERG. To start a new institution?

Mr. MULVANEY. Yes, sir.

Mr. GRUENBERG. I think that's the average cost, yes.

Mr. MULVANEY. And I also heard you say that the minimum amounts you would like to see in terms of capital are someplace about 2 million, but that the average is someplace around $10 to $20.

Mr. GRUENBERG. I think—yes, sir.

Mr. MULVANEY. Does that ratio bother you at all, that it might take up to 50 percent of my working capital to get approved for my bank?

Mr. GRUENBERG. To the extent we can lower the cost in regard to the million dollars that you are referring to?

Mr. MULVANEY. Correct.

Mr. GRUENBERG. To the extent we can lower that, and a lot of that, as you know, is accounted for by legal representation or utilization of consultants, to the extent we can help reduce that, that's——

Mr. MULVANEY. Can you give us two or three examples of the ways you've reduced the regulatory burden or the costs in the last year? If we are trying to encourage new entries, can you give us two or three real examples of what the FDIC is doing to reduce those barriers to entry?

Mr. GRUENBERG. Well, we had considerable concern by smaller institutions in regard to so-called S Chapter banks and how they dividend down, and we were able to adopt a policy to make it clear that they can dividend down to their shareholders, which was an important—and that's a large number of community banks.

Mr. MULVANEY. Yeah, but that only—okay.

Mr. GRUENBERG. It's several thousands, I think, are——

Mr. MULVANEY. But it hasn't worked, right? I mean, you've only got two applications and you got two approvals, it hasn't encouraged new entry into the market.

Mr. GRUENBERG. No, I thought you were speaking generally to regulatory burden on community banks.

Mr. MULVANEY. I'm asking what you meant by encourage new entry.

Mr. GRUENBERG. Yeah, I think the—well, probably the most significant thing we've done during the crisis, because de novo banks were failing at twice the rate of the industry as a whole, we have a—had a 3-year monitoring period for new institutions. During the crisis we extended that to 7 years in an effort to reduce the number of failures.

Now that we're past the crisis, earlier this year we were able to eliminate that extension and went back to the 3-year monitoring period, which is something, I think, the industry thought was worth doing.

Mr. MULVANEY. I could go on, but I'm already way over my time. You've been very gracious, Mr. Chairman.

Chairman CHAFFETZ. The gentleman is free to ask another set of questions in another round.

But let me go, first, to Mrs. Maloney of New York.

Mrs. MALONEY. Thank you, Mr. Chairman. This is really a very interesting hearing, and I thank all the panelists.

Chairman Cummings, regrettably, had to go to another meeting, he has a conflict, but he asked me to get some clarification on Mr. Browning's testimony.

In your testimony, and you talk about your startup on your LinkedIn page, and you state that you, and I quote, quote, "led strategy and execution of a de novo bank charter application," end quote.

You also say on your LinkedIn page that you, and I quote, "halted filing, due to the Volcker rule constraints, at a parent company."

I would first like to ask our resident professor, Professor Johnson, if you would give us a good definition of the Volcker rule. It is thrown around in every discussion. Give us a good definition of the Volcker rule.

Mr. JOHNSON. Well, the Volcker rule, which is complex in its details, is designed to reduce or eliminate—substantially reduce proprietary trading by financial institutions, by banks. So this should be—you shouldn't—you're not allowed, if you are a bank, to engage in more than a small amount of trading in securities for your own—using your own capital for your own account. So it's separation of client activity from proprietary trading.

Mrs. MALONEY. Thank you.

So, Mr. Browning, my question is, you said on your, as I said, your LinkedIn page, that you halted it due to the Volcker rule constraints. Exactly what were the Volcker rule constraints that prevented you from moving forward with Sterne Agee's FDIC application? It's a question to Mr. Browning.

Mr. BROWNING. Yes, thank you, Congresswoman. This simply, without getting into the extremely complex mechanics of the Volcker rule, which I'm happy to follow up with you on, this came down to a business tradeoff. The business, Sterne Agee, had been around for a century. It had multiple avenues to pursue. It was pursuing actively a bank charter, and that was its primary focus, where it was going to dedicate substantial capital.

As we worked through the process, we felt we would never actually achieve the desired end result of gaining a deposit insurance and a bank charter. And, therefore, Sterne Agee made a business decision to halt that process, go into another line of business that involved the Volcker rule, and as a result of that, we could not pursue the bank charter any further. It basically foreclosed that option for Sterne Agee.

But it was a business decision predicated on the fact of our experience in the application process and the lack of clarity, what we deemed an inauthentic application of those statutory criteria, that we would never be successful. So decisions at the parent company were made to pursue another course that took them down a path engaging in Volcker rule activities.

Mrs. MALONEY. Well, Mr. Cummings is very interested in this, and he would like to know, specifically, even though it's complicated, what prevented you, so you said, your application? How did the Volcker rule prevent you from going forward?

And also, he wanted to note that you did not provide the committee with any documents. The FDIC has produced documents in response to the committee's request. And one of those documents, dated May 27, 2014, provides information regarding the Sterne Agee. This document states that the bank would be owned by Sterne Agee, a brokerage firm, and would, quote, "be funded via sweep accounts from consumer brokerage accounts," end quote.

So, Mr. Browning, is it correct that your proposed ILC would have been funded primarily in this manner?

Mr. BROWNING. So that is very different from the Volcker rule implications. But, Congresswoman, yes, you're correct. Using sweep deposits, these are deposits from Sterne Agee, they have retail one-on-one client relationships with these brokerage account holders, those deposits are swept into other banks today. Having that primary account relationship, we were to take a small portion of those deposits to sweep them into this bank.

All of those deposits are FDIC insured in other banks today. There were roughly four to five times the volume of deposits in that program that this bank needed, so we were planning to take a small portion of those deposits.

Mrs. MALONEY. Okay.

Professor—my final question—Professor Johnson, what are bank sweeps, and are they as stable a source of capital for a bank or other sources?

And if I may, because this is a deeply debated issue before Congress, if you could get back to us in writing, even though it's complicated and intricate, exactly how the Volcker rule would have prevented you.

Mrs. MALONEY. But the last question is to Mr. Johnson. Yes.

Mr. JOHNSON. So Mr. Browning can correct me, but my understanding of this in general would be these are funds that clients have made available for trading, buying, and selling securities. And you, obviously, have some cash available, because you've sold something or because you're planning to buy something and you haven't yet bought it. I believe what they're going—what they'll be doing is sweeping that out of an account, which perhaps was held at another bank—I'm not sure about that—and sweeping it into their bank.

And the bottom line, Mrs. Maloney, would be this is less stable as a source of funding than a typical retail deposit, which is not subject to daily decisions that people are making. Should I buy securities? Should I sell securities? Those are big decisions relative to the underlying amount of funding. We don't do that, obviously, in our day-to-day retail financial transactions.

Mrs. MALONEY. Thank you.

Does Mr. Browning want to respond?

Mr. BROWNING. We could debate the technical aspects of the program we planned to use, which we've laid out in great detail to the FDIC, to show that these were actually dedicated deposit funds not used for other purposes. They were put into savings account deposit programs to be FDIC insured, and that there was a structure in which these were the last funds to ever be touched. And so it would be mathematically proven to actually be more stable than retail checking accounts.

Chairman CHAFFETZ. I thank the gentlelady.

Mr. Johnson, did you ever review, prior to this hearing, the information in Mr. Browning's application?

Mr. JOHNSON. I did have a chance to look at his testimony that was available on the table, and I am quite a quick reader, Mr. Chairman, yes.

Chairman CHAFFETZ. Yeah, I think it's pretty cavalier for you to pass judgment on the entire process by which Mr. Browning was trying to interact with the FDIC and for you to pass judgment on that. But that's my judgment.

Mr. JOHNSON. I'm sorry, Mr. Chairman, I didn't speak to that at all, in anything——

Chairman CHAFFETZ. I think you did. I think the record will reflect it. And I think you were very cavalier about that.

We now recognize Mr. Meadows for 5 minutes.

Mr. MEADOWS. Mr. Johnson, we will have a follow-up discussion about the security of sweep accounts versus a traditional deposit relationship at some particular future time. But I can assure you, being very familiar, I don't know that your statement is accurate 100 percent of the time. Would you agree with that?

Mr. JOHNSON. Well, I look forward to discussing these details with you further, Mr. Meadows.

Mr. MEADOWS. But would your statement be accurate 100 percent of the time that sweep accounts are not as secure as traditional banking relationship deposit accounts, 100 percent of the time, your sworn testimony?

I would challenge you, I would be careful, because it's sworn testimony. Is it 100 percent of the time? Is that an accurate statement?

Mr. JOHNSON. Look, I understand it's sworn testimony. The chairman has already said something about my sworn testimony that I believe is not accurate, Mr. Meadows.

Mr. MEADOWS. Mr. Johnson, yes or no?

Chairman CHAFFETZ. You were asked a direct question. We expect a direct answer.

Mr. MEADOWS. A hundred percent of the time?

Mr. JOHNSON. I feel that you are trying to trap me here, Mr. Meadows.

Mr. MEADOWS. No, I'm trying to get——

Mr. JOHNSON. I think it's unfair, and I think it's unreasonable, Mr. Chairman, for you and for Mr. Meadows to put me in this position.

Mr. MEADOWS. Well, it is unreasonable for you to challenge the integrity of someone sitting to your right when your statement may not be accurate 100 percent of the time.

Mr. JOHNSON. Mr. Meadows, I'm not challenging Mr. Browning's integrity, and there's nothing in the record today that will demonstrate to any fair reader that I have challenged his integrity.

Mr. MEADOWS. Well, I would invite you to come to my office, and we'll have a long economic and perhaps financial discussion over coffee that I'll be glad to provide, Mr. Johnson.

Mr. JOHNSON. Mr. Meadows, I will be delighted to have that conversation.

Mr. MEADOWS. All right. Thank you.

Mr. Gruenberg, let me come back to you, because there's three different areas that we need to clear up.

One is, you have laid out in very, what I would classify as ambiguous terms, how you're going to make sure that new bank applications improve. You've talked in generality, and in the sales environment we would say that's like vaporwear.

What I need from you is a business plan. If you were a bank applying for an application for a new charter, based on the ambiguous nature of your plan to improve it, it would be denied.

And so I guess what I need are specific timeframes. What can a consumer, wanting to establish a new charter, expect if they have a prediscussion? Because there are comments that you have a don't-call-us-we-will-call-you mentality on those pre-application meetings as it relates—which provides a chilling effect in terms of new application.

And I guess the results speak for themselves. If we only had two applications last year, there is a problem somewhere. Wouldn't you agree with that.

Mr. GRUENBERG. I agree with that.

Mr. MEADOWS. Okay. So here's what I need are specific deadliness, that if someone contacts you—and I don't want to go over historical, because it was much faster prior to 2007 than it is from 2010 to current timeframes—what kind of timeframe can a new charter application expect to get a real response from you? And what are those benchmarks? And so I'd like a business plan. And can you get that to this committee in the next 120 days?

Mr. GRUENBERG. I think we probably can.

Mr. MEADOWS. Thank you.

All right. Further, on all the applications that are either pending or have been denied, do you know what the total market cap that we're looking at? I mean, what would be the capital requirement for all of these? Because Mr. Browning said his was $30 million that he was going to provide, and you said that you can approve most that are $2 to $3 million. What are we looking at?

Mr. GRUENBERG. I don't think I can tell you off the top of my head.

Mr. MEADOWS. Well, we need to find that, and so that's why I'm asking whether it's in the pre or the official filing. We need to know. Because when we're talking about saving the American taxpayer's dollar, you could potentially approve 100 percent of these, and we're talking about a gnat on an elephant's back in terms of other regulatory compliance issues in the banking industry. Wouldn't you agree? That these are small potential risk to the American taxpayer.

Mr. GRUENBERG. Let us see if we can get back to you on that.

Mr. MEADOWS. Would you agree that it's small relative to the entire financial institutions?

But you can get me a market cap on what we're looking at, the potential?

Mr. GRUENBERG. I think that's what we'll try to do.

Mr. MEADOWS. All right. In that same 120-day timeframe?

Mr. GRUENBERG. We'll try to do that.

Mr. MEADOWS. Okay. Then the last thing that I would ask from you, Mr. Mulvaney was asking about potential Dodd-Frank compliance issues that should not apply to small or medium-sized banks, and you didn't want to give an official response to that. Here's what I would ask you to do, is officially respond to this committee in writing what Dodd-Frank compliance issue should not come all the way down to the smaller midsize or community banks and what should Congress look at to, perhaps, amend the Dodd-Frank regulations, because it is, perhaps, too onerous on those smaller institutions that do not provide the same risk that a larger institution perhaps. Can you provide three of those within the next 30 days?

Mr. GRUENBERG. Well, I mean, let us go back and take a look at it and we'll come back to you in 30 days with some thoughts on it, if that would be okay.

Mr. MEADOWS. All right.

I'll yield back. I thank you.

Chairman CHAFFETZ. Will the gentleman yield to the gentlelady from New York for a moment, please?

Mr. MEADOWS. Sure.

Mrs. MALONEY. I would also like to add to the gentleman's question Basel III. Now, the complaints that I get from the community banks are the requirements of Basel III, which is international banking. And they say to me, and it makes all the sense to me in the world, we're not involved in international banking. We are involved in helping a community. We're not over in Basel, Switzerland, or any other place.

And why do all—and they complain, believe it or not, Mr. Meadows, more in my district, and I have a lot of community banks that saved the city during the financial crisis. They were the only ones providing loans. But in any event, their major concern to me is the Basel III requirements that is just killing them.

And I don't see—maybe this is too simplistic—why you can't just say, if you're not involved in international banking, then you don't have to do Basel III requirements. I think that's a simple way to look at it, but then I'm always told, oh, you can't do that.

But I am very sympathetic to it. When somebody needs a college loan, when they need a house loan, when they need a small business loan, as Mr. Williams talks about, it's usually 100 percent the community banks that are providing it. And so I'm very sympathetic to the statements of Mr. Mulvaney and Mr. Meadows on this.

But I would like to add that too, if Mr. Meadows would allow that, to why—what are the things that you think are in Basel III that are needed for safety and soundness for community banks? It doesn't make any sense to me at all.

Mr. GRUENBERG. And I think it's fair to say as part of this GPRA review process, the review of the regulatory—regulations issue, one OF the issues that the agencies, the three banking agencies are focused on is simplifying risk-based capital, which would be Basel III, for community banks. To do that it would require a joint rulemaking, so the three of us would need to get together on that. And we are working on that, and I'm hopeful we can come up with a joint proposal in regard to that.

Chairman CHAFFETZ. Thank you.

Mr. GRUENBERG. A joint proposal.

Chairman CHAFFETZ. We now recognize the gentleman from South Carolina.

Mrs. MALONEY. He's got his hand up, the community bank.

Chairman CHAFFETZ. Hold up. Let me allow Mr. Williams to add to that, and then we will allow Mr. Mulvaney of South Carolina.

Mr. WILLIAMS. Just to further your comments on Basel III. I was in Europe this spring. The Europeans are shocked that we apply Basel III to community banks. They said it should really only apply to the 12 or so banks in America.

Chairman CHAFFETZ. I thank the gentleman.

We now recognize the gentleman from South Carolina, Mr. Mulvaney.

Mr. MULVANEY. To follow up, and I appreciate the opportunity, Mr. Chairman.

When we left off, Mr. Gruenberg, we were talking about two or three things that you all have done to try and encourage new entry. And I don't think we finished that conversation. So can you name two or three things you've done in the last, I don't know, 2 or 3 years to try and encourage more entry into this space?

Mr. GRUENBERG. As I mentioned, we've reduced the monitoring period from 7 to 3 years for de novos. We are holding meetings in regions around the country with interested industry and organizing groups to inform them about the application process.

We have—are going to be releasing before the end of this year, and I owe the chairman a report on the date on this, a handbook laying out, essentially a guidebook for applicants interested in accessing deposit insurance. We've issued guidance in a couple of instances trying to clarify the application process itself.

Mr. MULVANEY. Okay.

Mr. GRUENBERG. And we've worked with the State and Federal regulators responsible for chartering institutions, because deposit insurance has to go with the charter as well, so we need to work together if we are going to make the process——

Mr. MULVANEY. I appreciate that and don't want to, and won't, diminish that. But looking at the appendix from your testimony, it seems like maybe we could be doing more, because it doesn't seem to be working, that the numbers seem to be there have been 49 total applications received since 2009 and only 3 have been approved. I'm not real good on math, but that's really close to, like, 6 percent approval.

What does return mean in your world, Mr. Gruenberg, on an application? If an application is returned, what does that—that's not an approval, right?

Mr. GRUENBERG. No. It's generally when an applicant is unable to satisfy all the application requirements.

Mr. MULVANEY. And then a withdrawal would be similar to a return or——

Mr. GRUENBERG. When the applicant itself decides to—chooses to withdraw the application.

Mr. MULVANEY. All right. So return is the closest thing to a rejection that you guys do then, I guess, is what it comes down to?

Mr. GRUENBERG. In order to make a decision on an——

Mr. MULVANEY. It's not that big a deal, because you haven't done one since 2010, so I'm just trying to get the nomenclature right.

Mr. GRUENBERG. And this is, as you can see from the chart, from the appendix, both of these things occurred in the early part of the decade as well.

Mr. MULVANEY. Correct. Okay. And there are two pending, apparently?

Chairman CHAFFETZ. Will the gentleman yield?

Mr. MULVANEY. Absolutely. To the chairman, I've learned that that's usually a good practice.

Chairman CHAFFETZ. How many have you rejected?

Mr. GRUENBERG. Well, I think—the way——

Mr. MULVANEY. If return equals rejection——

Chairman CHAFFETZ. No, I don't think it does.

Mr. GRUENBERG. I think with—the general experience is that when an application is going to be rejected, we give the applicant an opportunity to withdraw the application, because as a general matter they prefer that than a formal rejection, which could have some consequence for them. And we try to give them that accommodation.

Chairman CHAFFETZ. But a rejection would have a consequence for you too.

Mr. GRUENBERG. Yeah. And, look, Congressman, I think, as we talked about, in terms of reviewing the process here, I take your point on that. I think that's something we could look at.

Mr. MULVANEY. I thank the chairman.

Dr. Johnson, thank you. It's good to see you again. Let's talk about barriers to entry and talk about new capital formation.

It's healthy, right? You and I would agree? You and I typically disagree on a lot of thing, but we'd agree new entrants into this space is a good thing. I think you said that earlier. So, in your mind, what could we be doing? If you and I both agree on an end goal, we might disagree on how to get there, but what are your ideas on how to encourage new entrants into this market?

Mr. JOHNSON. So I think we completely agree on this point, Mr. Mulvaney. Just to be clear, though, on the data, you made a very important point at the beginning. You said it's a highly profitable industry, we should expect a lot of entry. That's totally correct. But as we were discussing earlier, the profitability of de novo banks is rather low as an unfortunate, you could say, side effect of the very low Federal funds rates and the low 10-year Treasury rate.

Mr. MULVANEY. Yes.

Mr. JOHNSON. Now, as interest rates go up, that will help.

Mr. MULVANEY. But let me cut you off there, and I'm sorry to do that, but I get to do that, because I'm on this other side of the aisle, right? I apologize.

But you said something else, which is regarding economies of scale. One of the reasons that the small banks can't be as profitable is because they don't have economies of scale. You mentioned specifically technology. Would you agree with me, sir, that there's an economy of scale when it comes to compliance and that it's easier for the big banks to meet the compliance regulations and requirements than it is a small bank?

Mr. JOHNSON. Absolutely. And I think a lot of the discussion here and a lot of the suggestions you're making to the FDIC are completely appropriate. I think we should be asking, are there compliance requirements that are unfair, unreasonable, out of proportion to the risks that are posed? I think that's an entirely reasonable question.

The only point I was trying to make was there are other factors which according to the research are very important in the current situation, so don't be too hard on them given the interest rate environment. But as interest rates come back up, we should, to your point, Mr. Mulvaney, exactly expect more entry into the sector.

And to also support you, Mr. Mulvaney, if we look at Fintech, so other kinds of financial services where it's not generally funded by an insured bank, right, that's a typical characteristic of fintech, we see a lot of entry into that sector, we see a lot of risk capital, we see a lot of people wanting to provide loans to—particularly away from mortgages to consumers in different ways. So that's——

Mr. MULVANEY. Capital is trying to find a way into this space.

Mr. JOHNSON. Exactly. Exactly. So there are impediments in this sector, no doubt. The impediments are about the structure of banking. The impediments are about the nature of the economies of scale and potentially also the compliance. Fintech, you know, is an end run around some compliance. Maybe that's appropriate. Maybe we should have some concerns about it, separate discussion. But I think we're agreeing, Mr. Mulvaney, more than anything else here.

Mr. MULVANEY. And I think it's rare, so I'm enjoying it while it's lasting.

I guess my primary point is this, is that if we boil it down to just three barriers to entry, and we know that's not the case, but if the three that we've talked about today were the low interest rate environment, the high regulatory burden, and the technology component, there's really only one that anybody at that table can do anything about, and it's Mr. Gruenberg. And he could help lower the regulatory burden.

We can't—technology is market driven. And the Fed has more to do—as much as I'd like to think we have more influence over them than do, we don't. So we don't have much influence over the interest rate environment, but we do have influence over the regulatory burden to new entry into this marketplace. And I'm hopeful that maybe as a result of this hearing we can try and do something about that.

I thank the chairman for the opportunity.

Chairman CHAFFETZ. I thank the gentleman.

As we conclude here, you could see people filing in for the next hearing, which starts in 7 minutes.

This has been very productive. I appreciate all the participants.

Mr. Gruenberg, for both the ILCs and the community banks, can we by the end of the month, can you give us a good listing of what you are going to be working on to provide for this committee? Is that fair?

Mr. GRUENBERG. Yes, sir, I think we can do that.

Chairman CHAFFETZ. That would be great.

And then, Mr. Meadows was pretty generous on saying 120 days. But I think we have several of those items, including Dodd-Frank and others, that we would like to see. So if you can provide it to us by the end of the month, that would be most helpful. I appreciate it.

Thank you all for your participation. It's an important segment, important to our economy, and affects more Americans than most people realize. And we thank you all for your participation.

The committee stands adjourned.

[Whereupon, at 12:54 p.m., the committee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

Response to questions from the Honorable Jason Chaffetz
Prepared by the Division of Risk Management Supervision
Federal Deposit Insurance Corporation

Question: When did you start work on the applications guide and when will the work be completed?

Response: The deposit insurance application handbook was initiated in March/April of 2015, and drafting began in earnest in July 2015. The FDIC will issue the handbook for public comment by the end of 2016.

Response to questions from the Honorable John Duncan
Prepared by the Division of Risk Management Supervision
Federal Deposit Insurance Corporation

Question: For the deposit insurance applications approved during the timeframe 2013 – 2015, how much capital were the applicants required to raise?

Response: Please see the following chart.

Name of Entity	Date Received	Date Approved	Capital Proposed by Applicant	Capital Required in Approval Order	Capital Raised
Bank of Bird-In-Hand Bird-In-Hand, PA	01/09/2013	11/27/2013	$16,000,000	$16,000,000	$17,110,000
Primary Bank Bedford, NH	10/31/2014	03/09/2015	$25,000,000	$25,000,000	$30,435,000
Core Commercial Bank Newport Beach, CA	05/27/2015	12/29/2015	$25,000,000	$25,000,000	TBD

Response to questions from the Honorable Mick Mulvaney and Gary Palmer
Prepared by the Division of Risk Management Supervision
Federal Deposit Insurance Corporation

Question: Would the FDIC consider implementing a system to track pre-filing meetings?

Response: The FDIC plans to implement an internal system that will document and track pre-filing meetings held with parties interested in forming a newly insured depository institution. Formal implementation will be through guidance to professional staff, which will be issued by August 31.

In the interim, FDIC will issue a reminder to staff, by electronic mail, that pre-filing meetings should be documented in writing.

Response to questions from the Honorable Mick Mulvaney
Prepared by the Division of Risk Management Supervision
Federal Deposit Insurance Corporation

Question: For the deposit insurance applications approved during the timeframe 2013 – 2015, provide the date of receipt and the date of approval for each of the applications.

Response: Please see the following chart.

Name of Entity	Date Received	Date Approved
Bank of Bird-In-Hand Bird-In-Hand, PA	01/09/2013	11/27/2013
Primary Bank Bedford, NH	10/31/2014	03/09/2015
Core Commercial Bank Newport Beach, CA	05/27/2015	12/29/2015

Response to questions from the Honorable Mark Meadows
Prepared by the Division of Risk Management Supervision
Federal Deposit Insurance Corporation

Question 1: Provide timeframes of when an applicant can expect to get a response; what are the FDIC's benchmarks?

Response 1: The general timeframes within which an applicant can expect a response from the FDIC are listed below. FDIC will include these guidelines in the handbook to be issued for public comment by year end. In the interim, FDIC will share the guidelines with staff by electronic mail.

- Within 3 days of receiving an application, provide a letter to the applicant acknowledging receipt and discussing publication of the filing in a local newspaper, if publication has not already been addressed.
- Within 30-45 days of receiving an application, provide a letter to the applicant noting either that the application is complete, or that additional information is needed. If additional information is needed, the letter will include specific questions and requests, and will include a timeframe within which information should be submitted. Applicants are normally provided approximately 30 days to respond to such requests.
- If the application is complete, a field investigation will be coordinated among the relevant agencies, including the chartering authority and, if appropriate, the local Federal Reserve Bank. Following the field investigation, the FDIC will address any identified issues or concerns. This communication may occur by formal letter, or may occur through a presentation to the proponents. While the duration of each of these steps is dependent on the nature and complexity of the underlying proposal, the process should generally be completed within 60 to 90 days of the applications being deemed substantially complete.
- Following resolution of any identified issues or concerns, the FDIC will continue the review process, notify the applicant in writing of any proposed non-standard conditions, seek the applicant's written concurrence, and finalize the recommendation to the Regional Director. This process should be completed within 30 to 60 days of the FDIC's letter immediately above regarding issues or concerns identified during the field investigation.

Question 2: What will be the capital requirement for the pending *de novo* applications?

Response 2: Capital requirements for the pending applications, should the applications be approved, will be established in accordance with the applicable statutes, regulations, and guidance. The following chart presents the applicants' proposed capital.

Name of Entity	Date Approved	Capital Proposed by Applicant
FMCC Auto Bank[1] Draper, UT	Pending	$850,000,000
Power Capital Bank[2] Las Vegas, NV	Pending	$265,000,000
Blue Gate Bank Costa Mesa, CA	Pending	$30,000,000
International Bank of Commerce Oklahoma Oklahoma City, OK	Pending	$345,370,000

Question 3: What provisions of DFA should not apply to small and medium sized banks? Provide three ways Congress could amend DFA to reduce regulatory burden.

Response 3: Changes to legislative requirements applying to banks generally affect the achievement of multiple objectives involving bank safety-and-soundness, consumer protection, and compliance costs. Two significant statutory changes affecting small banks, relating to consolidated capital requirements of bank holding companies and statutory safety-and-soundness examination frequencies, were supported by the FDIC and have already been implemented. These are described below. Another possible change more relevant to mid-sized banks, regarding the statutory requirements for company-run stress tests, is also discussed below.

Company-run stress testing

Section 165(i)(2) of the Dodd-Frank Act requires the federal banking agencies to issue regulations requiring financial companies with more than $10 billion in total consolidated assets to conduct annual stress tests. Stress testing requirements are an important risk-assessment supervisory tool. The stress tests conducted under the Dodd-Frank Act provide forward-looking information to supervisors to assist in their overall assessments of a covered bank's capital adequacy and to aid in identifying downside risks and the potential impact of adverse outcomes on the covered bank.

That being said, the statutory language governing stress testing is more detailed and prescriptive than the language covering other prudential standards, leaving the regulators with less discretion to tailor the stress testing process. Congress could consider simply requiring banking organizations with assets greater than $10 billion to conduct company-run stress tests subject to regulations promulgated by the agencies, while leaving it to the agencies to determine the details of those regulations.

[1] At the request of the applicant, the application has been held in abeyance since 9/18/2009.

[2] Original application filed on 10/20/2009, which was returned to the applicant because it was materially incomplete. Applicant refiled on 12/28/2009; the resubmitted filing was subject to the Dodd Frank Act moratorium.

Small bank holding company policy statement

Section 171 of the Dodd-Frank Act requires that the federal banking agencies' generally applicable capital requirements serve as a floor for other capital requirements the agencies establish. As it was originally enacted, section 171 did not apply to bank holding companies subject to the Federal Reserve's Small Bank Holding Company Policy Statement in effect on May 19, 2010. The result was that bank holding companies with assets greater than $500 million were subject to the agencies' generally applicable capital requirements.

Public Law 113-250, enacted in December 2014, directed the Federal Reserve to increase the asset size threshold in its Small Bank Holding Company Policy Statement to $1 billion, and amended section 171 to exempt bank holding companies subject to this new size threshold. The Federal Reserve announced its final rule implementing this change in April 2015. As a result, most bank holding companies with assets less than $1 billion are no longer subject to the agencies' generally applicable leverage or risk-based capital requirements. This legislative change was supported by the FDIC.

Statutory examination frequency

Pursuant to Section 83001 of the Fixing America's Surface Transportation Act (FAST Act), the agencies are permitted to employ an 18-month examination cycle (instead of a 12-month examination cycle) for insured banks with assets of less than $1 billion meeting defined criteria. This represents an increase from the previous asset size threshold of $500 million. The FDIC supported this statutory change. On February 29, 2016, the FDIC and the other federal financial institution regulatory agencies jointly issued interim final rules that implement this statutory change. The new rules increase from $500 million to $1 billion the total asset threshold below which an IDI may qualify for an 18-month (rather than 12-month) on-site safety-and-soundness examination cycle.

Response to questions from the Honorable Jason Chaffetz and Mark Meadows
Prepared by the Division of Risk Management Supervision
Federal Deposit Insurance Corporation

Question: Would the FDIC provide a business plan (i.e., planned activities and timeframes) to promote the formation of *de novo* financial institutions?

Response: The FDIC has undertaken a multi-step approach to promote *de novo* banking. The following chart summarizes initiatives completed and in process. For each initiative, guidance for professional staff will be issued in conjunction with public releases. The culmination will be the release of the deposit insurance handbook, which will be issued by year end.

Initiatives to Promote the Formation of *De Novo* Institutions	
Completed Initiatives	
Date Completed	**Initiative**
November 2014	• Issued "Questions and Answers" (Q&As) associated with the FDIC's Statement of Policy on Applications for Deposit Insurance to provide transparency and aid applicants in developing proposals. Topics included pre-filing meetings, processing timelines, capitalization, and initial business plans.
March 2015	• Provided overview of the deposit insurance application process during a conference of state bank supervisory agencies.
September 2015	• FDIC hosted an interagency training conference to promote coordination among state and federal agencies in the review of charter and deposit insurance applications. Attendees included the State banking agencies, FRB, OCC, and FDIC.
April 2016	• FDIC returned the period of enhanced supervisory monitoring of newly insured depository institutions to three years from seven years. • Issued additional Q&As to supplement the November 2014 Q&As. This supplement addressed multiple issues related to business plans.

[continued on next page]

Initiatives In Process	
Target Completion Date	**Initiative**
By end of August 2016	• Issue guidance to staff regarding the maintenance of a central repository for documentation of pre-filing meetings.
During Third and Fourth Quarters of 2016	• Conduct industry outreach meetings in San Francisco (9/28), New York (10/13) and Atlanta (11/29). The events are being developed to ensure that industry participants are well informed about the FDIC's application review process, as well as the tools and resources available to assist organizing groups. • Include successful *de novo* banker panel in each session.
By end of December 2016	• Issue deposit insurance application handbook for public comment. The publication is intended to serve as a practical guide for organizing groups, and will incorporate lessons shared by the *de novo* banker panelists during the aforementioned roundtables, as well as the timeframes within which applicants may expect communication from the FDIC regarding the status of their submission.

In addition to the above activities, the FDIC will undertake a review of its internal processes and procedures for deposit insurance applications. As part of this internal activity, an interdivisional team will review the deposit insurance application process, including:

- the application form, references (including regulations, Statement(s) of Policy, and other guidance), and resources available to the general public for completeness, transparency, clarity, and consistency;
- questions or issues raised by applicants as difficulties or problems;
- internal processes and delegations; and
- internal guidelines regarding the timing of FDIC activities and action.

Action plan timeline:

- Identify working group members by August 5, 2016.
- Develop review plan for presentation to the Chairman by September 9, 2016.
- Conduct review.
- Present findings and recommendations to the Chairman by November 18, 2016.
- As appropriate, incorporate findings into the handbook to be issued for public comment by year-end 2016.
- Incorporate other findings and recommendations into a procedural manual for staff to follow in processing and evaluating applications for deposit insurance. Issue the internal procedural manual publicly by June 30, 2017.