S. HRG. 114–634

REDUCING THE BURDEN OF FEDERAL REGULATIONS ON COMMUNITY BANKS AND SMALL BUSINESSES

FIELD HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

APRIL 9, 2015

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REDUCING THE BURDEN OF FEDERAL REGULATIONS ON COMMUNITY BANKS AND SMALL BUSINESSES

THURSDAY, APRIL 9, 2015

COLORADO STATE CAPITOL,
DENVER, CO.

The Committee met, pursuant to notice, at 1:35 p.m., at the Colorado State Capitol, 200 East Colfax Avenue, Hon. Cory Gardner, presiding.

Senator Present: Cory Gardner.

Representatives Present: Ken Buck and Mike Coffman.

OPENING STATEMENT OF HON. CORY GARDNER, A U.S. SENATOR FROM COLORADO

Senator GARDNER. All right. Thank you, everyone, for joining us today for today's Senate Committee hearing. I'll call this hearing of the Small Business Committee of the United States Senate to order. I'm pleased with everybody that is here today. Welcome to the U.S. Senate Small Business Committee's field hearing on the fabulous subject of Reducing the Burden of Federal Regulations on Community Banks and Small Businesses.

I'm very pleased to be joined by Representative Buck and Representative Coffman, as well as our expert witnesses from around the State. Thank you to all of you and each of you for being here.

We're going to have two panels testifying today. We'll start with opening statements, and then we'll move on to a question-and-answer period. For the first panel we'll focus on Dodd-Frank issues and other federal regulations burdening community banks in Colorado and throughout the country. Then we'll do another round of opening statements and Q & A for the second panel to discuss the effect of financial regulations on small businesses' access to capital, as well as those broader federal regulations that are affecting small businesses, impeding job creation and economic growth.

I thought that it was important, though, today to lay out a couple of things that are happening in this country. Really, the narrative that we're hoping to draw out today is talking about our financial institutions. Community banks around the State and around the country are shrinking at an accelerating rate, at least partially due to financial regulations that negatively affect small businesses, among other groups, because community banks devote a disproportionate amount of their portfolios, their resources, to small business lending. This comes at a time when small businesses are already reeling, of course, from many other areas of federal regulation.

Just to lay some of the groundwork, the consolidation in the banking industry, as many of you know, has occurred since the 1980s. The number of community banks has fallen dramatically. The overall number of banks today is less than half the number that existed in 1984, according to the FDIC. From 1984 to 2011, the number of banks with assets less than 25 million declined by 96 percent. That's a 96 percent decline. Meanwhile, larger banks grew 11-fold in size over the same period, raising their share of industry assets from 27 percent in 1984 to 80 percent in 2011.

And right here in Colorado we see a similar trend. In 1994, Colorado had 307 federally insured banks. We now have half that number, with 148 operating in the State. At the same time, the market share of the three largest institutions increased from 34 percent in 1994 to 46 percent in 2014. Many of the regulations that we'll be talking about today weren't focused on Main Street banks in Burlington or Main Street banks in Grand Junction, but were focused on other areas. So the Wall-Street-driven regulations are affecting Main Street banks. It has nothing to do with crisis.

So that's what this hearing is about. It's about making sure that we get back to a country and state that is able to meet the needs of its people, its businesses, its communities in a way that reflects the passions of our communities. We'll talk about compliance costs falling disproportionately on small institutions. We'll talk about consolidation and the effect it has on small institutions' access to capital. We will talk about the share of money that banks, small banks, community banks, are providing to small businesses, which the White House website describes small businesses in this country as providing two out of every three jobs created. That's a significant impact that is being borne by some of the smallest of our communities and some of our greatest assets of this country.

So I hope that you'll have an opportunity, as well as me, to engage, to have a good back-and-forth discussion about the issues that matter and solutions to the challenges that we have laid out today.

And I want to thank all of you again for being in this committee hearing. It's great to be back in the state legislature. This is a unique experience for me. I was always in the minority in the state legislature, so I never held a gavel. This is new territory for us all.

Thanks again to the witnesses for being here. Thanks to the audience for your participation today and for your feedback. We'd love to continue to hear your thoughts on today's subject and beyond. Again, I hope that this field hearing provides an opportunity for the Small Business Committee, for Congressman Coffman and Congressman Buck to take back to Washington, D.C., to accomplish things that we need to in order to get our economy back on track and to address the vital role that all the institutions represented here today, from credit unions to banks, really do perform in our community.

So thank you very much for the opportunity to be here.

And I will turn it over to Congressman Buck.

OPENING STATEMENT OF HON. KEN BUCK, A U.S. REPRESENTATIVE FROM COLORADO

Representative BUCK. Thank you, Senator. I appreciate that. First of all, it's a great honor to be under a gold dome where a legislative body knows how to balance the budget.

Senator GARDNER. Cool.

Representative BUCK. And I must mention that I do have a favorite legislator. My wife, Perry, is right over there. I usually get in trouble naming favorites, but not in this case. I'd get in trouble if I didn't.

One of the honors of being a congressman is to have the opportunity to go around the Fourth Congressional District and listen to stories from various people and their concerns. And I have heard over and over again concerns of small business people and the regulatory burden that they face. It's not just the tax burden; it's not just the rising energy cost. But the regulatory burden is hitting so many businesses so hard.

I was with a group of bankers a couple months ago. They told me about one banker who had one compliance officer five years ago, and he now has four compliance officers. They explained to me, compliance officers don't make money, they don't help the community, they don't help loan money to businesses in the community that need it. It's overhead, and it's overhead that's caused by the Federal Government.

I was out on the eastern plains near Burlington, visited with a group of business people. A gentleman had a greenhouse. He was telling me that OSHA came out to do an audit. And he had a bottle of Windex, and he didn't have a spec sheet for the bottle of Windex. He was fined for not having a spec sheet for a bottle of Windex.

I talked to an owner of a mid-sized to large construction company, and he told me that they were audited by the Department of Labor. And the Department of Labor wanted to see the Christmas list for the employee Christmas function. And then they wanted to see a list of the people who didn't attend the Christmas function. Then they were fined because they didn't go to the people that didn't attend and ask them if they felt included at the Christmas party, or the holiday party.

It's that kind of regulatory burden that we put on job creators that's causing us problems. And one of the biggest problems that I find in talking to business people and bankers is that they have no certainty. They don't know what's going to happen three, four, five years from now. And they can't make investment decisions without knowing what the interest rate is going to be. They can't make investment decisions without knowing what their healthcare costs are or what their management costs are. It goes right down the line.

If we can't, as a government, create more certainty so that business people can grow, we will never deal with the $18.3 trillion debt that we now have. And that's something that, as a country, is, in my opinion, the greatest threat to our national security. We've got to be able to deal with that, got to bring certainty.

I thank the panel and Senator Gardner.

Senator GARDNER. Thank you, Congressman Buck.

Congressman Coffman.

OPENING STATEMENT OF HON. MIKE COFFMAN, A U.S. REPRESENTATIVE FROM COLORADO

Representative COFFMAN. Thank you, Senator Gardner, for holding this important hearing on the regulatory burdens facing Colorado's community banks and small businesses.

I would also like to extend a warm welcome to a couple folks from my district: Papa Dia, a branch manager of KeyBank, located in Aurora, Colorado, an immigrant from Senegal and a leader in my community; and Mel Tewahade from Infinity Wealth, also located in Aurora, Colorado, a strong leader in the Ethiopian community in my district. Both of these men are distinguished leaders.

And finally, I would like to thank our witnesses for making the trip to the capitol today to testify.

When I was a small business owner in the 1990s with an Aurora-based company, I can remember having accounts with a community bank that was later taken over by an interstate bank—I won't give the name—but how the decisions could no longer be made by the officers at that bank—they were outsourced—and how impersonal that relationship became and, ultimately, how I had to leave that bank to join another community bank.

So I think it's a problem that, in my view, is an overreaction by the Congress of the United States, a regulatory overreaction, in terms of passing Dodd-Frank. And the problems that it has imposed on smaller financial institutions is to the benefit, quite frankly, I think, of large financial institutions in this country. The notion of too big to fail—too big to exist, from my point of view. If the institution is so large it presents a systemic risk to the economy, and somehow we're supposed to protect it, I think it's problematic.

The passage of Dodd-Frank was a massive change in law, hundreds of pages long with thousands of pages of complicated regulations. Community banks are now forced to spend millions of dollars on regulatory compliance costs instead of using those resources for lending. Although banking regulation may have started with good intentions, ill-fitting rules harming small banks and their customers must be changed.

There are some in the administration and Congress who are unwilling to make any changes to Dodd-Frank, no matter how small. Dodd-Frank is almost five years old. It is hard for me to believe that such a major law is perfect. It is now time to make some commonsense changes to help our small businesses and community bankers.

I look forward to hearing from our witnesses today. Thank you very much.

Senator GARDNER. Thank you, Congressman Coffman.

Now I am pleased to introduce our first panel of Colorado experts that will discuss the state of community banking in Colorado and the federal regulations they're subject to.

Once I introduce you, please give your opening statement, and then I'll introduce the next witness.

Jay Davidson is the founder, chairman, and CEO of First American State Bank. He brings more than 25 years of experience in the banking, private business, and corporate sectors, and he's been recognized by numerous industries and public organizations for his expertise.

Jay, go ahead and give your testimony.

STATEMENT OF JAY DAVIDSON, FIRST AMERICAN STATE BANK, DENVER, CO

Mr. DAVIDSON. Thank you. It's an honor to be here, and I appreciate the representatives' involvement in this very important issue.

I'm a relatively small bank, with a little less than 3 million, in Greenwood Village. Started in 1995, 20 years ago. I've got to say that the environment in which we exist has changed dramatically over the years. It's become much—it's become much more difficult for us to do what we do best, which is, in our case, lend to independent business people. The job creators in our nation are not getting funds that they need to grow their business.

And so my testimony is not about poor banks. I don't feel sorry for major banks, and I don't think anybody else does. But I do feel sorry for the independent business person, the consumer, the person who can't get a job. And I think that's something that you can address particularly, and you do have weight in your roles as senators and representatives to make a difference.

I'd like to point out that commercial banking has declined dramatically since 1990. In 1990, there were 15,335 commercial banks in the United States. Today there are 6,570. That's a 57 percent decline. I might also add as an addendum that only one de novo bank has been chartered in the past seven years. One. And it's normally five to ten in any particular year in a normal recovery. That's one in five years. People aren't starting banks. There's reasons for that.

The smaller community banks have a unique role to play, and that is that we have the ability to understand the small business person, the independent business person. The large guys can do it, can certainly make those loans, but they've got to spend an inordinate amount of time doing it. They'd probably rather focus on the hundred-million-dollar loans or a lot of volume with consumer lending.

But we independent banks, community banks, focus predominantly on the independent business person. This is the person that creates over 60 to 65 percent of the new jobs that exist in the United States, that are created in the United States. We have an inordinate effect upon jobs creation and people's well-being, because I think you feel better when you have a good job, a good-paying job, and you contribute to society. I don't think you feel well when you're getting welfare or a handout. I think most Americans want to work.

I might also add, the largest banks have become larger. In 1990, the ten largest banks controlled 33 percent of the deposits in the nation. Today, that ten control 81 percent. Too big to fail, that's really done very well. It's made the big boys even bigger. And that's fine. We'll all get our market share. That's not bothering me at all. But we are creating a systemic risk in our nation that can't be handled by anybody, even somebody as good as the Fed Reserve or the OCC. They can't handle what's going to come down the pike when one of these gigantic guys goes under. And it's going to happen eventually.

So I just want to include that this information that I just read into the testimony is from SNL Financial. And I want to conclude—make a statement on their conclusion.

Smaller community banks play an essential and important role in our economy by servicing the small- to medium-sized business that adds jobs to our local economy. These same banks provide flexible financing for opportunities to help nurture the entrepreneurial endeavors in the local community. Increased regulatory burden is placing a large cost and time burden on the smaller community banks and has the potential to stifle economic growth in these communities.

And everything we've seen indicates that growth is stifled, that we are not—our economy is not growing and we are not recovering from the Great Recession. GDP has been sitting at 2.4 percent for about two years. It should be at 8 or 9 percent. We're not increasing the productivity of our nation of products and services. The Labor Participation Rate is sitting at 62 percent. 38 percent of the people out there that could work are not working. You tell me that it's only a 4 percent differential between 2005. Well, that's 8 million people without work. And I hear, at least, statistics that unemployment is 6 percent. Excuse me. You've got to add that 4 percent in. It's 10 percent. And we're seven years into this recovery, and we're not going anywhere.

And I'd submit to you the reason we're not going anywhere is that—I'm not—I've got to be real careful here because they regulate me. And I respect what they're doing. They've got a difficult job. But the Fed has two jobs. The Federal Open Market Committee, they determine monetary policy. The FOMC determined that they would stimulate the economy by creating vast amounts of money, unheard of, 4.5 trillion in the past five years. Unheard of printing of money. And they reduced the interest rates to near zero. This is very stimulative.

Why isn't the economy coming around? Because, on the other hand, the regulatory agencies are shutting the banks down from lending. I can't lend when I have to hold a 13, 14, 15 total risk-based capital ratio. I can't lend when I have to hold a 6, 7, 8, 9, 10 leverage ratio. I can't lend when my CRE 1 and 2 ratios are at 300 percent of capital.

I don't know how the other fellows are going to talk to this issue, and they may not even speak to it. But I think this is the major problem: Regulatory overreaction. And honestly, they have a really difficult job. In fact, it's almost an impossible job. They can't prevent the next recession, but people think they can. It's impassable what's being put on them.

So they are overreacting to the stimulus that they saw in the subprime markets. They came in and changed the way that we do banking, commercial banking on commercial real estate lending, and caused this liquidity crunch that we're facing today.

So I think that is one of the main reasons that we're not seeing an expansion of the economy. That's why I say it's not us poor banks. We'll get through this thing. But it really is sad that we can't do what we started our banks to do, which is lend to the independent business person and the individuals.

Thank you very much for this opportunity.

[The prepared statement of Mr. Davidson follows:]

Testimony of Jay Davidson,
April 9, 2014

Senator Gardner Field Hearing

Reducing the Burden of Federal Regulations on Community Banks and Small Business

Re: KPMG Report on Banking in Colorado

Thank you for the opportunity to speak to you about a topic with which I am very familiar. I started First American State Bank as a de novo bank in 1995; we grew the bank to $275 Million in assets in 20 years and serve the commercial banking needs of our community in Greenwood Village, Centennial and Cherry Hills.

I would add my support to the fine study that KPMG created (I believe Adam Fiedor or Wes Brown will also testify) outlining the declining role of community banking in small businesses and with Main Street. The studies' conclusion describes the net negative effect upon our economy, jobs, business start ups and the general well-being of our region.

Community banks fill a role that the much larger banks cannot or chose not to fill: we community banks have the unique ability and flexibility to understand the needs of small business and start ups and provide capital in the form of loans so they can expand. This role is extremely important in job creation, and thereby tax revenue. Let me explain. In a September 2012 white paper, the SBA Office of Advocacy makes the point that 60% to 65% of all new jobs are created by start up and small businesses. This is the very area that Community Banks serve.

You will note two phenomena: banks have not been lending very much into this sector and small business formation, for the first time in decades, declined significantly. In fact, small business failures now exceed small business start-ups. In a 1 April 2014 article in the New York Times: "The forces driving this trend include the increasing regulation of small businesses, corporate consolidation, more occupational licensing requirement..."

Is it any wonder the Labor Participation Rate sits at a dismal 62.4% or that GDP growth remains an anemic 2.4% for the past several years? The dual solutions for job creation are reduce the burden of federal regulations on business and reduction of the regulatory burden on community banks so they might provide much needed liquidity to small business.

Jay Davidson
Chairman, CEO, Founder
First American State Bank
First American Bancorp

Examples of regulatory burden:

Commercial Real Estate (CRE) Loans as a % of Capital: in 2006, federal banking regulators introduced guidance for CRE 1 and CRE 2. The ratios are commercial real estate lending as a percent of capital. In 2008, federal banking regulators, with little warning and no time to implement, started enforcing limits for CRE 1 and 2 lending. Commercial banks, in an effort to comply, stopped lending to small businesses and created the Second Liquidly Crisis of 2008. These lending limits were enforced universally and across the nation with no consideration that CRE lending in Denver Colorado is substantially different from that in Detroit. Well, guess who suffers when we stop lending to this segment, it is the very businesses that create the majority of new jobs: small business.

Capital Ratios: Federal banking regulators indicated they may not adhere to Basil III capital guidelines. Instead, they have stated they will apply premiums to the capital ratios based upon their subjective judgment of each bank. In other words, bankers will not know the proper level of capital and will be hesitant to lend because additional loans decrease capital ratios. Banks can work best and lend most efficiently if there are set standards, not arbitrary and ever-changing requirements, for capital.

Trust Preferred Securities (TPS): federal banking regulators are not willing to allow some banks to make regular payments on their TPS obligations. This creates a dangerous environment for community banks that gives rise to the potential for foreclosure by the TPS Trustees. When banks are profitable and above "well" capitalized levels, they should be allowed to make capital debt payments out of current earning.

Senator GARDNER. Thank you very much, Mr. Davidson. We appreciate your words today.

And I notice that the minority leader of the House, Brian DelGrosso, is here. I appreciate his participation as well.

We will go to Dave Reyher next, the president of Colorado East Bank and Trust, an independent community bank serving Eastern Colorado—and Central Colorado as well—families and farms. Dave started his career in banking in 1982 and understands firsthand the community banks in small, rural communities.

STATEMENT OF DAVE REYHER, COLORADO EAST BANK & TRUST, DENVER, CO

Mr. REYHER. Thank you, Senator Gardner. It's my pleasure to be here to testify on the reduction of the burden of federal regulations on community banks and small businesses.

Colorado East Bank & Trust was founded in the early 1990s, and we currently operate under the community bank model. What the community bank model means is we know our customers much better than any federal regulator, any bureaucrat that creates some of these rules we're operating under today. With this knowledge of our customers came the ability for us to custom tailor products and services that best met the needs of our customers. That's been taken away, slowly and slowly. We are now facing a commoditization of our business unlike any other. And I'll speak to that in a moment.

There was a recent survey of community banks. There was a hundred community banks that were surveyed by KPMG, and senior executives and CEOs from these banks responded to a number of questions. One of those was—when asked which of the following are the most significant barriers facing your bank over the next 12 months, 32 percent indicated that the regulatory and legislative pressures are the most significant barriers. Interestingly, only 8 percent responded there was a lack of creditworthy borrowers.

There was a similar survey done by the Independent Community Bankers of America; 6500 surveys were sent out, and 519 bankers responded. Some of the results from that indicated that lenders who are participating in consumer lending, which includes multifamily residential real estate loans, home equity lines of credit, and consumer lending—that there were 9 percent of those banks that were considering getting completely out of that product line. Of those respondents that indicated that they were getting out of that product line, they indicated that they were just going to stop making loans.

When asked what factors prevented them from making loans, those that are in the category of residential real estate lending, 73 percent indicated that the regulatory burdens of new rules and requirements were preventing them from making these loans.

So there's two clear conclusions to the results of these surveys. Lenders are leaving the markets because of the regulatory risk of needing to comply with all of these new rules and regulations and the severe consequences of noncompliance, which includes civil money penalties, regulatory consent orders and, in extreme cases, potential closure of that bank. The second thing is the rules and regulations that were meant to protect customers have done exactly the opposite and, in some cases, have had very negative effects on the customers.

Sadly, as a result of the increased regulatory scrutiny in our industry and the new regulations that have been brought to the table, we are slowly seeing, as I mentioned before, commoditization of the products and services that we can offer to our customers. Gone are the days of taking care of our customers on a personal, one-on-one basis. The cookie-cutter approach to lending today in particular has led to less credit being available, not only in smaller communities, but to small businesses and consumers nationwide.

I look forward to taking part in the rest of the hearing today and answering any questions. Thank you.

[The prepared statement of Mr. Reyher follows:]

Testimony of David P. Reyher

before the

U. S. Senate Committee on Small Business and Entrepreneurship

Reducing the Burden of Federal Regulations on Community Banks and Small Businesses

Good afternoon. My name is David (Dave) P. Reyher, and I currently serve as President of Colorado East Bank and Trust. I am here today to provide testimony on the negative effects that excessive federal regulation is having on the access to credit for consumers and small businesses served by community banks.

Colorado East Bank and Trust originated in the early 1990's through the purchase of an existing Bank Charter that was comprised of two small banks in separate communities in rural Southeastern Colorado. Today, the bank is comprised of 19 locations, 17 of which are located in Colorado and two in Western Kansas. Our footprint covers essentially the greater part of rural Eastern Colorado with locations in Pueblo, Colorado Springs, and the Greeley area, along with locations in two small rural communities in the mountains of Central Colorado (Buena Vista and Fairplay). As of quarter end March 31, 2015, the asset size of our bank ended at just over $780,000,000.00. Within these locations, we have 225 employees.

Colorado East Bank and Trust was founded and operates under the "Community Bank Model", which is probably best stated by one of the bank's six core values; "Provide quality products and services at a fair price, maintain local decision making and superior service to demonstrate our commitment to our communities and customer base".

Those of us that live and work in small communities, including all of the 225 employees mentioned above, realize that the local community bank is a major part of the economic engine that drives and helps these small communities to survive. Our 225 employees have a vested interest in schools, churches, community functions, volunteer and community service organizations located within these communities. For this reason our employees live that core value mentioned above every day. The community bank model serves banks like ours best because before it became a part of "Enhanced Due Diligence", we actually knew our customers quite well.

We knew that each customer was unique in not only their finances, but also their level of sophistication in operating their businesses as well as their personal finances. With this knowledge came the ability to custom tailor products and services unique to that customer; to be a true community banker.

A recent KPMG survey of 100 Bank CEO's and other senior executives of regional and community banks provides some candid perspectives and insights of the hefty regulatory demands now faced by community banks. Some of those results are as follows:

- When asked which of the following are the most significant growth barriers facing your bank over the next 12 months, 32% indicated that regulatory and legislative pressures are the most significant barriers, while lack of credit-worthy borrowers came in at only 8%.

- 37% of the banks surveyed indicated that they will be spending significant amount of capital on the regulatory control environment.

- When asked about the percentage of total operating costs driven by regulatory compliance requirements, 45% indicated it was between 5 and 10%, and 33% indicated that it was between 11 and 20%.

A similar survey conducted by the Independent Community Bankers of America was sent to 6,500 banks nationwide. Of these surveys sent, 519 CEO's and senior executives sent responses that begin to point to the issue of how the increased regulatory burden is affecting credit availability. Some of those results are shown below:

- Of the lenders that are active in Consumer Lending (Residential First Lien Mortgage Loans, Consumer Lending, Multi-Family Residential Loans, and Junior Lien Residential Loans, HELOC's), 9% indicated they were active in these markets currently but are considering an exit.

- Of the respondents that are exiting the line of business mentioned above, the exit strategy involves a passive exit; not making new loans.

- When asked the factors preventing them from making more loans, in the category of Residential Mortgage lending, 73% indicated the regulatory burdens of new rules and requirements was preventing them from making more loans.

There are two clear conclusions to the results of these surveys:

1. Lenders are leaving markets because of the regulatory risk of needing to comply with all of the new rules and regulations and the severe consequences of non-compliance which includes civil money penalties, regulatory consent orders, and in extreme cases potential closure of the bank. The CFPB provides Rural Exceptions to some of the burdensome regulations, but these do not adequately protect small banks, and even with the most recent proposals for easing these rules, it doesn't go far enough. Unfortunately, individuals that reside in smaller, rural communities have fewer and fewer options available to them when their bank no longer offers products and services as a result of the regulatory risks.

2. The rules and regulations meant to provide protection to customers have done exactly the opposite and in some cases have had very negative effects on customers. Obtaining credit for long term, solid customers used to take an hour or so to consummate for simpler loans, and a week or two for more complex deals. Today, simple loans take a day and a half and more complex deals to the same customer will, at best, take 30 days, and in most cases take up to 60 days to consummate. Further, the blame for the delay in "getting the deal done" does not end up with the bureaucrats and rule makers, but instead with the banker sitting across the desk from the disgruntled customer.

Sadly, as a result of the increased regulatory scrutiny of our industry the new regulations have brought to the table, we are slowly seeing a "commoditization" of the products and services we can offer to our customers. Gone are the days of taking care of our customers on a personal, one-on-one basis. This cookie cutter approach to lending in particular has led to less credit being available not only in smaller communities, but to small businesses and consumers nationwide.

Thank you for the opportunity to be a part of this hearing today, and I would be happy to answer any questions.

Senator GARDNER. Thank you, Mr. Reyher.

Koger Propst is the president of ANB Bank. He brings more than 30 years of experience in community banking, advocating for the role independent banks play in our communities. He serves in various roles in banking and community organizations, most recently having served as the past chair of the Colorado chapter of the Nature Conservancy and the immediate past chair of the Colorado Bankers Association.

Koger, thank you very much for joining us today.

STATEMENT OF KOGER PROPST, ANB BANK, DENVER, CO

Mr. PROPST. Thank you.

ANB Bank is a privately held community bank headquartered in Colorado, and our bank focuses on small businesses and commercial banking. And we serve customers both in metropolitan areas, as well as small communities throughout the State.

The prescriptive regulations that Basel III and Dodd-Frank impose substitute regulator judgment for, as Dave was talking about, the commonsense lending that our bank and other community banks provide. There are numerous vexing issues in both of those, and I certainly support the comments about mortgage lending, but I will not comment on those today.

Today I'll comment on Basel III capital requirements. And essentially, through those capital requirements, regulators are picking winners and losers on who the banks should lend to. And they do that by assigning risk weightings. And those risk weightings require us to put more capital to support certain types of loans and less in others.

More importantly, the borrower needs and local community needs are put aside for a judgment made by a regulator at a point in time, in a faraway place, in Washington, D.C., than what's happening in local communities. And I would add that probably the biggest winner of it is the Federal Government. Federal government debt requires zero percent capital for us to support, so there is a strong encouragement to put our money there instead of local municipalities or local borrowers.

I want to hit a couple things really quickly within Basel III. One is called high volatility commercial real estate. The goal was good. The goal was to say that there was a lot of speculative lending and that more capital should be required. Unfortunately, it casts a very wide net and it's very punitive if you go outside of that. And I want to hit a couple or three examples of those.

One is—and this is certainly not speculative lending—but we often partner with SBA and organizations like Colorado Lending Source to provide financing for small business owners to be able to buy their own business instead of renting it. We do that through a combined loan program and we'll lend up to 90 percent. That 90 percent, however, triggers this HVCRE lending and actually causes us to have to keep 50 percent more capital. Arguably, that means we've got to charge 50 percent more to those folks. So it's highly—it creates great discouragement to help them.

Another one would be, as we look at these, there's a certain amount of equity that has to come in. Oftentimes we'll partner with local EDCs or nonprofits who will put credit enhancements in place to make up the difference because the community has decided they want this type of business or this type of activity to occur. We cannot count their credit towards the down payment. And in fact, again, it can trigger the HVCRE and, again, 50 percent higher capital requirements.

And then a final note on HVCRE is that even if, in Yuma, Colorado, for example, someone has owned a piece of property for generations, we cannot give value towards the value of the property. We have to go to the old cost. The cost might have been impossible to determine. That means the borrower has to not only come up with the land they're putting in, but excess cash. Again, very limiting and has nothing do to with the goal of trying to solve the original sort of speculative lending problems.

Two other things within the capital that I think are troubling. Small businesses rely heavily on lines of credit. Our bank provides those. And under the capital guidelines, we have to set aside 20 to 50 percent capital for unused lines. That means we earn no money on the unused line, but we have to use scarce resources to support it. That causes you to think really hard, as a bank, whether you're going to give that line of credit to that small business, because it's extremely expensive to do it. As we all know, it's the lifeline for that small business. Again, it discourages.

And then the final one that I want to mention is past-due borrowers. If a loan goes 90 days past due, again, the capital, in addition to normal loan reserve, increases for problem assets. We have to increase our capital to 150 percent, so, again, 50 percent more. What's the reality of that? The reality is when our borrowers need us most, when we're in difficult economic times and they need a bank to work with, we have regulator incentive to get them out of the bank because it costs us dramatically.

Again, these are all things kind of just trapped in capital that haven't been thought through, and they need to be reopened and considered.

I would just make one comment on the overall weight of the regulatory burden. These are just minor examples of things that need to be fixed that are suffocating community banks. The losers of this assault—certainly we heard the stats on community banks, but it's not just them. It's the communities and the borrowers they serve.

I thank you for having this hearing.

[The prepared statement of Mr. Propst follows:]

Koger L. Propst, President
ANB Bank
Denver, Colorado

Testimony of Koger L. Propst

Senator Gardner Field Hearing

Reducing the Burden of Federal Regulations on Community Banks and Small Businesses

My name is Koger L. Propst, President of ANB Bank in Denver, Colorado. At the request of the Honorable Senator Cory Gardner, I am here today to provide testimony on the impact of Federal regulations on restriction and/or commoditization of lending by Community Banks and the impact on credit availability to the communities served.

For background, ANB Bank is a privately held community bank headquartered in Colorado. Our bank focuses on small business and commercial banking, serving customers in both metropolitan areas and small communities in Colorado, Wyoming and Kansas. ANB Bank provides traditional deposit products, trust services and provides small business loans, energy and Ag lending along with a variety of consumer loans, including portfolio mortgage products. ANB Bank provides a common sense lending platform that pairs traditional underwriting with community-based lenders who strive to learn our borrowers' story, and there is always a background story, to create flexible and tailored banking solutions.

The prescriptive regulations in Dodd-Frank and Basel III substitute regulator judgement and commoditized lending for the common sense lending solutions that community banks provide. Ironically, utilizing local judgement and sound lending policies have allowed many community banks' credit experience to fare far better than those models being dictated by the regulations.

While there are numerous vexing issues worthy of discussion, today I will briefly mention the mortgage rules and then will focus on the impact of the Basel III capital rules on community bank lending.

Others will testify more deeply on the Qualified Mortgage (QM) and Ability to Pay (ATR) rules. I would simply mention that not only is our ability to serve our customers restricted, but it is ironic that many of the new rules are patterned after FHA, whose delinquency/foreclosure rates during the crises were 5-15 times the rates experienced by many community banks. The QM and ATR rules imposed on community bankers require commoditized, "one size fits all", underwriting with no clarity that either access to credit or credit quality will improve.

Embedded in the Mortgage Regulations are compensation rules that severely limit the amount of bonus income that can be based on the institution's profits. There are many details (180 pages) to this "minor" piece of the legislation, but the net effect is that Washington is substituting its judgement for our board and management. At ANB, we don't pay any commissions; but even so, we must limit the amount of profit-based bonuses and instead now have to pay part of our bonuses based on other criteria, like production, whether or not the bank is profitable. This mandated solution seems like a fundamental part of the previous problem that Dodd-Frank intended to fix.

Now let's focus on Basel III and capital requirements. The early versions had several provisions that would have been disastrous to many banks. Fortunately, the worst were removed. However, Basel III and subsequent capital rules still contain problematic provisions. Through assigning risk weights to various assets and loan types, the regulators essentially allocate credit. Borrower needs and community banker judgement are placed second to those of far-away regulators, who essentially pick winners and losers. Interestingly, the primary winner is anything guaranteed by the US government which requires no capital support.

While there are numerous impacts, this testimony will focus on three notable areas that are negatively impacted by the risk weighted capital rules.

Koger L. Propst, President
ANB Bank
Denver, Colorado

- High Volatility Commercial Real Estate (HVCRE) addresses certain types of loans that the regulators deem as being high risk. For the loans that meet this very expansive definition, the bank is required to keep 50% more capital to support those assets. HVCRE is highly punitive and does not fit well with actual credit risk of many of the loans. Additionally, the regulation is pushing many legitimate borrowers into the shadow banking system for credit when there is little evidence that many of the covered loans are actually high risk.

    - One important lending program ensnared in the HVCRE trap is the SBA 504 loan program which is highly valued by community bank and small business owners.
    - In addition, HVCRE rules do not allow credit enhancements from local economic development entities and/or non-profits to count toward equity requirements, so the rules directly impede the efforts of local growth initiatives.
    - Once cash is injected in a construction project, it cannot be removed until the project is complete. This rule creates significant challenges for our customer's ability to manage their cash flow or even to pay their taxes.
    - Another, of many examples, is if a borrower plans to build on land that has been owned for a few years. To avoid the HVCRE designation, community banks may now only use the provable actual price for the land, even if it has been owned for generations and has no relevance to current market conditions. However, the shadow banking industry will continue the traditional practice of looking to the land's current value to determine how much the borrower is putting into the project.

    There are numerous other challenges with the HVCRE capital rules. Rather than assigning fixed capital costs, the banks and their borrowers would be better served by having a well-based loan loss reserve and good regulatory supervision—not by painting all loans of a certain type with a broad brush that drive borrowers, large and small, out of the banking system.

- **Small Business Lines of Credit** – Capital requirements discourage community banks from providing this essential service. Regulators now require that unused lines of credit be allocated a 20-50% risk weighting, which discourages the granting of operating lines that provide a critical source of liquidity to small business owners.

- **Past Due Borrowers** – Basel III assigns an extra 50% of capital to all loans over 90 days past due. While the extra capital sounds prudent, it is worth noting that it is in addition to increased loan loss reserves that regulators require in down economic cycles. During difficult times, community banks will now be forced to choose between helping a troubled borrower or finding the 50% additional capital necessary to support the loan. It is particularly troubling that this counter-cyclical provision will impact borrowers when they need help from their banker the most.

A key economic function of banking is to provide capital by carefully assessing and mitigating credit risk, and then lend accordingly. The ability for community banks to provide this central service is being deeply eroded. Under the weight of regulatory burden, the number of community banks with less than $1.0 billion in assets continues to decline, particularly those under $100 million. Notably, the numbers of large banks, which are better able to absorb the increasing overhead, continues to increase.

The weight of the regulatory burden is literally suffocating community banks. The losers of this assault are not only community banks, but also the customers they serve. The great irony for many community banks is to have survived the "Great Recession" only to be killed by friendly fire from Congress and the regulators.

Senator GARDNER. Thank you, Mr. Propst.

David Kelly, who we're looking to next, is the chief risk officer for FirstBank, where he is responsible for the development and implementation and ongoing management of all enterprise risk management processes for the company. This includes developing the company's Dodd-Frank Act stress-testing practices and implementing FirstBank's enterprise risk management practices.

Make sure you get close to the mic. And thanks for your testimony.

STATEMENT OF DAVID KELLY, FIRSTBANK, DENVER, CO

Mr. KELLY. Senator Gardner, thank you for having this communication. And Representatives Coffman and Buck, thank you for being here as well.

This is an important topic. I will try to be brief. You have a copy of my written testimony, and that goes into more detail. I'm going to hit the high points because my colleagues here have briefly touched on there is a dramatic impact to the community, but also to small banks, banks of all sizes, but more disproportionate in smaller institutions.

I think Representative Buck previously mentioned talking to someone who had to hire additional compliance officers. The amount of volume of regulatory change that's happened since the crisis, even pre Dodd-Frank—so I go back to 2008, when the crisis was there, through 2014—I highlighted about 15 regs that have taken effect, not all on mortgage lending, but throughout every aspect of banking, including safety and soundness and the like. They come in at a higher volume really fast. They have more complexity to them.

For example, the Truth-In-Lending Act implementation of Regulation Z. In 2008, the Government Printing Office had 248 pages, the regulation, commentary, and all its appendices. As of 2014, that stood at 988 pages. That's the actual reg, the commentary, and all the appendices. It's not the preamble. There's thousands of pages in its preamble to all these new rules that we have to have people read through and figure out how do we implement that within our organization and what are the pitfalls to doing that.

The complexity has definitely grown throughout this time as well. And depending on the regulator, you have a lot more prescriptiveness coming into the regulations, which are basically dictating business practices and trying to account for the maybe problem practices that could have been dealt with by regulatory enforcement action. But they want to make sure it doesn't happen anywhere, so they put restrictive rules into regulations such that you have to follow them. And it has caused a lot of companies to have to reconfigure business practices, and all those who didn't have any real problems with their practices.

If you look at the background of FirstBank, they are predominantly a mortgage lender, or predominantly a real estate lender. We had about 10,000 mortgages outstanding in 2009. We've got 24,500 today. Throughout the crisis in 2014, we had 179 total foreclosures. That's entering foreclosure; not all of them went through foreclosure.

We didn't change any of our underwriting practices as a result of the economic downturn. We had to change as a result of the regulatory burden. I often get asked, how much does it cost to implement a reg? I would have to hire a full-time person just to go through that to figure that out. It's not the single reg by itself that actually creates burden; it's the cumulative impact of all the regs. And I think today there is no thought to cumulative impact.

Dodd-Frank was put into place. It attacked everything that was wrong as part of the crisis. If there was a problem here, put a fix to it. Problem here, put a fix. Every little thing that was thought to be a problem, they put a fix in. But when you add all that up, it's a huge impact. We go back and look at the time we spent processing mortgage loans. I can give you an example of this. Between 2010 and 2014, for a hundred-thousand-dollar or less transaction, consumer loan transaction, we're spending 67 percent more time on that transaction than we were pre crisis. For a mortgage loan, same dollar amount, we're spending 44 percent more time; 47 percent more time for a mortgage transaction over 250,000.

This is not changing any of our underwriting standards. It's all the additional disclosures and documentation that we have to ask from our borrowers. And small business borrowers actually do get impacted on the consumer mortgage side as well. If you are a small business owner and your business is growing, I can't give you credit today for the trends in the industry. I have to look at historically what's happened. If I do want to give you credit for that, I can't just take your word for it. I have to have you go hire a CPA to certify that what you're telling me is accurate so that I can give you credit for it.

That does add cost to the small business owner, either through that additional expense or by having to delay your financing until your tax returns catch up to where we can underwrite you for. And the interest rate environment can change completely. Small businesses are impacted there.

There's technology that goes along with all of these changes today, and there's quality control practices that we must have. So throughout this whole process you have to have resources to show that you are doing things right, that it's not going to trip you up. A lot of these rules that Congress enacted double the liability for some of these, from a civil liability perspective, and brought in technical compliance to help manage that civil liability.

So you have to be very careful about how you go about it. It's no wonder that large or small bank institutions have re-thought whether they should continue in this line of business and some of them have exited the lines of business, reducing credit that it needs.

Again, it is the cumulative impact of all of the regs that are the biggest item that needs to be addressed. But, absent that, I will cut my commentary off.

Thank you for your time. I look forward to your questions.

[The prepared statement of Mr. Kelly follows:]

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Testimony of David A. Kelly

before the

U.S. Senate Committee on Small Business & Entrepreneurship

Field Hearing Regarding Reducing the Burden of Federal Regulations on Community Banks and Small Businesses

I am here at the request of the Honorable Senator Cory Gardner to provide testimony on the impact of regulations on financial institutions and would like to thank him for the invitation to share my perspective.

My name is David A. Kelly, Chief Risk Officer for FirstBank Holding Company, based in Lakewood, Colorado. Founded in 1963, FirstBank currently has over $14 Billion in assets and over 120 locations and 2,000 employees serving Colorado, Arizona, and California. In my role, I oversee the enterprise risk management practices of the organization, stress testing under the Dodd-Frank Act, and provide senior management oversight to the Compliance and Loan Review functions. Previously, I was President of our Loan Operations and Mortgage Operations and have also served as head Compliance Officer for the company. I also currently serve as Treasurer of the Colorado Bankers Association and am the former Chair of its Dodd-Frank Act Task Force, which reviewed a number of the new regulatory proposals for impact on Colorado banks.

While FirstBank is no longer classified as a small business, I will share some of our information, as I believe it will provide insight into the impact resulting from all of the new regulatory requirements. Given our history, the impact to our organization was likely less than it was for smaller institutions. However, the impact to our organization has been, and continues to be, significant.

FirstBank is a predominantly retail banking organization, with a large consumer customer base. The company has also been predominantly a real estate lender and significant mortgage lender, with both portfolio and secondary market products. Our organization has always assessed a borrower's ability to repay before entering into a mortgage loan transaction. Our underwriting and documentation standards were flexible and risk-based to meet the needs of our diverse customer base, including many small business owners. Between 2009 and 2014, our mortgage portfolio has grown from over 10,000 loans to just over 24,000. During that time period, we had a total of 179 residential foreclosures. Our peak year for foreclosures was 2010, where we had approximately 50 residential foreclosures, which represented 0.4% of our total mortgages. We did not change our underwriting standards as a result of the economic downturn.

Since 2008, there has been a significant amount of new regulations and risk management guidance issued related to banking in general. Many of these rules impact organizations of all sizes. Some have been scaled to provide limited exemptions or streamlined compliance for smaller institutions. However, minor changes in practices can make an institution subject to all of the requirements. In addition, there is anecdotal evidence that guidance intended to be scaled to the size and complexity of an organization has been fully applied, regardless of size or complexity, often through the suggestion of complying as a "best practice." Whether fully complying or not, small institutions have needed to hire resources, internal or external, to understand the rules and ensure compliance.

The following is a listing of some of the primary regulatory changes that have occurred or are currently in the rulemaking process:

- Mortgage Disclosure Improvement Act
- Electronic Funds Transfer Overdraft Regulation
- Mortgage Loan Originator Compensation Rule (Initial and Revised by CFPB)
- Real Estate Settlement Procedures Act (RESPA - HUD Revision and New CFPB Revision)
- Electronic Funds Transfer Foreign Transactions
- Ability to Repay and Qualified Mortgage Rule
- Mortgage Servicing Rules
- Appraisal Independence, Disclosure, and Practice Rules
- Prohibition on Proprietary Trading (Volker Rule)
- Revised Risk-Based Capital Rules (BASEL III)
- Guidance on Model Risk Management Practices
- Third Party Risk Management Oversight
- Data Integrity Regulatory Expectations
- RESPA/TILA Merger (Effective August 1, 2015)
- Home Mortgage Disclosure Act Data Collection and Reporting (CFPB Rule being finalized)

While the cost of complying with any single rule may be manageable, it is the velocity of change and the cumulative impact of all of the rules that have created the need to significantly increase staffing, change and modify systems, and ensure ongoing proper training for all employees involved in the areas being regulated.

Not only has the volume and velocity of change been significant, the level of complexity of the rules has increased significantly as well. This is especially true with the newer consumer protection regulations. The recent revisions to the Mortgage Loan Originator Compensation, Qualified Mortgage, and Mortgage Servicing rules are all very prescriptive, which adds significantly to the burdens for community banking organizations. The complexity, coupled with the significantly increased civil liability for non-compliance, has made a number of smaller organizations reconsider whether to stay in certain lines of business.

As an example of the growth and complexity of rules, I will discuss the implementing Regulation Z to the Truth-in-Lending Act. This law has governed consumer credit disclosures and protections for decades. In 2008, the regulation, commentary, and appendices totaled 248 pages in the Government Printing Office's Code of Federal Regulations publications. Since 2008, modifications related to disclosures, underwriting, appraisals, and servicing has brought the total page count to 988 as of 2014, with the majority of that occurring since the passage of the Dodd-Frank Act in 2010. Its size has almost quadrupled within a six-year period of time and is only reflective of the actual changes in the rule. It does not account for the thousands of pages of associated preamble commentary discussing the determinations and underlying intent contained in the final rules. No institution could effectively review, understand, implement and ensure compliance with such significant changes without significantly increasing resources.

Between 2008 and 2014, we have increased our centralized compliance personnel resources by approximately 200%. Some of the personnel increase is attributed to the normal growth in operations. However, most of it relates to increase in regulatory burden and the associated complexity of ensuring the rules are understood and implemented appropriately.

Smaller institutions have struggled to find and hire experienced compliance personnel. The salaries for compliance personnel have increased significantly for these institutions, as the demand has outpaced the supply of qualified individuals within the institution's market. Alternate resources, such as external counsel and consulting companies, have been hired to assist with compliance understanding and implementation. These often come at increased costs and may only be a short-term solution for some organizations. Often, these resources need to understand the operations of the entity, which increases the time period for an engagement and costs associated with their utilization.

The Ability-to-Repay rule poses special compliance challenges. This is one of the first rules where traditional compliance overlaps with sound underwriting. Failure to underwrite properly exposes the institution to civil liability in the event the loan defaults. Failure to document the transaction in accordance with the rule opens the institution up to civil liability, regardless of whether the underlying underwriting is sound and the borrower has the ability to repay the transaction. In order to properly test for compliance, it requires a special skill set – one that addresses both components. This can be accomplished in a number of ways, but both require additional resources. The company either needs to have the same loan reviewed by multiple parties, or it needs to employ personnel that can do both. Either way, it results in increased personnel expense to the organization.

Our experience is that the Ability-to-Repay rule has also increased costs for small business owners who are seeking consumer real estate credit. Our institution has a large customer base of small business owners. Small business owners who are in the early growing phases of their business find it more difficult now to obtain financing for buying or refinancing a home. The reason is that their financial information must be verified by a third party. For established business, historical tax returns can be used to establish a stable earnings trend. Even though the verified tax information may be considered stale for making a credit decision and not prudent to rely on from a creditor's perspective, it is acceptable from a regulation perspective. For small businesses in early growth phases, historical income may not be sufficient to qualify, but current earnings and trends are sufficient. In these situations, the business owner must hire an accountant to review their current financials to be considered verified by a third party before the lender may rely on the earnings in making a credit decision. Often, otherwise qualified business owners will need to either incur the expense or delay financing until the taxes are actually filed and can meet the regulatory standard for acceptability. This may prevent them from being able to take advantage of current interest rates, which could also become an indirect cost for them.

The regulatory and documentation requirements also are not scaled to the relative size of the transaction. Smaller transactions carry the same amount of regulatory risk as the larger transactions, so compliance is equally important. The costs associated with originating smaller credits have grown significantly as well, and can outweigh the benefits of offering the products. While it is difficult to quantify costs to particular rules, the amount of time spent processing loans prior to origination gives an indication of the increase. Between 2010 and 2014, which is the timeframe when the majority of the regulation changes were implemented, the time spent processing a consumer loan transaction less than $100,000 has increased 67% within our organization. On the mortgage side, the time spent processing a loan increased 44% for mortgages less than $100,000, 35% for mortgages between $100,000 and $250,000, and 47% for transactions over $250,000. As I mentioned at the beginning of my testimony, we have not changed our underwriting practices, except to comply with the new rules. Most of this increase can be attributed to the increased documentation and disclosure requirements that have already taken effect.

In addition to increased compliance personnel and origination costs, there has also been a significant increase in quality control and ongoing compliance monitoring. For mortgage loans sold on the secondary market, an institution must have a quality control review process in place. An institution's files must be reviewed to ensure quality of underwriting, documentation, and compliance with all applicable laws and regulations. In most cases, an institution must hire an independent third party to conduct such reviews. In these situations, the company is also required to "check the checker" by conducting quality reviews of the third party reviews. For the few private secondary market outlets that have developed, the restrictions in the sale contracts make the originator liable for any inaccuracy or failure that may occur during the loan process. Therefore, it is necessary to have a thorough pre-close and immediate post-close review process to ensure 100% compliance. While this illustration involves mortgage lending, all aspects of compliance require some level of quality control review and remediation processes. The increasing regulatory burden requires additional personnel in this area as well, resulting in increased costs to the organization.

Mortgage servicing is another area where there has been a significant increase in costs resulting from regulations. In many respects, the regulations issued went well beyond the laws passed by Congress. This has required a significant expense for infrastructure related to servicing and collection of loans. The required practices are very prescriptive and opens and institution up to civil liability for technical failures to comply. The documentation standards are inflexible and do not allow organizations to implement the rules in a risk based manner without significant liability. This is one area where the regulators sought to exempt smaller servicers from the rules. However, this has still come at a cost. From a competitive perspective, some institutions comply with certain aspects of the rules, because consumers come to expect similar experiences involving non-defaulted loans. This may involve the ability to offer escrow accounts to its customer base. In other situations, small institutions have needed to forego revenue in order to remain exempt from the servicing rules. For example, some institutions have serviced owner-carry notes for its customer base. However, if they accept a fee for doing so, they are no longer eligible for the servicing exemption. Most institutions involved in this activity ceased offering the service or waived collecting fees on existing arrangements in order to avoid full coverage under the rules.

The full impact of regulation cannot be understood without discussing changes in technology and systems. Financial institutions rely on many software platforms and vendors to assist in compliance with the rules and regulations. The reliance on technology has become more important as the complexity and required formatting for disclosures continue to change. Any time a change is necessary, the software platform must be updated. The expense of updating the systems is passed on to the users of those systems. Significant resources are employed by the vendor to ensure that changes are implemented appropriately. This becomes challenging when substantial changes to the rules are made and a relatively short period of time for implementation is mandated. It gets exacerbated when the regulatory agencies need to continue issuing clarifications during the implementation period.

Once the updates are received, the institution needs to engage in quality control testing to ensure that the systems are working as necessary related to the new rules, and to ensure that the updates didn't corrupt the items not impacted by the changes. In recent years, it has become more challenging to receive the system updates with sufficient time to test them prior to the mandatory compliance dates. This is directly attributed to the significant amount of, and complexity of, the changes being implemented. Since liability to the institution begins immediately, the delays create real challenges. It is frequently necessary to dedicate additional resources to conduct the testing in shorter periods of times. However, the institution must insure that these resources understand the compliance requirements. Even with dedicating additional resources, unrelated errors are periodically discovered post implementation, which require another round of updates and testing.

Separate from the specific software application updates, institutions must re-evaluate internal processes and systems with any new regulation or revisions to existing regulations. Modifications must be made to implement necessary changes, capture appropriate data, test for compliance, and remediate any weaknesses identified. While the processes employed by an institution may be risk-based relative to its activities, the underlying steps must be conducted for every regulatory change as part of an appropriate compliance management system.

Finally, financial institutions must engage in some level of independent compliance testing. This is often referred to as a "third line of defense" for an organization and is important from an overall compliance management program perspective. The testing may be conducted by qualified independent internal or external personnel. While it can be risk-based and scaled to the particular organization, the coverage needs to be sufficient to provide the institution with reasonable assurance that its compliance program is effective. As the amount of regulation continues to grow, along with the liability for non-compliance, the institution's program must expand. This leads to additional costs, especially for smaller institutions.

As I mentioned earlier, the cost of implementing any particular rule may be manageable and appear insignificant. It is the cumulative effect of all of the rules that is significantly impacting the costs for financial institutions, especially the smaller ones. These costs must ultimately be passed onto those utilizing the services.

Thank you again for the opportunity to provide this testimony and be a part of the discussion surrounding the impact of regulation on businesses.

Senator GARDNER. Thank you, Mr. Kelly.

Probably what we'll do is just go to the roundtable part of this discussion. I'll ask a question, and Congressman Buck and Congressman Coffman can jump in with a question at any time. That way, you don't have to suffer listening to one of us.

I'll start with you, Mr. Davidson, just talking a little bit about the numbers that you cited, the banking numbers, 15,000 reduced to 6,000 today. What does banking look like in Colorado in another 20 years?

Mr. DAVIDSON. If this trend continues—and I hope it doesn't, with your help—but if this trend continues, you'll see a few very large banks and you won't see community banks, I don't believe. That's the broad sense.

Senator GARDNER. In your mind, this consolidation is being driven by regulatory burden?

Mr. DAVIDSON. I think predominantly by regulatory burden. I'll give you an example. My grandfather started—bought a bank in 1903. It truly was a one-horse bank, up in North Dakota. It's still in the family. I kind of hoped that when I started this bank, I'd pass it on to my kids. I don't want to do that anymore.

Representative COFFMAN. Let me ask Jay Davidson a question, but I'd like everybody in the panel to reflect on this.

First, going back to my small business days, if I didn't know my bankers, I would never have been in business, because there was a crucial relationship of someone who believed in my business model. And if you commoditize that—Dave, I think you said, Mr. Reyher, there's no way that they could have taken that crucial relationship and could have made that decision. So the 20 jobs that I created for my small business would not have existed.

But community banks have a concentration in commercial real estate, and I think they've been penalized, by that concentration, under Dodd-Frank. I know that in talking to community bankers, that if they are performing loans, that they would require a down payment because of that. I wonder if, Jay, you could speak to that.

Mr. DAVIDSON. Yeah. The ratio is called CRE 1 and 2, Commercial Real Estate Number 1 and 2; 1 is the speculative land lending, which is dangerous, I will admit. That's what brought down a lot of banks during this last recession. The other one is CRE 2, which is a performing loan, a cash-flowing business, an office, an industrial space, a multi-family residence. But that cash flow made cash flow throughout this downturn.

In 2006 or 2007, the regulators advised us banks that are heavy commercial real estate lenders that they were going to provide guidance, and that guidance was 300 percent of capital for CRE lending. I'm in the 600 percent. I'm one of the outliers. I don't think I really am, because most of Colorado lending is commercial real estate. You can't go find an industry like you could in Detroit. And I know a lot of my compatriots here do a lot of C&I lending. We're born and raised and bred for CRE lending, commercial real estate lending.

Well, when these guidelines became hard and fast rules one year later, we had no time to adjust. This was the beginning of what I call the second liquidity crisis, Congressman. All of us banks immediately tried to sell our commercial real estate loans, get them out of there. We had to increase our capital ratio. The best way to do that is certainly not to raise capital in a down market; it's to get rid of assets and increase your capital ratio. Well, that created a liquidity crisis because nobody wanted to buy anybody else's loans. Nobody wanted commercial real estate.

I think we're still feeling the effects of that activity today. We're still being held to a 300 percent of capital CRE 2 level.

Representative COFFMAN. Mr. Reyher.

Mr. REYHER. Yes. Representative Congressman, I find it interesting that you talked about that personal relationship that you had with your banker. You would never have had a shot without that. I think all three of my—the other three of my compatriots here, that's one of the things that they find that kind of drives them to be a banker. It's that personal relationship; it's that community bank model.

One of the things that I found today in our report is that you have long-established customers within these community banks. And a simple deal that years ago used to take an hour, an hour and a half, now takes a day or a day and a half to get done. And if it's got any complexity at all to it, it's 30 days to 60 days before this can get done, by the time you figure out all of your appraisal requirements, all of the disclosures that have to be filled out today.

And these, on top of everything with the folks that we're doing business with today, they're not wait-around kind of people. They're, I got a deal, let's get it done. Unfortunately, we're the ones sitting across the desk from a disgruntled customer, not the bureaucrat in Washington, D.C., who dreamed this stuff up. So that's a problem. It's definitely impacting the availability of credit to these folks. No doubt about it.

Representative COFFMAN. Koger.

Mr. PROPST. Two quick comments. One, in both of these, the other CRE—I mean, the limits that Jay was talking about, the 300 percent, number one, that was guidance, and so you could go above it. But the problem with guidance says you're okay till you're not. So as soon as the regulators said you weren't, that's what caused the crisis that Jay was talking about.

The second piece is that as we layer all these regulations and requirements that Dave was talking about, the world is moving faster, and we're driving it out of a regulated industry into shadow banking. If you look at jumbo mortgages and all those sorts of things, the shadow banking is coming in and solving the problems that the regulated entities can't. I'm not sure that's good for our economy as well.

Mr. KELLY. I will echo the comments that have all been made. I've heard that with my term on the CBA and with a number of other institutions. And our institution has seen different type underwriting standards throughout the crisis and afterwards. There is definitely higher expectations on how you handle credit transactions. Something Koger just mentioned triggered something else, another thought. But it's regulatory guidance.

You talk about small business trying to make it, and they're making it in an industry that is one of these higher-risk industries, and they get basic banking service now being shut out. Are you going to loan to somebody that you can't hold a deposit relationship with? Aren't you afraid that they're going to club you over the head with it? The Bureau for Consumer Financial Protection, I think, yesterday issued a new lawsuit for debt collection practices and bring-in payment process. It's no longer sufficient that we just know our customers; we have to know our customers' customers. If there's a sense they might be violating a law, any law, state or federal, we're now held accountable for it.

Yes, we have the credit side, and we have a lot more that goes along with that too. But the operation side can also prohibit the banking businesses.

Representative COFFMAN. Just a follow-up on that. Getting into Q & A as to what the Federal Government thinks is a desirable business and what isn't, absent any violations of law, absent any violation of regulations, it's a pretty insidious thing for, essentially, the government to say, we don't like this industry.

Mr. KELLY. I agree with that in some respects. They are making that statement. And, unfortunately, everybody gets swept up in what's called the risk because we just don't want the liability that goes along with banking. But even over the years, any other high-risk industry that you bank, there's always going to be a segment that's problematic. The problem is they come in with a huge hammer that just flattens the whole industry. It's too much of a penalty for us to sit there and make them, so it's easier for us to say no. Then they do go to the Strato Bank. They have to find those services somewhere.

Senator GARDNER. Congressman Buck.

Representative BUCK. Thank you, Senator.

All of you talked about regulatory burden that you face, the amount of cost that it takes to comply with these areas. None of you mentioned the penalties that are associated with the audits of those regulations. And I've heard from bankers that they have been penalized because a staple was on the left-hand side. There are very significant things in audits. I'm wondering what your experience is. I'll put it in context first.

These audits are done by the executive branch of the Federal Government, the same executive branch with a secretary of state who has an email server in the basement, in violation of federal law; the same Federal Government that the president appointed to recess appointments to the NLRB, and the Supreme Court, I believe, remanded its decision and determined that those were unconstitutional; the same Federal Government that the president has issued executive orders on immigration and those orders are now delayed in the courts; the same executive branch that has negotiated, in my opinion, a horrible deal with Iran and is avoiding the treaty obligations by not presenting it, or having no intention to present it, to the United States Senate.

That, to me, is ironic that that executive branch would audit more banks, banks that really bring business and jobs in this country, and then fine you and penalize you. I'm wondering what your thoughts are on penalties associated with these regulations.

Mr. PROPST. I'll jump in on that. The one thing I would say is we are—or our primary regulator is the Federal Reserve in the State of Colorado. And we have found our regulators to be extremely professional, and we have not had any issues with them.

Unfortunately, I think the challenge for them is they have to implement the rules. And it's the rules and the laws and the regulations that are coming along. I know probably not everyone has had good experiences with the regulators, and I can't speak to that.

But what I would say is that the penalties have increased dramatically, if you step out of line. The reason we're all putting so much emphasis on this is because the cost of failure is extremely high.

Mr. KELLY. I'll go ahead and add on to that. We are also regulated by the Federal Reserve in the State. Our regulators are very reasonable. What I think you do see, though, sometimes is that, especially into the crisis, the pendulum did go too far, not only from the congressional side in the passage of Dodd-Frank and some of that stuff, but from the regulator side.

And then you're in a state where the field examiner is always concerned about being second-guessed. They're looking at an institution, and that institution might happen to fail down the road. Then they're going to get their auditor in there and they want to make sure they have everything checked off. Maybe we're doing everything fine, but I want you to do it slightly different or document it more times so I can check this box off so I can make sure that, just in case, somewhere down the road, if their institution has problems, I won't have a problem. That's kind of the environment that they're in.

The penalties they have gone back to, I believe, not only with some of the congressional changes recently from Dodd-Frank, but even before, found new ways to raise penalties or to institute old penalties against new wrongdoing as a punishment. That's when you see them come out in enforcement action. It's, oh, better not be doing that, we have to put more resources to make sure you're documenting everything.

Senator GARDNER. Thank you.

I'll ask another question to Mr. Propst or Mr. Reyher. As we talk about mortgage rules impacting mortgage customers, some who may have an established customer history, others who may not, what is happening in small town banks, financial institutions, mortgage lending institutions, to some of the regulations, and what happens to the customer who doesn't have established credit, on the mortgage lending side?

Mr. REYHER. I'll try to give a very brief example of that. So a lot of our banks are in very small communities. Many of these, we're the only bank in town. We're looked upon as the place to go for a loan, including the 1–4 family residency. So let's just say a retired couple walks in that's lived in that community for their entire life. They've banked at that bank. They have a good relationship with the bank and they've handled their business in a sparkling manner.

So counter that with somebody new moves to town, walks in and says, I'd like a 1–4 family loan. You have no history with that person. But you have to judge those two the same. So what that creates is a cookie cutter. We have these set guidelines because you cannot discriminate against that person, even though it's not overt discrimination. But maybe the debt-to-income ratio is a little higher on this retired couple and you're willing to give them a chance, just as Congressman Coffman mentioned.

But if you give that one a chance and you don't give this one a chance, Senator Buck, then you go to the Department of Justice. That's not a fun place to be, I understand. And the fines are just astronomical. They start out at a million bucks and go up.

So that's the issue. That's the problem with the community banks, cutting off credit to those that most need it.

Senator GARDNER. Mr. Propst.

Mr. PROPST. I'll hit a couple things. There are some qualifying standards, so qualifying mortgages. Essentially, that would mean anything that the GSEs would buy. If you go outside that, you have a liability back to your customer, if something ever goes wrong, that says you should not have made that loan, you should have qualified it. The bank can be liable for three years of interest. Because of that, there's a number of community banks that said you have to qualify that risk and they said, we're out of business.

I will tell you, in our bank, we continue to do that, but we don't know what that risk is. But we felt like we could not cut off our small business customers.

There's a second piece called the ability to repay, which is what David was referencing, saying that there are certain things—and, frankly, it's patterned after FHA, which is also ironic, in that FHA had 30-day foreclosure rates up in the mid-teens. An organization like FirstBank was under 1 percent. Yet, you can tell me which way we got to be underwriting, but I can tell you which way we are today.

If you violate that, that's actually a violation of law, penalties and all the other things. So, for us, we primarily do accommodate mortgage loans, which means we lend to people that don't fit in the rest of it. We do small loans, we do other—any lender of small business is for their house because, for a business, it's all one. Your mortgage, your personal, your business is all together.

We actually had a deal the other day, because we can underwrite commercial loans the way we underwrite them, we approved a million and a half dollars of credit. We could not approve their mortgage loan.

Senator GARDNER. They got to apply for credit, but they didn't qualify?

Mr. PROPST. They're still stuck in a high rate mortgage loan. We couldn't do it because of ability to repay.

Just one last quick comment. The QM and ATR rules have had a perverse impact on the market. If you look at what's occurred, it used to be the GSEs, the loans under 417, 417,000, were less expensive than the jumbo loans. Because of the regulations and all the burden, the extra cost, like what David referenced, those rates are higher. And we're not seeing jumbo loans. So the wealthy people are getting loans that are less expensive than what's going through what's supposed to be the low-cost provider of the GSEs. At least they have—anyway, I won't go there.

But that's what's occurred in the market, is that Dodd-Frank is actually—and the reason that's occurring is because shadow banks are filling that need. You get a whole bunch of the TIC loans and others coming in.

Senator GARDNER. Give me an example of what a 0.5 percent, less interest rate, would mean to the life of an average loan.

Mr. PROPST. You're going to assume I'm a banker. Well, if you take a $200,000 loan, it's a thousand dollars a year.

Senator GARDNER. On a 30-year loan?

Mr. PROPST. Yeah.

Senator GARDNER. With a lower-income recipient, okay.

Mr. PROPST. Yes. They're paying it off.

Senator GARDNER. Yes, Congressman Coffman.

Representative COFFMAN. To all of you, so these—so, obviously, there's some, I think, regulations in the minor loans that existed. You see it in Dodd-Frank, CRA loan, Community Reinvestment, and the like.

But let me ask you this. We had a financial crisis in 2008, late in 2008. Dodd-Frank was a reaction to that financial crisis, in my view. But I wonder maybe if you could tell me, in your view, what actions the Federal Government should have taken in response to the financial crisis, obviously, going forward, to ensure that it didn't happen again to the extent that it did, where there wasn't the issue of systemic risk.

Jay.

Mr. DAVIDSON. Let me try and start a short conversation on that. I think you have to go way back to the 1990s and a very well-intentioned effort on the part of Barney Frank, of Frank-Dodd fame, to get everybody into a new home. It's really a great thing. It feels really good. They just forgot that there are certain underwriting standards that all bankers meet. Nobody sitting here at this table would ever write a subprime loan and hold it on its books. We never did.

So I, sadly, have to say, Congress has to take a little bit of the blame here. Stay out of our business. You know, Fannie and Freddie bought the risk off these banks and did all the subprime deals, and we created the Great Recession. This is horrendous that we're seven years into this so-called recovery and we're not recovered yet. And there's no indication that we're going to be recovered anytime soon. That was the genesis of this issue, in my humble opinion.

Senator GARDNER. Any more questions?

Representative COFFMAN. See if anybody else would like to comment on that question.

Mr. REYHER. I don't totally disagree. I will say that our bank—we don't do near the volume of Fannie residential mortgages, but we might have had two foreclosures in that total period of time. Smaller banks, community banks did a good job of underwriting their business. The bad actors are the ones who caused this. What could we have done? Maybe we need to go after those more aggressively.

Mr. PROPST. Just a quick comment on that. The GSEs were the number one purchasers of subprime, at one point held a trillion dollars. If you look at—one of the things that happened in the crisis is that banks became—everybody was a bank. So all the investment houses were banks; Fannie and Freddie were banks. So we lost that battle right away.

Then when Dodd-Frank came along, it was aimed at what do they know how to regulate as banks. Community banks did not solve the issue. But all those ills that were talked about were all thrown into Dodd-Frank and targeted towards regular banks and not—there hasn't been—GSEs have had nothing done. And a lot of the others that came in—maybe the bureau is going after some now, but it really didn't have any.

To me, that's the big mistake, is that they piled regulation after regulation, because the regulators know us. They don't know the others.

Mr. KELLY. I don't know that I can answer that because you can't really stop the next crisis that's going to come. It's going to come in some way, shape, or form. To be honest, in my opinion, government sometimes interferes too much and likes to see the economy always going, and the economy sometimes needs to rest.

When interest rates started to move, the last part of the last decade, up, the mortgage market completely disconnected from the interest rate. That's because too much capital was going in there. It wasn't coming from the regulating institutions; it was coming from outside. But when you have that much money flowing into it, the yields are not sufficient to the risk that's aligned with it. And the investors need to be held accountable for the risk that they take on by buying those securities. Unfortunately, when you get into a lot of other public policy, you hold those securities, whether it's foreign governments or retirement funds or what.

I think Dodd-Frank was an overreach because it didn't take enough time to really analyze the true impact to do a well-thought-out response. That massive piece of legislation that was 2,000 pages really passed Congress within a one-year time period. It dwarfs anything that passed, from a lender perspective, prior to that time. There's got to be fixes that come to it. I think you will find reasonable ways to do that. I encourage you to do that.

Representative COFFMAN. I think that the problem—one of the problems I see is that the members of Congress who had their fingerprints all over putting individuals into homes that they couldn't afford—those loans, securitized and misrated dramatically, were the catalyst for the collapse in 2008. So you had those same members that pushed for that in charge of finding a solution, and they refused to acknowledge government's culpability that got us into that place in 2008. So the solution was never going to face the actual problem.

And I think there was a commission created by Congress in 2009, and the minority report reflected, I think, what was the actual cause of the crisis, and the majority report did not.

Senator GARDNER. Thank you.

If there are no further questions from the members here, then I wish to thank the first panel for their participation. Thanks for coming all the way to the capitol to share your thoughts and wisdom.

We'll welcome the next panel to join us.

[Representative Coffman was absent for the remainder of the proceedings.]

Senator GARDNER. Mike O'Donnell, Tony Gagliardi, Roger Hays, and Don Childears, come on up.

Mike O'Donnell is the executive director of Colorado Lending Source, a nonprofit organization providing lending resources to Colorado small businesses. Colorado Lending Source has partnered with more than 3,000 small businesses since it was founded 25 years ago. That's the official bio.

The unofficial bio, of course, is that Mike O'Donnell is a fine resident of Yuma County, Colorado. And our daughters were in tai kwon do class together.

Mr. O'Donnell, welcome to the panel. Thank you for being here.

STATEMENT OF MIKE O'DONNELL, COLORADO LENDING SOURCE, DENVER, CO

Mr. O'DONNELL. Thank you, Senator. I appreciate the opportunity. My name is Mike O'Donnell. I'm the executive director of Colorado Lending Source. We're a mission-based nonprofit economic development organization. This is our 25th year here in Colorado. Our mission is to foster the economic growth of diverse small businesses within our communities, which really means that we help small businesses access capital, grow, and add jobs to the State. This last year we assisted more than 200 small businesses, working with 53—partnering with 53 different community banks to provide debt financing to assist with about $274 million worth of credit here in the State of Colorado. And those projects will create just a little bit less than 2,000 jobs in the State, which is great. We've always been an active lender under the SBA 504 loan program. And as the last Great Recession began to unfold, we expanded our operations to become an SBA-approved lender service provider, which means that we assist, currently, 40 local community lenders, help process SBA guaranteed loans. We also borrow some funds ourselves to make loans, under our Main Street loan program, to small businesses unable to secure funding anywhere else in the State.

We recently expanded our direct lending activities to become one of the nation's newest SBA Community Advantage lenders, which allows us to provide smaller loans to businesses unable to secure financing through the community banking system. And the source of the funding for our Community Advantage loans is that we've gone out to community banks ourselves to borrow money from them so that we can turn around and break that up and make loans to small businesses. So that's our process for that.

I've been with the organization for almost 15 years, as you can probably tell from my Eastern Colorado accent here. Although our organization is based in Denver, I myself reside in southern Yuma County, about six miles east of the rural town of Kirk, with a population of just 59 people. So I very much appreciate the opportunity to be here today too.

Community banks play a critical role in providing capital to small businesses. Closures, ongoing consolidations and excessive regulation negatively impact small businesses in many, many ways. It shouldn't be surprising that the number of business startups in the United States has been falling consistently over the last few decades, just as the number of community banks has been declining.

The FDIC only began reporting on the performance of community banks in the quarterly banking profile reports during 2014. The FDIC defines community banks as those institutions that provide traditional relationship-based banking services in their local communities.

During the second quarter of 2014, the FDIC recognizes that we had 6,163 community banks in the United States. These represented 93 percent of all FDIC-insured institutions that are responsible for assets totaling $2 trillion. That was just 13 percent of the industry assets. So these community banks accounted for 45 percent of all the business loans to small businesses in the United States. So if you look at these numbers the other way around, the big banks that control 87 percent of all of the money in the banking system only account for 55 percent of small business loans.

Because the big banks don't carry the weight when it comes to small business lending, being more interested probably in a profitable transaction than a relationship with a client, it's really the community banks that have a pivotal role to play in access to capital for small businesses.

Really, without a vibrant community banking system, not so many loans would be made to small business. It's really as simple as that. Big banks don't appear to be interested in picking up the slack as the number of community banks in the United States has fallen.

And we've heard the numbers before from other panelists. But back in 1980, according to the Federal Reserve, we had more than 12,000 community banks in the country. And the FDIC says we have 6,163 now, and they only hold 13 percent of the assets. Back in 1980, those banks had 30 percent of all of the assets in the country. So it very much had a concentration, as you would expect.

During that same time frame, business start-ups had been declining steadily, reaching a national tipping point in 2008 when the number of business closings began outnumbering the number of start-ups each year. This is a trend that continues even since the Great Recession has ended. In Colorado, because of the special economic boost this State receives by being the destination of choice for a large, highly educated influx of entrepreneurial-minded Millenials, Colorado's own tipping point didn't really occur until early last year when more businesses started closing than opening in the State.

New business creation is vitally critical to a healthy, vibrant economy for two primary reasons: job creation and innovation. Contrary to popular belief, it is not established small businesses or big businesses that create jobs, but it's the new and young businesses that drive job creation in the United States. New and young companies are creating nearly all of the net new jobs in the United States. It's not the big companies; it's not the existing small businesses. It's new small businesses. Without new jobs and innovation, the nation will face significant competitive challenges in the decades ahead.

Economist Enrico Moretti's research reports that every job generated through innovation creates five other jobs, three of which are nonprofessional jobs. Even jobs generated by non-innovative new businesses have a multiplier effect with regard to consumer spending, taxation receipts and, thus, the quality of life.

It's always been the case that small businesses account for nearly half of private sector output and employment in the U.S. Coming out of the Great Recession, however, job creation by small businesses has lagged and continues to lag, while new business formation rates continue to fall. While experts won't directly suggest that these trends are driven by weaker borrowing or limited access to small business loans, it doesn't take a degree in astronomical science to realize—or even aeronautical science—to realize that businesses need adequate credit to succeed and grow.

Big businesses just don't seem very interested in providing much of the capital, and certainly not to early stage or start-up companies.

I had a conversation last week with the owner of a six-month-old and pretty profitable small business located in Boulder, Colorado. The owner was only looking for a $20,000 loan to help him add some employees to grow his business a little more quickly. The large bank he spoke with told him to come back in four years, if he was still around.

It's challenging for community banks to pick up the slack for the big banks because they are now so hamstrung by regulations. And most of them would not be able to assist these individual businesses because of the paperwork burden and the perception by the regulators that lending to early stage and start-up businesses is intrinsically risky and should be avoided. A community bank runs the risk of being adversely impacted by regulators who better know than they, the bank's owners, how the capital of community banks—how much they should have, hold, reserve, and allocate.

The facts bear this out. The volume of small business loans made within the banking system dropped significantly between 2008 and 2012, as you would expect, but it's barely recovered through today. Small business loans at the end of 2014 are still 17 percent below the peak reached prior to the recession. And while small commercial and industrial loans grew 3.4 percent from 2013 to 2014, according to the Federal Reserve, this modest improvement does not provide strong assurances about the health of lending in this space. In contrast, the lending to larger businesses bounced back quickly, and loans outstanding are now more than 24 percent higher than pre-recession levels.

So the increasing competitive banking landscape, the high cost of regulation and compliance, and the limited resources available represent major challenges for community banks. The current regulatory burden is a key factor affecting community banking, with employees now wearing more hats and doing more jobs for basically the same return, which has its own issues related to internal controls in the banks. But, regardless, regulations are likely here to stay in some way, shape, or form, even though these do hamper the ability of community lenders to be responsive to the financing needs of small businesses.

As a result, the community banks aren't able to make as many loans to early stage and start-up businesses today as they probably were able to do in years past. But they certainly do a much better job than big banks.

So, in conclusion, if the community banking system continues to experience closures and consolidations, the true cost to the United States will be in ongoing declining small business start-up rates, stifled innovation, and lethargic job growth. And this is something that should concern everyone. It certainly concerns me.

Thank you, Senator.

[The prepared statement of Mr. O'Donnell follows:]

Testimony of Mike O'Donnell
before the
U.S. Senate Committee on Small Business & Entrepreneurship
field hearing regarding reducing the burden of Federal Regulation
on community banks and small businesses.

My name is Mike O'Donnell; I am the executive director of Colorado Lending Source, a mission-based, nonprofit, economic development lender that is celebrating its 25th year in Colorado. Our mission is to foster the economic growth of diverse small businesses within our communities, which means that we help small businesses grow and add jobs.

During 2014, we assisted 211 small business owners working with 53 different community lending institutions to secure debt financing to assist with $274 million worth of expansion projects that will result in the creation or retention of 1,948 jobs.

Colorado Lending Source has always been an active lender under the SBA 504 loan program and as the last great recession began to unfold, we expanded operations to become an SBA-approved Lender Service Provider with a focus on assisting (currently) 40 local community lenders facilitate SBA Guaranteed loans. Colorado Lending Source also borrowed funds to make direct loans under our Colorado Main Street loan program to small businesses unable to secure funding elsewhere and has recently expanded direct lending activities to become one of the nation's newest SBA Community Advantage lenders, again, to provide smaller loans to businesses unable to secure financing through the community banking system. The source of funding for our Community Advantage loans is financing directly provided to Colorado Lending Source by (so far) two community banks. (Colorado Lending Source takes the money we borrow from community banks to make smaller loans directly to small businesses who aren't directly able to secure the funds from the community banks.)

I have been with Colorado Lending Source for almost 15 years and although our organization is based in Denver, I myself reside in southern Yuma County, Colorado, 6 miles east of the rural township of Kirk, which has a population of just 59 people. I appreciate the invitation of the Honorable Senator Cory Gardner to provide testimony today on the topic of reducing the burden of federal regulations on community banks and small businesses.

Community banks play a critical role in providing capital to small businesses so closures, on-going consolidations and excessive regulation negatively impact small businesses in many ways. It shouldn't be surprising that the number of business startups in the United States has been falling consistently over the last few decades, just as the number of community banks has been declining.

The FDIC only began reporting on the performance of community banks in quarterly banking profile reports during 2014. They define community banks as "those institutions that provide traditional, relationship-based banking services in their local communities."

During the second quarter of 2014, the FDIC recognized 6,163 community banks, representing 93% of all FDIC-insured institutions, that were responsible for assets totaling $2.0 trillion, just 13% of industry assets. These community banks accounted for 45% of small business loans to businesses. [1]

Looking at these numbers the other way around, the big banks that control 87% of all the money in the banking system only account for 55% of small business loans. Because the big banks don't carry their weight when it comes to small business lending, being more interested in a profitable transaction than a relationship with a small business client, it is really the community banks that have a pivotal role to play in access to capital for small businesses.

Without a vibrant community banking system, not as many loans will be made to small businesses. It is as simple as that. Big banks aren't or don't appear to be interested in picking up the slack as the number of community banks in the United States is falling.

There were 12,366 community banks in 1980 holding 30.8% of the banking assets in this county. By 1990, that number had dropped to 10,180 and 21.7%. In 2002, the Federal Reserve estimated 6,936 community lenders holding 14.8% of assets. [2] Using the FDIC numbers referenced earlier, there are currently around 6,163 community lenders now holding 13% of all assets.

During the same time frame, business startups have been declining steadily [3] reaching a national tipping point in 2008 [4], when the number of business closings began outnumbering the number of startups each year, a trend that has continued even since the great recession ended. In Colorado, because of the special economic boost this state receives by being the destination of choice for a large, highly educated influx of entrepreneurial-minded millenials, Colorado's own tipping point didn't truly occur until early 2014 when 8,416 new establishments opened and 8,948 closed. [5]

New business creation is vitally critical to a healthy, vibrant economy for two primary reasons: job creation and innovation. Contrary to popular belief, it is not established small businesses that create jobs but new and young businesses that drive job creation. New and young companies are creating nearly ALL of the net-new jobs in the United States. [6] Not big companies. Not existing small businesses. New small businesses!

Without new jobs and innovation, this nation will face significant competitive challenges in the decades ahead. Economist Enrico Moretti's research reports that every job generated through innovation creates five other jobs, three of which are non-professional jobs like waiters and store clerks. [7] Even jobs generated by non-innovative new small business have a multiplier effect with regard to consumer spending, taxation receipts and thus the quality of life in the United States.

[1] FDIC Press Release; August 28, 2014.
[2] "The Role of Community Banks in the U.S. Economy" by the Federal Reserve Bank of Kansas City. Q2 2003.
[3] Testimony of Jonathan Ortmans, senior fellow, Ewing Marion Kauffman Foundation, to U.S. House Committee on Small Business, Subcommittee on Contracting and Workforce, September 11 2014.
[4] U.S. Census Bureau, Business Dynamic Statistics.
[5] "Small Business Profile – Colorado" by the SBA Officer of Advocacy, 2015, referencing BED.
[6] "Who Creates Jobs? Small Vs. Large Vs. Young" by John Haltiwanger, Ron. S. James and Javier Miranda, Review of Economics and Statistics, 2013.
[7] "The New Geography of Jobs" by Enrico Moretti, May 22, 2012.

It has always been the case that small businesses account for nearly half of private sector output and employment in the U.S. Coming out of the great recession, however, job creation by small businesses has lagged and continues to lag, while new business formation rate continues to fall. While experts won't directly suggest that these trends are driven by weaker borrowing or by limited access to small business loans, it doesn't take a degree in aeronautical science to realize that businesses need adequate credit to succeed and grow.

The big banks don't seem to be very interested in providing much of it, and certainly not to early stage or start-up companies. I had a conversation last week with the owner of a six month old and profitable small business located in Boulder, Colorado. The owner was looking for a $20,000 loan to help him add some employees to help grow his business more quickly. He contacted a large bank that told him to come back in four years, if he was still around.

It is challenging for community banks to pick up the slack for the big banks because they are now so hamstrung by regulation that most would still not be able to assist this individual business owner due to the paperwork burden and the perception, by the regulators, that lending to early stage and start-up businesses is intrinsically risky and should be avoided where possible. A community bank runs the risk of being adversely impacted by regulators who better know than the bank's owners and staff, how much capital the community bank should have, hold, reserve and allocate.

The facts bear this out. The volume of small loans being made within the banking systems dropped significantly between 2008 and 2012, as one might expect, but it has barely recovered through today. Small business loans at the end of 2014 are still 17 percent below the peak reached prior to the recession. And while small commercial and industrial loans grew 3.4 percent from 2013 to 2014, according to the Federal Reserve of Cleveland: "*This modest improvement does not provide strong assurances about the health of lending in this space. In contrast, lending to larger businesses (loans greater than $1 million) bounced back quickly and loans outstanding are now more than 24 percent higher than pre-recession levels.*" [8]

The increasing competitive banking landscape, the high costs of regulation and compliance, and, the limited resources available, represent major challenges for community banks. The current regulatory burden is a key factor affecting community banking with employees now wearing more hats and doing more jobs for basically the same return, which has its own issues related to internal controls. But regardless, regulations are likely here to stay in some way shape or form, even though these do hamper the ability of community lenders to be responsive to the financing needs of small businesses.

As a result, community banks aren't able to make as many loans to early stage and start-up small businesses today as they probably were in years past, but they certainly do a much better job of it than big banks.

If the community banking system continues to experience closures and consolidation, the true cost to the United States will be in ongoing declining small business startup rates, stifled innovation and lethargic job growth. And this is something that should concern everyone. It certainly concerns me.

[8] "Good News and Bad News on Small Business Lending in 2014" by Ann Marie Wiersch, Federal Reserve Bank of Cleveland, January 5, 2015.

Senator GARDNER. Thank you, Mr. O'Donnell, for your testimony.

If anyone is wondering where Kirk is, it's just southeast of Joes.

Tony Gagliardi is the Colorado state director for the NFIB, National Federation of Independent Business, and an advocate for small business owners. Tony has decades of experience working with small businesses and trade associations, supporting their priorities, and understanding firsthand what small businesses are struggling with under the burden of excessive government regulations and that what we could be doing to help decrease regulations on small businesses will help them succeed.

Mr. Gagliardi, thank you very much.

STATEMENT OF TONY GAGLIARDI, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, DENVER, CO

Mr. GAGLIARDI. Thank you, Senator. On behalf of the National Federation of Independent Business, I appreciate the opportunity to submit, for the record, testimony before your committee.

NFIB is the nation's leading small business advocacy association, representing members in Washington, D.C., and all 50 capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents over 350,000 independent business owners who are located throughout the United States.

Now, I'd like to clarify that my comments will apply across the board concerning regulations, everything from banking to the way an independent business owner cleans their windows in the business.

Overzealous regulation is a perennial cause of concern for small business owners and is particularly burdensome in times like these when the nation's economy remains sluggish. According to NFIB's most recent Small Business Economic Trends survey, government requirements and red tape was the most frequent answer when NFIB members were asked to identify the single biggest problem facing their business. The uncertainty caused by future regulation negatively affects a small business' ability to plan for future growth. While regulation is necessary, it must be pragmatic and sensible.

Unfortunately, the regulatory burden on small business has only grown. A study by Nicole and Mark Crain for the U.S. Small Business Administration Office of Advocacy in 2010 found that the total cost of regulation on the American economy is $1.75 trillion per year. A 2014 update to this study, commissioned by the National Association of Manufacturers, found the cost impact now sits at $2 trillion. If that number is not staggering enough, the study reaffirmed that small businesses bear a disproportionate amount of the regulatory burden.

While the American public and small business owners hear daily about the thousands of new jobs being created, most of these jobs are part-time, lower-wage positions. Job growth in America remains stagnant. Small businesses create over two-thirds of the net new jobs in this country, yet the NFIB Research Foundation's most recent edition of Small Business Economic Trends revealed, in the next three months, only 12 percent of the respondents plan to increase employment. Reducing the regulatory burden would go a long way toward giving entrepreneurs the confidence they need to expand their workforce in a meaningful way.

Our solutions to ease the burden of excessive regulations start with clarifying the indirect costs of regulation. The Regulatory Flexibility Act requires agencies to conduct small business analysis for any regulation that would impose a significant economic impact on a substantial number of small entities, and the bill only requires agencies to consider those small agencies that are directly impacted by a new regulation. Consequently, regulators may ignore foreseeable indirect impacts a new regulation may have on a small business. Regulatory agencies often proclaim indirect benefits for regulatory proposals but fail to analyze and make publicly available the indirect costs to consumers, such as higher energy costs, lost jobs, and higher prices.

NFIB believes agencies should be required to make public and to take into account, for procedural purposes, a reasonable estimate of indirect impact. Congress should hold these agencies accountable for providing a balanced statement of costs and benefits in public regulatory proposals.

Increased small business input in the regulatory process. Complying with regulations has a disproportionate burden on small businesses, as few small companies have employees devoted to compliance. Typically, the business owner is the janitor, the HR manager, and the greeter. To help alleviate this burden, it is critical that agencies only issue rules that are necessary and have considered the impact on small businesses.

Currently, the Small Business Regulatory Enforcement Fairness Act requires covered federal agencies to conduct a Small Business Advocacy Review panel before publishing a proposed rule. These panels include representatives of the regulated small entities and provide an opportunity for small businesses to collaboratively work with the regulators to find alternatives that minimize any potential burden on small businesses. Unfortunately, these panels only apply to EPA, OSHA, and the Consumer Financial Protection Bureau. NFIB believes these panels, which work well when agencies engage in the process, should be expanded to cover all agencies issuing rules that affect small businesses as a means to require these agencies to evaluate the burdens their rules place on small employers.

NFIB strongly supports H.R. 527, the Small Business Regulatory Flexibility Improvements Act, which passed the House of Representatives in February. This legislation directly addresses indirect cost impact and would give small businesses a greater voice in the process.

Conclusion: Agency focus on compliance. NFIB is concerned that many agencies have shifted from an emphasis on small business compliance assistance to an emphasis on enforcement. Unfortunately, the evidence in this area is plentiful. As an example, OSHA's fiscal year 2016 budget request. The agency proposed hiring 60 new full-time equivalent staff for enforcement, with no additional request for compliance assistance. This would bring the total number of enforcement FTE to 1,601, while they have only 254 FTEs devoted to compliance assistance.

Likewise, the Department of Labor's Wage and Hour Division requested 300 full-time equivalent positions for additional enforcement staff and support. That represents 63 percent of the division's overall increase request and 94 percent of the new hires they want to make with this increased funding. None of the increase will go to compliance assistance. Small businesses rely on compliance assistance from agencies because they lack the resources to employ specialized staff devoted to regulatory compliance.

Congress can help by stressing to the agencies that they need to devote adequate resources to help small businesses comply with the complicated and vast regulatory burdens they face. Additionally, Congress should pass legislation waiving fines and penalties for small businesses the first time they commit a non-harmful error on regulatory paperwork. Because of lack of specialized staff, mistakes in paperwork will happen. If no harm is committed as a result of the error, the agencies should waive penalties for first-time offenses and, instead, help owners to understand the mistake they made.

With employment at pre-recession levels, Congress needs to take steps to address the growing regulatory burden on small businesses. The proposed reforms previously listed are a good starting point.

Thank you for holding this important hearing. And I am happy to answer any questions.

[The prepared statement of Mr. Gagliardi follows:]

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB
The Voice of Small Business.

United States Senator Cory Gardner
State of Colorado

April 7, 2015

on the subject of

The Regulatory Effects on Small Businesses

Dear Senator Gardner:

On behalf of the National Federation of Independent Business (NFIB), I appreciate the opportunity to submit for the record this testimony concerning the effects of the current regulatory environment on small businesses.

My name is Tony Gagliardi and I serve as the Colorado state director of the National Federation of Independent Business. NFIB is the nation's leading small business advocacy association, representing members in Washington, D.C., and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents about 350,000 independent business owners who are located throughout the United States.

Overzealous regulation is a perennial cause of concern for small business owners, and is particularly burdensome in times like these when the nation's economy remains sluggish. According to NFIB's most recent *Small Business Economic Trends* survey[1], "government requirements and red tape" was the most frequent answer when NFIB members were asked to identify the single biggest problem facing their business. The uncertainty caused by future regulation negatively affects a small business's ability to plan for future growth. While regulation is necessary, it must be pragmatic and sensible.

Unfortunately, the regulatory burden on small business has only grown. A study by Nicole and Mark Crain for the U.S. Small Business Administration Office of Advocacy (Office of Advocacy) in 2010 found that the total cost of regulation on the American economy is $1.75 trillion per year.[2] A 2014 update to the study commissioned by the National Association of Manufacturers found the cost impact now sits at $2 trillion dollars. If that number is not staggering enough, the study reaffirmed that small businesses bear a disproportionate amount of the regulatory burden.

While the American public and small business owners hear daily about the "thousands of new jobs being created" most of these jobs are part-time, lower wage positions. Job growth in America remains stagnant. Small businesses create two - thirds of the net new jobs in this country, yet the NFIB Research Foundation's most recent edition of *Small Business Economic Trends*[3] revealed in the next three months 12 percent of respondents plan to increase employment. Reducing the regulatory burden would go a long way toward giving entrepreneurs the confidence they need to expand their workforce in a meaningful way.

In a 2011 paper Susan Dudley, a former administrator of the Office of Information and Regulatory Affairs (OIRA). Dudley wrote: "Whether the President's actions signal a

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[1] NFIB Research Foundation, Small Business Economic Trends , February 2015. http://www.nfib.com/Portals/0/PDF/sbet/sbet201502.pdf

[2] Crain, Nicole V. and Crain, W. Mark, The Impact of Regulatory Costs on Small Firms , 2010. http://www.sba.gov/advo/research/rs371tot.pdf

[3] NFIB Research Foundation, Small Business Economic Trends , February 2015. http://www.nfib.com/Portals/0/PDF/sbet/sbet201502.pdf

real recognition that regulations can place unreasonable burdens on economic growth remains to be seen. Over the first two years of his term, the federal government issued 132 economically significant regulations (defined as having impacts of $100 million or more per year).

That averages out to 66 major regulations per year, which is dramatically higher than the averages issued by [the previous two administrations."[4]

Today there are over 3,400 pending regulations in the pipeline at the Federal level.

Solutions to Ease the Burden of Excessive Regulations

Clarify the indirect costs of regulation
The Regulatory Flexibility Act requires agencies to conduct small-business analyses for any regulation that would impose a significant economic impact on a substantial number of small entities, and the bill only requires agencies to consider those small entities that are directly impacted by a new regulation. Consequently, regulators may ignore foreseeable indirect impacts a new regulation may have on a small business. Regulatory agencies often proclaim indirect benefits for regulatory proposals, but fail to analyze and make publicly available the indirect costs to consumers, such as higher energy costs, lost jobs and higher prices. NFIB believes agencies should be required to make public and take into account, for procedural purposes, a reasonable estimate of indirect impact. Congress should hold agencies accountable for providing a balanced statement of costs and benefits in public regulatory proposals.

Increase small business input in the process
Complying with regulations has a disproportionate burden on small businesses, as few small companies have employees devoted to compliance. Typically, the business owner has to deal with complex new rules. To help alleviate this burden, it is critical that agencies only issue rules that are necessary and have considered the impact on small businesses.

Currently, the Small Business Regulatory Enforcement Fairness Act (SBREFA) requires covered federal agencies to conduct a Small Business Advocacy Review (SBAR) panel before publishing a proposed rule. These panels include representatives of the regulated small entities and provide an opportunity for small businesses to collaboratively work with the regulators to find alternatives that minimize any potential burden on small businesses. Unfortunately, these panels currently only apply to the EPA, the Occupational Safety and Health Administration (OSHA) and the Consumer Financial Protection Bureau (CFPB). NFIB believes that SBAR panels, which work well when agencies engage in the process, should be expanded to cover all agencies issuing rules that affect small businesses, as a means to require these agencies to evaluate the burdens their rules place on small employers.
NFIB strongly supports H.R. 527, the Small Business Regulatory Flexibility

[4] Dudley, Susan E. President Obama's Executive Order: Improving Regulation and Regulatory Review, January 2011. http://www.regulatorystudies.gwu.edu/images/commentary/20110118_reg_eo.pdf

Improvements Act, which passed the House of Representatives in February. This legislation directly addresses indirect cost impact and would give small businesses a greater voice in the process.

Agency focus on compliance
NFIB is concerned that many agencies have shifted from an emphasis on small business compliance assistance to an emphasis on enforcement. Unfortunately, the evidence in this area is plentiful. As an example, in OSHA's FY 2016 budget request, the agency proposed hiring 60 new full-time equivalent staff for enforcement, with no additional request for compliance assistance. This would bring the total number of enforcement FTE to 1,601, while they have only 254 FTE devoted to compliance assistance. Likewise, the DOL's Wage and Hour Division requested 300 FTE for additional enforcement staff and support. That represents 63 percent of WHD's overall increase request, and 94 percent of the new hires they want to make with this increased funding. None of the increase will go to compliance assistance. Small businesses rely on compliance assistance from agencies because they lack the resources to employ specialized staff devoted to regulatory compliance.

Congress can help by stressing to the agencies that they need to devote adequate resources to help small businesses comply with the complicated and vast regulatory burdens they face.

Additionally, Congress should pass legislation waiving fines and penalties for small businesses the first time they commit a non-harmful error on regulatory paperwork. Because of a lack of specialized staff, mistakes in paperwork will happen. If no harm is committed as a result of the error, the agencies should waive penalties for first-time offenses and instead help owners to understand the mistake they made.

With employment at pre-recession levels, Congress needs to take steps to address the growing regulatory burden on small businesses. The proposed reforms previously listed are a good starting point.

Thank you for holding this important hearing on reducing the regulatory burden on small businesses. I look forward to working with you on this and other issues important to small business.

Sincerely,

A.F. Tony Gagliardi
State Director
NFIB/Colorado

Senator GARDNER. Thank you, Mr. Gagliardi.

Roger Hays is the president of Premier Employer Services, an organization providing human resource and administrative services to small businesses. In this role, Roger helps small and mid-size businesses navigate government regulations on a daily basis.

STATEMENT OF ROGER HAYS, JR., PREMIER EMPLOYER SERVICES, INC., DENVER, CO

Mr. HAYS. Thank you, Senator. I appreciate your inviting me.

Representative Buck, thank you for being here.

As you said, I own a company in Centennial, Colorado, by the name of Premier Employer Services. And what we do is help mid- and small-sized companies deal with HR regulation because, truthfully, what I've found over 18 years in this industry is that no one, outside of myself, starts a business to become an employer.

People start a business because they have found a better way to manufacture the product or they have found a way to do a service or to provide a service that they think is more cost-effective. It's an economical service. They can do it better than anybody else out there on the market. They do not start a business to become an employer.

But as that business gets going and they have to hire someone to help them either with sales or in-house, they find out that they no longer have any time to actually do what it is they started their business to do, because most people run two businesses at once. You run the business that you started, and then you also run an employment office. As an employer, you spend an enormous amount of time dealing with regulations that come from the Federal Government, state governments, and local governments.

Very quickly, if your business is successful and you're good at what you wanted to do, you're swamped, you're overrun by all these regulations. What we've seen is bureaucrats had to work in a vacuum. They come up with these really great ideas to solve problems that don't really exist a lot of times. They think, well, this isn't too onerous. This one regulation it wouldn't take somebody very long to comply with, maybe four or five hours a month to comply with the full regulation.

The problem is there's a whole bunch of paragraphs, there's a whole bunch of different agencies, and there's only one small employer. As all these different agencies start to pump out all these different regulations, that one small business owner very quickly gets swamped. They can't keep up with it. One regulation by itself might not be so bad. But the fact that we've got thousands and thousands of regulations coming out of Washington every year that affect small businesses, it becomes almost impossible for them to keep up.

So what we do at my company is we contract with these small businesses and we take over that difficult part of being the employer. That's not why they started their business. So we help them with regulations, human resource rules, OSHA issues, workers' compensation, benefits, health insurance. So I've been exposed to this difficulty that small businesses have in terms of operating under this onslaught of regulation on a daily basis, which really makes me fun at Christmas parties. But it does help the business, because they are not there to just spend all of their time filling out documents.

If we can somehow figure out a way to go through the process and get rid of all the redundant and repetitive and ridiculous regulations that are in the books and then slow down the onslaught from folks at the Department of Labor, the EEOC, and those locations, it would really help small businesses out, not just in Colorado, but across the country. This is a problem that isn't just local, unfortunately. We operate in 18 different states. The bulk majority of our work is here in Colorado. It isn't just the Federal Government these folks have to answer to; it's also the state government.

So when you have all of the regulations coming out of D.C., then you have the regulations coming out of this building at a high rate of speed, then you've got local city and county regulations, a lot of small employers just don't survive. I've had a number of clients over the years who have either just completely given up and sold their business or just shut down because it has become so difficult for them to just operate in the environment. They get worn out and give up. It's not what they wanted to do. The profit margin is pretty low. It really begins to go.

So what we're seeing, as some of the other folks have already testified, is fewer and fewer people decide to get into business. The entrepreneur rate is dropping rapidly. Now, it's a dichotomy for me because the more regulations that come out of D.C., the busier I get. But I'm also noticing fewer and fewer new start-up companies in certain segments here in Denver because they just don't want to deal with it. It's easier to keep working where they're at than go try to start a business; whereas, 10, 15, 20 years ago, when I first got into this business, people were starting businesses left and right. It was a very hot time. It's not the case anymore. It's just become too difficult, too costly.

I appreciate the time here. I'm happy to answer any questions. And thank you so much.

[The prepared statement of Mr. Hays follows:]

Roger Hays Jr., President/CEO
Premier Employer Services, Inc.

**Testimony of Roger Hays, Jr.
before the
U.S. Senate Committee on Small Business & Entrepreneurship
Field Hearing Regarding Reducing the Burden of Federal Regulations
on Community Banks and Small Business**

Senator Gardner I want to thank you for the opportunity to testify before you today. My name is Roger Hays and I am the owner of Premier Employer Services, Inc. located here in Centennial, CO. My company is a Professional Employer Organization or PEO as we are commonly called and I started Premier in October 2008. The PEO industry as a whole currently employs between 2 and 3 million workers in America through what is called a co-employment agreement with the PEO. The vast majority of our clients are small businesses located mainly here in Colorado, but we do have clients and employees throughout the US.

PEO's like mine enable these clients to cost-effectively outsource the management of human resources, employee benefits, payroll and workers compensation. My clients are then better able to focus on their core competencies so that they may maintain or grow their businesses easier.

Honestly, no one starts a business to become an employer; they start business' to provide a better product or service to the public where they see a need for such items or services. However once they begin to grow and hire that first employee to help them with their new business they quickly find themselves spending more and more time dealing with the increasingly complex employee related matters of health and retirement benefits, workers' compensation insurance and claims, payroll, payroll tax compliance, and unemployment insurance claims. Small Businesses contract with my company and outsource the responsibilities of those employee related matters I just mentioned as we can better provide expertise in Human Resource Management and allow our clients to concentrate on the operational and revenue-producing side of their business.

The National Federation of Independent Business lists over 3,000 regulations currently in the works at the Federal level with 1/3 of these impacting small business directly and many others indirectly. This does not include the Affordable Care Act and the vast number of regulations that were a result of its passing and the continuing number of new rules and regulations that continue to be released to effect its implementation.

Small Businesses are not well positioned or equipped to handle the daily implementation of the numerous rules that are already in existence let alone continue to stay current on these constant additions to the Federal Register. Large corporations have teams of attorneys and compliance specialists to help them navigate this regulatory mess, or at the very least they have more capital that they can use to acquire help in dealing with these regulations. However these regulations have a disparate impact on small businesses, especially those that have fewer than 50 employees and who cannot possibly operate their businesses while also staying on top of all the various regulations. There just are not enough hours in the day to do this. I know this from firsthand experience in working with small business for the past 18 years in the PEO industry.

The PEO industry has grown significantly over the past 6 years as more and more regulations have been added to the small business agenda, and while this may be good for my business specifically it is not good for small business as a whole. There have been far too many onerous rules and regulations for the smaller business person to try to navigate and many have either been pushed out of the market place because they just can't stay profitable and comply or they have just given up trying to stay in compliance all together and are operating on more of a hope and a prayer that they just don't get caught. Most of the small business that come to us have done so because the desire to be in compliance with the law but they just do not have the money or man power to do so and have found many of these regulations to be prohibitive to their business.

I have worked with a number of business that unfortunately had chosen to risk operating as best they could but had found that they were not complying with one of more regulations and were now the subject of an audit from one of the many state or Federal agencies that have regulations they needed to comply with. They came to us hoping we could assist with the current problem but unfortunately we do not provide compliance but instead advise and assist companies with compliance and in many of these cases saw the business ultimately fail due to a past error.

I would like to say that of all the companies that I have personally worked with over the past 18 years that I have saw receive fines or ultimately go out of business due to a compliance failure not a single one did so willfully but rather because they could not afford to are out of ignorance of the laws. The vast majority of small businesses want to comply and they want to follow these rules but they either do not have the financial ability to hire attorneys or specialists to help them or they or they cannot figure all of these vast rules out by themselves and make mistakes.

Whatever you can do to streamline the many, many regulations that are already in the Federal Register: through repeal of redundant or contradictory rules or through the slowing of additional unnecessary and burdensome regulations will be greatly appreciated by the small business community and will help small business grow and put more Americans to work.

I thank you for the opportunity to testify before you today and we look forward to continuing this conversation with you. I am happy to answer any questions that you may have.

Senator GARDNER. Thank you, Mr. Hays.

Don Childears will give his testimony next. He's been with Colorado Bankers Association since 1975, serving as president and CEO since 1980. He is actively engaged in the community, holding various board roles in community and banking organizations.

Mr. Childears, thank you very much for your time and testimony today.

STATEMENT OF DON CHILDEARS, COLORADO BANKERS ASSOCIATION, DENVER, CO

Mr. CHILDEARS. Thank you, Senator, and Representative Buck.

I am going to focus today on the solutions, or possible solutions, to the glimpse that you've gotten today of many problems with providing credit to small businesses and other small business problems. Let me start off with a little bit of perspective.

You've heard a lot of numbers today. Out of the 2,300-page Dodd-Frank Act adopted five years ago, there would be just shy of 400 rules to be written. Today, 58 percent of those rules have been written. That's 231 separate rules. Another 24 percent have not yet been proposed, and all the deadlines have passed. They should have been done some time ago. And another 18 percent are in process. To date, with 58 percent of the rule-making done, we have 20,000 pages of new regulations that have been imposed on the banking industry, in addition to all the rules that we had before.

Twenty thousand pages is about six-and-a-half feet of paper. We project that by the end of the rule-making to implement all of Dodd-Frank, we will top 30,000 pages of rules, and that will take us to the ten-foot mark.

So that gives you a little perspective on the volume that we're dealing with. You've had other glimpses of the complexity of the rules that we're dealing with. I think there are three broad categories of solutions that we're dealing with here. One is improving access to home loans, because that, in fact, is a source of credit for most small businesses; secondly is removing impediments to serving customers; and thirdly is eliminating the distortions that government makes in the marketplace.

Let me start off with the home loans. Without home loans, most Americans would not be able to purchase a home or, in fact, to finance a small business, because that's where their credit comes from. As potential solutions in this area, I want to focus on one, but there are a number of others that are detailed in the written testimony that I have provided. By the way, by all of these there are bill numbers, in the written testimony, that reflect the concepts I'm talking about.

But the first one is to basically treat loans that are held in a bank's portfolio as automatically complying with the qualifying mortgage regulation. You heard references to that earlier this afternoon. The QM regulation, as we call it, effectively keeps banks from lending to lots of people that we believe are creditworthy, that we know and are glad to lend to. But government regulation basically stands in the way.

There are a number of different issues that that creates for a variety of different constituencies. It affects low income, small businesses, rural populations, recently hired, newly employed, and I can go on and on. Each of those has a slightly different twist as to how they have trouble getting in compliance with the government regulations, even though we're glad to lend to them.

But there is one common solution. That is, if the bank makes the loan and keeps it in its loan portfolio and keeps 100 percent of the risk on that, with no risk going to any other party, then we think it should be deemed compliant with that regulation. So that is a major step in terms of easing credit both for homeownership and for the use of credit in financing small businesses.

Now, in the written testimony I provided, there are a variety of others that deal with the definition of rural areas, which has, oddly enough, become a significant complication in this area; mortgage servicing; escrows for home mortgages; and a variety of other topics. But I just wanted to focus on that one.

Now I want to move to the second category of impediments to serving customers. The key to dealing with the consolidation of the banking industry, where we have fewer and fewer providers all the time, is to stop treating all banks alike, imposing the one-size-fits-all regimen on the entire industry that ranges from a little $15 million bank to a $2.2 trillion bank. Quite a variety there. There is a big difference not only in the size, but in the complexity of these institutions. And right now we're effectively seeing one-size-fits-all imposed on the entire industry. And the worst culprit in this is actually beyond Dodd-Frank. It's the Basel III capital accords international agreement that sets capital standards for banks. In this area, I would say that Congress can first reduce unnecessary and redundant paperwork. It could do a review and reconciliation of existing regulations. Specifically, it could eliminate unnecessary currency transaction report filings, could provide greater accountability by law enforcement for the use of Bank Secrecy Act data that we provide, and eliminate redundant privacy policy notices that have to be provided.

The second thing I focused on in that general area is to create a more balanced and transparent approach to bank exams and regulation. And again we've got legislation that's identified in the written testimony. We believe Congress should encourage the regulators to expand the number of banks, not contract the number of banks, so we have more providers, more competition, which benefits all the customers in the end run.

There should also be an independent appeals mechanism. When a bank regulatory agency has harsh treatment for a bank that the bank thinks is unjust, you get to appeal to the very same people who made the original decision. So it effectively is no appeal. We believe there should be an independent external appeal system that we think will bring about better accountability of the regulators themselves.

The third broad category in this area is to urge regulators to reform the entire Basel III capital requirements. You heard the discussion earlier today about high-volatility commercial real estate. I've given you another example. There are winners and losers in society chosen by the capital levels that are established in the Basel III capital requirements. And we don't think that that's government's role, is to say that this industry is favored, so it should get more credit and cheaper credit and this industry we don't like, so it should not get as much credit or have to pay more for it.

The last one is to limit the burdensome trickle down where we take the processes applied to very large, complex banks and apply them to the smallest institutions. And very specifically, we think that Congress should remove arbitrary regulatory thresholds set by dollar amounts that don't correspond to a bank's risk or business model. We think that the way the regulators ought to look at it is, in fact, the business model and the amount of risk in that bank's lending activities.

So that leads me to the next item, which is to enact a requirement for the regulators to actually mold their regulations to fit the business model and risk profile of the entity, the bank, that they are regulating. And we've written an entire bill on that that I am sharing with you in the next week or so.

Lastly, the banking industry's ability to serve customers is affected by a variety of forces. Where the government has gotten involved, we face what we regard as unfair tax-subsidized competition from both the credit unions and the Farm Credit system. Beyond that, we think you should encourage regulators to create new bank charters so that there is more competition. We think Congress should ensure that all participants, banks and non-banks alike, are subject to the same consistent rules and oversight for consumer protection and safety and soundness of their institutions and the risk they impose on the entire system.

Right now we've got a piper-paying system where the regulated banks are treated one way, and that's with this crushing regulatory burden, but we have a lot of other financial intermediaries out there that are narrowly going about their business, almost void of regulation many times. I think their consumers are at significant risk.

The last one is to hold breached parties responsible for the damages that their bank breaches. That is becoming a more prevalent issue. We see daily breaches all the time. In 99 percent of the cases, the party that loses the data does not suffer any significant financial costs. Those are borne by the banking industry. We think they might be a little more responsible if they had to pay the cost of reissuing cards and covering the fraud losses of customers.

Several of these topics are in multi-topic bills, as referenced in the written testimony. I note that there are six of them that have already been bundled and passed out to the House Financial Services Committee. So there is no shortage of bill language to be worked upon. We just appreciate the attention you're giving this issue and the direction in which we're moving.

In general, we think banks are a significant backbone of the economic fiber of hometowns across the country. And bankers have a personal stake in not only the economic growth of their community, but every other aspect of the community, the entire vitality of that community.

So we appreciate the attention you're giving this issue. And I'd just say thank you.

[The prepared statement of Mr. Childears follows:]

Don A. Childears, President/CEO
Colorado Bankers Association
Denver, Colorado

Testimony of Don A. Childears

Senator Gardner Field Hearing

Reducing the Burden of Federal Regulations on Community Banks and Small Businesses

My name is Don Childears, President and CEO of the Colorado Bankers Association, located in Denver, Colorado. The Colorado Bankers Association represents about 95 percent of the assets, offices and employees in the 148 regulated, traditional banks in Colorado, which have about $120 billion in assets, 1,700 branches, and 20,000 proud professionals.

Thank you, members of Colorado's Congressional Delegation, for conducting this important field hearing here in Colorado on a critical topic.

Let me start with a note about the volume of regulation now faced by community banks.

- The 2,300 page Dodd/Frank Act adopted five years ago required 398 rules
  - 231 of those have been finalized (58%)
  - 94 have not yet been proposed (24%)
  - 73 are in process (18%)
- Regulations adopted to date exceed 20,000 pages of new regulations (in addition to 1,000s of pages of prior bank regulations)
- 85% of conventional mortgage loans now range between 400 and 2,000 pages
- The new TILA/RESPA home mortgage disclosure act requires a single form, but has 1,800 pages of instructions (an error on any point in those instructions no matter how minor can create legal liability)
- $2 billion spent in reporting and paperwork costs in the first year of existence of the Dodd/Frank Act

This has been a good discussion today about how the growing volume of bank regulation—particularly for community banks—that is negatively impacting the ability of banks to meet our customers' and communities' needs. The job of figuring out how to meet our customers' needs in spite of the ups and downs of the economy has become much more difficult by the avalanche of new rules, guidances and seemingly ever-changing expectations of the regulators.

The fact is that there are 1,200 fewer community banks today than there were 5 years ago—a trend that will continue until some relief is obtained for America's hometown banks.

Bank regulatory changes—through each and every law and regulation, court case and legal settlement—directly affect both the cost and ability to provide banking products and services to customers. As we have seen even small changes can have a big impact on bank customers by reducing credit availability, raising costs and driving consolidation in the industry.

It is essential that Congress take steps to enhance the banking industry's ability to facilitate job creation and economic growth. But it is more than economics. This is about people's dreams. Borrowers are fulfilling their dreams with the money banks provide. Whether that dream is to start a small business, add on to the house, buy a new one or a car, pay for their child's education or whatever, the ability to borrow often determines whether or not a dream can be realized.

The time to address these issues is now before it becomes impossible to reverse the negative impacts. We urge Congress to work together— Senate and House, and Republican or Democrat—to pass bipartisan legislation now that will enhance the ability of banks to serve our customers.

Specifically, Congress needs to take action to ensure credit flows to consumers, businesses and communities by (1) improving access to home loans, (2) removing impediments to serving customers, and (3) by eliminating distortions by government in the marketplace.

I. Improve Access to Home Loans

Without home loans most Americans would not be able to purchase a home, or to finance a small business using the equity in their home. Banks are a major source of mortgage loans—holding more than $2 trillion in one-to-four family home loans on their books and originating others under government guarantees.

As discussed earlier, new regulatory requirements have restrained mortgage lending and have made it particularly difficult for first-time homebuyers to obtain a home loan, and for small businesses owners to borrow against the equity in their home to finance the small business. The complex and liability-laden maze of compliance has made home loan origination more difficult, especially for borrowers with little or weak credit history. Congress should:

Treat Loans Held in Portfolio as Qualified Mortgages: H.R.685, H.R. 1113

The Dodd Frank Act (DFA) is very restrictive in its definition of "ability to repay" and this is having a detrimental impact on the market and consumer access to credit. Loans held in a bank's portfolio – that is not sold into the secondary market – are in demand for many customers, particularly those in rural areas seeking smaller dollar loans and those that do not meet secondary market eligibility requirements.

That can be done by adopting legislation (similar to H.R. 2673 in the 113th Congress) that would deem any loan made by an insured depository and held in that lender's portfolio as compliant with the Qualified Mortgage rule under the DFA (so long as the loan is not sold). Loans held in portfolio are, by their very nature, loans which can be repaid; otherwise they would present safety and soundness concerns and would not be allowed by a lender's prudential regulators. This would allow banks to make loans they must decline today – where they believe in the customer and their ability to repay the loan, but government restrictions stand in the way. Here banks hold all the risk that a loan might default. The rule was intended to protect the secondary market, but these loans never see the secondary market; they are held by the bank for the life of the loan. This is a common sense approach.

Eliminate the Excessively High Life-of-Loan Liability:

Not only are the rules complex and liability-laden, the level of liability is both high and often extends for the life of the loan. A liability with such a long life will give any lender pause when considering any but the lowest-risk borrowers. Why should ability to repay liabilities hang over a lender's business for twenty years or more into the life of a thirty-year loan? Common sense suggests that any mortgage loan that has remained current for a number of years has certainly demonstrated the borrower's ability to repay. Congress should replace the ATR life of loan liability with a more reasonable term so that liability ends after a loan has performed for a reasonable number of years.

Establish an Effective Appeals Process to the Definition of a Rural Area: H.R. 1259, S.774
The definition of rural and underserved is critical and can dramatically affect banks and the communities they serve. The CFPB has already recognized this and has exempted certain loans from the qualified mortgage rule. However, the exemption applies only in some cases.

CBA supports legislation (like S. 1916 introduced last Congress by Majority Leader McConnell) that would direct the CFPB to establish an application process to have an area designated as a rural area if it has not already been designated as such by the Bureau. An appropriate exemption process is critical to a bank's ability to meet their community's needs since it would help to assure that whatever definition of rural is ultimately used by the CFPB, there would be an avenue to apply to include a county that may have been inappropriately excluded.

Mandate a Study of the Basel III Capital Requirements Impact on Mortgage Servicing Assets: H.R. 1408
Implementation of Basel III is disrupting the market for mortgage servicing rights by imposing punitive capital requirements that are causing many banks to sell these assets, usually to nonbank mortgage servicing firms that have little connection with the original borrowers. We support legislation which requires the banking regulators to study the overall impact of these requirements on the safety and soundness of the banking system, and on banks' ability to serve customers.

Urge Regulators to Reform the Basel III Capital Requirements for High Volatility Commercial Real Estate:
Basel III Capital Rules for High Volatility Commercial Real Estate restrict the ability of small business to borrow, and discourage banks from this kind of important lending. Letters of concern from Members of Congress will help encourage them to take another look at this problem.

Encourage the Federal Housing Finance Agency to Reconsider its FHLB Membership Rule:
For more than eighty years Congress has maintained eligibility requirements for lenders to join the Federal Home Loan Banking system. On several occasions, including in recent years, Congress has even taken actions to expand eligibility for members in certain ways. Currently, the FHFA has proposed restrictions which might limit the ability of banks of all sizes, including community banks, from retaining this critical source of liquidity.

Escrow restrictions: H.R. 1529
Certain escrow requirements for impose a significant burden on smaller institutions. This bill would provide a legal safe harbor from escrow requirements for smaller institutions that hold loans in portfolio for three years.

II. Remove Impediments to Serving Customers

Rules and requirements surround every bank activity. When it works well, bank regulation helps ensure the safety and soundness of the overall banking system. When it does not, it constricts the ability to serve customers. Finding the right balance is critical. The key to changing the consolidation trend is to stop treating all banks as if they were the largest and most complex institutions. Financial regulation and examination should not be one-size-fits-all. All too often, regulation intended for the largest institutions become the standard that is applied, often as "best practices," to every bank—Basel III being the most egregious. Such an approach only layers on unnecessary requirements at great cost to the customer and the bank with no resulting benefit. Congress can:

Reduce unnecessary and redundant paperwork:
Congress should require a review and reconciliation of existing regulations that may be in conflict with or duplicative of new rules being promulgated by the banking agencies, or which in their application badly fit the variety of institutions that make up the banking industry. This would help to eliminate conflicts among different regulations, thereby eliminating additional and unnecessary compliance burdens. It would also result in more effective policies. Congress should also (among other things):

- Eliminate unnecessary currency transaction report filings;
- Provide greater accountability for law enforcement's use of the Bank Secrecy Act data; and
- Eliminate redundant annual privacy policy notices by passing S. 423

Create a more balanced, transparent approach to bank examination and regulation:
Congress should expand the number of banks eligible for an 18-month exam cycle for highly rated community banks.
Congress should also:

- Provide an independent appeals process for bank examination decisions resulting in better accountability;
- Require the Securities and Exchange Commission and the Bank Regulators to perform cost-benefit analyses before issuing new rules; and
- Revise the cost-benefit test for rules proposed by the Commodity Futures Trading Commission.

Limit burdensome trickle-down of complex bank regulations:
Congress should support legislation that prevents the "trickle-down" of complex bank regulation onto smaller and midsized banks. For example, Congress should:

- Require targeted rulemaking by regulators that focus on the purpose of the rule, appropriately adjusted to the risk footprints of banks;
- Remove arbitrary regulatory thresholds not corresponding to a bank's risk and business model, and enact a requirement for regulators to tailor regulations for banks to reflect their business model and risk profile;
- Exempt small banks from Commodity Futures Trading Commission clearing requirements which would improve their ability to manage risk within the firm;
- Eliminate unnecessary public stress test disclosures for midsized banks; and
- Ensure capital rules designed for systemically important financial institutions are applied only to banks that are truly SIFIs, based on multifactor assessments of systemic risk, not merely asset size. H.R. 1309

III. Eliminate Distortions by Government in the Marketplace

The banking industry's ability to serve customers is affected by many forces, including regulatory- or tax-advantaged nonbank competition and unreasonable legal risks.

Nonbank financial institutions offer identical products and services but do so without the same regulatory oversight, consumer compliance or tax treatment. As bank regulations become increasingly restrictive, products migrate from the safety and soundness of the banking system to the under-regulated or unregulated market. This magnifies risk for all who use financial services.

Furthermore, some nonbanks benefit from special tax privileges which have created economic distortions that shift resources and banking activity from taxpaying banks to the tax-privileged sectors. Credit unions and the Farm Credit System are prime examples. Such marketplace tax distortions are neither good public policy nor fiscally responsible. In addition, unreasonable legal risks faced by banks have restrained the credit cycle. For example, uncertainties surrounding the interpretation of fair lending rules have raised the risks of costly litigation and forced financial institutions to limit mortgage lending operations. Similarly, unjustified and abusive patent litigation and licensing fee demands have drained funds available for lending. These legal risks create no benefit for local communities. Congress should eliminate unreasonable legal risks so that the banking industry can return to the business of banking.

Another potential and serious distortion involves innovations within the payment system by nonbanks. Banks have always protected the integrity of the payments system. As new innovations come forward it is critical that they are within a secure regulatory system that promotes consumer protection and system integrity. Equal access and equivalent regulation are key principles to ensure this.
Congress should:
Support legislation that eliminates government distortions in the private market by:

- Eliminating the Credit Union industry's special tax treatment
- Ending the Farm Credit System's unjustified tax privileges
- Ensuring agencies do not impose price controls, directly or indirectly Support legislation to eliminate unreasonable legal risks and impediments by:
- Enacting patent troll reform to reduce the threat of patent abuse
- Removing uncertainties in fair lending rules, such as penalties where there is no intent to engage in unlawful discrimination

Support Taxpaying Bank Charters by:

- Conforming savings and loan holding company thresholds and registration rules with those of banks
- Supporting charter flexibility for mutual banks and federal savings associations
- Encouraging regulators to charter new banks Protect the Payments System by:
- Ensuring that all participants – banks and nonbanks – are subject to consistent rules and oversight for consumer protection, safety and soundness and systemic risk
- Avoiding technology mandates
- Expanding information-sharing between public and private entities to fight threats
- Ensuring all parties have consistent accountability to customers before and after breaches
- Holding breached parties responsible for costs of breaches

Bank Regulatory Relief Packages of Multiple Items:

- S. 812
- H.R. 1233
- H.R. 1389
- Bundled (already passed out by House Financial Services Committee)
  - H.R. 601, H.R. 685, H.R. 1408, H.R. 1259, H.R. 1529

Conclusion

Banks have been the backbone of hometowns across America. Our presence in small towns and large cities everywhere means we have a personal stake in the economic growth, health, and vitality of nearly every community. We urge Congress to act now to help turn the tide of community bank consolidation and protect communities from losing a key partner supporting economic growth and customers' opportunities. There are more potential solutions forthcoming.

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Senator GARDNER. Thank you, Mr. Childears.

And thanks to all the witnesses on the panel for your time today.

I want to let everybody know that Congressman Coffman had to leave early due to a previous doctor's appointment that he had scheduled for today. So he apologizes that he had to leave during the middle of the hearing.

We'll go back and forth a little bit. I appreciate both the solutions and presenting the problems, again, that we have today.

To Mr. O'Donnell or Mr. Childears—either one, feel free to jump in on this—you talked a little bit about the income verification rules and that they make it much harder to lend to the small business owner that wants to take out a home equity loan to help finance their business. Why is that the case and why is a change to that regulation needed?

Mr. O'DONNELL. Defer to Mr. Childears on that.

Mr. CHILDEARS. Okay. Basically, you have a mandate in the Dodd-Frank Act, and the Consumer Financial Protection Bureau is the rule-making entity for that. It's basically created a third-party verification concept—and that is a concept that was adopted in Dodd-Frank—that the lender can no longer accept the word of the borrower on the income they have to pay back the loan or the other resources they can bring to the loan, or the entire transaction. We have to have a third party verify that. And that's not just any third party; it's got to be one that you can really rely upon.

So the typical boat that a small business is in is to get that third-party verification. Since we can't accept their books as verification of income for that home loan that's financing their business, they then have to get a third party, usually their accountant, to do a year-end review—it's kind of short of an audit—which takes a lot of time and is a frustration and a hassle and expensive, because I think for lots of small businesses you're looking at a couple of thousand dollars for that. Suddenly that CPA's liability is on the line. Because they're signing that document, they're basically asserting that this borrower has that much income.

So that is basically mandated by the Dodd-Frank Act and in the rules written by the Consumer Financial Protection Bureau, and we don't have any leeway around that.

Senator GARDNER. Congressman Buck.

Representative BUCK. Thank you, Senator.

Mr. Gagliardi, you mentioned that certainty was an important factor in small businesses and job creation.

I want to ask each of you a few questions in the short time we have. If you'd limit your answers, I'd sure appreciate it.

I just want to know whether we create more certainty or less certainty with the Affordable Care Act.

Mr. Childears.

Mr. CHILDEARS. I am far from an expert on that topic. In fact, we try to avoid it as much as we can. I think, from what I hear from all sorts of banks and their customers, there is a lot of uncertainty.

Representative BUCK. Mr. Hays.

Mr. HAYS. It definitely created a vast amount of uncertainty.

Representative BUCK. Mr. Gagliardi.

Mr. GAGLIARDI. As a full—having full standing in the federal lawsuit against ObamaCare, we still, to this day, have created enough uncertainty to bring business creation to a standstill in hiring.

Representative BUCK. Mr. O'Donnell.

Mr. O'DONNELL. Congressman, there's definitely uncertainty and challenges ahead for small businesses.

Representative BUCK. Mr. Childears, same question as to waters and U.S. EPA regulation.

Mr. CHILDEARS. Again, I don't know a lot about that. But I think I'd have to give you the same response, that there is uncertainty.

Representative BUCK. Mr. Hays.

Mr. HAYS. I would agree. It creates a lot—it is also creating an enormous amount of uncertainty for small businesses.

Representative BUCK. Mr. Gagliardi.

Mr. GAGLIARDI. A very ridiculous idea.

Mr. O'DONNELL. Again, water is, of course, an issue in Colorado. Not every small business will be impacted by it in the short term, but in the long run, yes.

Representative BUCK. Mr. Childears, EPA regulations concerning ozone, more certainty, less certainty?

Mr. CHILDEARS. I would guess that—my own personal opinion, based upon what I hear, less certainty.

Mr. HAYS. It's creating more problems.

Mr. GAGLIARDI. Less certainty.

Mr. O'DONNELL. Again, less certainty.

Representative BUCK. Mr. O'Donnell, I have a couple tough questions for you. My chief of staff and former state senator is from Wray. Senator Gardner is from Yuma. You are from Yuma County. I'm just wondering, when the football teams play, do you lean gray or do you lean red?

Mr. O'DONNELL. Actually [unintelligible] which is a small, six-person team.

Senator GARDNER. I'm afraid that Liberty would probably beat us both.

Mr. Hays, you talked a little bit about the regulations in Congress, and I wanted to follow up on a couple of them. The Department of Labor issued a fiduciary standard rule on small business. Are you familiar with that?

Mr. HAYS. Yes.

Senator GARDNER. Can you explain what effect that will have on small businesses?

Mr. HAYS. They've been arguing back and forth on this since 2010. They put it off a couple of times, but it's coming back this year. The Secretary of the Department of Labor has said this is their number one priority, before the end of the Obama administration, to get this rule out. And what they're doing is they're rewriting the fiduciary rules to solve a problem that they think exists, but it, in my opinion, does not yet really exist.

They're going to rewrite the whole thing so that it can really expand who is a fiduciary. And in that context, where it relates to small businesses, it becomes kind of scary for a small business owner because they're stepping into an area that they don't know anything about, they normally don't deal with, when it comes to

401(k) plans for small businesses. When those regulations go up, they become more intense. And a lot of the people that are currently in a fiduciary role, because it's going to expand that group, a lot of those folks aren't going to want to deal with a lot of smaller companies. It's just not worth their time or energy because the risk is going to go up so much.

The Department of Labor is trying to make it, in their opinion, so that people who give advice to small businesses are going to be held accountable if they give bad advice. Really, I think, personally, from what we've seen in the PEO industry, it's scaring small businesses and scaring the people that advise them, to the point where we're looking at probably 30, 35 percent reduction in service offerings to those small industries, which means, once again, the government is going to actually go the other direction than what they're intending on doing.

Rather than making this a safer place and making sure more people can participate, fewer employees are going to have the opportunity to participate in a 401(k) plan, save money for retirement, because folks who just, depending on what the bankers do, say, oh, it's just not worth our effort, there's too much risk now, we're just going to walk away from it. So the smaller businesses with three, four, five, ten folks, they're not going to be able to offer 401(k) plans.

Senator GARDNER. Thank you, Mr. Hays.

We talked in the first half with this panel about regulations. I want to ask all four of you a question. We've talked about the problem with the number of regulations. I don't think anybody here is saying, let's do away with regulations. We're not saying do away with regulations. We're saying, have smaller, better, more effective, more efficient regulations.

Is that correct, Mr. Childears?

Mr. CHILDEARS. Oh, I agree. Even I would say that about the Dodd-Frank Act. There are good elements of it, there are some that we're neutral on, but there are an awful lot that we think are fair game.

Senator GARDNER. Mr. Hays.

Mr. HAYS. Absolutely. Most regulations that have come out, we agree some of them are necessary. It's just that there are so many redundant ones, so many that are so expensive and very difficult and time-consuming for a small business to comply with. It's not that we're saying get rid of all regulations, we have kind of a wild west attitude, but let's be smart about the regulations we pass. And let's get some input from those businesses on, is this really necessary, and how much is this going to cost you.

Senator GARDNER. Mr. Gagliardi.

Mr. GAGLIARDI. Thank you, Senator. Regulation is necessary; however, it must be balanced. And currently, as we sit here today, there's over 3,400 pending regulations in the pipeline in Washington, D.C. And business cannot survive with that type of environment.

Senator GARDNER. Mr. O'Donnell.

Mr. O'DONNELL. I concur with my colleagues. [Unintelligible] report that the [unintelligible] opposition of rules serves no purpose other than sub-creation of rules.

Representative BUCK. Thank you, Senator.

I guess this is really a supplement to the last question, but I want to ask the question. I'll start with Mr. Childears. Would America be better off if we repeal the verification with the Consumer Financial Protection Bureau? And I ask that because this is an agency that was set up as its own, in effect, taxing authority, was able to create a budget without congressional oversight. The appointments are not approved by the United States Senate. It concerns me greatly that we have an agency that could easily go broke. Some think that it has gone broke, but it certainly could in the future.

I'm just wondering, I'd like to ask each of you, would America be better off if we did not have a Consumer Financial Protection Bureau?

Mr. CHILDEARS. I think the simple answer is yes. Our consumer protection was appropriately carried out by the bank regulatory agencies beforehand. It's not that they were shy about imposing consumer protection restrictions on the banking industry. They did that and did that well. But you hit the nail on the head. You have an agency now that does not need to come before Congress for appropriations. And it has a single individual that determines every decision that comes out. There's no board or council that weighs the merits of these issues. You literally have one individual making all determinations.

Representative BUCK. Mr. Hays.

Mr. HAYS. Any agency that does not have some sort of oversight, somebody that—some kind of a trigger to keep them in line, we'd be much better off without that.

Representative BUCK. Mr. Gagliardi.

Mr. GAGLIARDI. There was sufficient regulation prior to it. It was not needed.

Representative BUCK. Mr. O'Donnell.

Mr. O'DONNELL. I concur. It creates uncertainty. And again, constant regulation on regulation, it's not appropriate.

Senator GARDNER. And to Mr. Gagliardi, just talking about—wrapping into the conversations we've heard from various people in the financial institutions, the businesses, the organizations that you represent, what do you hear from small businesses when they're trying to get a loan, they're trying to get capital they need to invest to grow their earnings? These numbers that we're seeing, 15,000, 6,000, is that having an effect on them? If so, what do you see the future of that problem being?

Mr. GAGLIARDI. Thank you, Senator. What we find is—we conduct a monthly—you heard me mention the Small Business Economic Trends. That report is produced monthly, and it has been produced monthly for over 35 years by the NFIB. We go out to our membership, and this is one of the questions—the availability of credit is one of the questions that we ask. And I just happen to have the numbers out of the latest one.

Real briefly, 33 percent of the respondents say that their credit needs are met; 53 percent said they do not want a loan, they're not borrowing money. When we have customers coming through the door, then the small business owner or the independent business owner will be willing to take on the risk of a loan. But until that time, borrowing still is at a low rate. And then only 3 percent say that financing is a major concern to them.

So, again, there are certain segments in the small business community that still need access to capital. We see those as high-tech industries that are having difficulty, through traditional lending, getting that funding.

Representative BUCK. Before Senator Gardner left the people's house and went to the House of Lords, he was noted for the REINS Act, which is the Regulations from the Executive In Need of Scrutiny. And it requires Congress to address all regulations that have more than a hundred-million-dollar impact on America.

I'm just wondering, it has now passed again by this Congress, the 2014 Congress, and sent over to the Senate. I'm wondering whether you would be in favor of that act or opposed to it.

Mr. CHILDEARS. I'd be in favor, but I don't know why you put the threshold so high.

Mr. HAYS. I agree.

Mr. GAGLIARDI. Absolutely. In fact, there was a 2011 paper done by Susan Dudley, who was a former administrator of the Office of Information and Regulatory Affairs, stressing the importance.

Mr. O'DONNELL. I'm definitely in favor of it, yes.

Senator GARDNER. Mr. Childears, a question for you. This is a comment that I had from somebody who was in a financial institution here in Colorado. I want to clarify, this is a story that he told me about rules that I'm not familiar with, in terms of how they affect the day-to-day operations of this particular bank.

But he talked about having some auditors or people who were reviewing the books of the bank. And it dealt with the student loans that the bank institution was offering. They offered student loans to the community. But a lot of the students couldn't qualify for the student loan on their own, so they went out and they sought cosigners, trying to get cosigners for the student loans.

So they had two different auditors in the bank around the same time. One auditor came to them and took a look at the student loans and felt that the bank was committing a violation of going out and getting cosigners. I don't know if the word is steering, but they felt that they were violating this in getting too many people to cosign these student loans. The second auditor that came in had said they weren't issuing enough student loans, so there must be a problem.

Is that something that you're familiar with? Have you heard of it?

Mr. CHILDEARS. I don't know the technicalities behind that, but I hear anecdotes like that frequently. In fact, in the fair lending area, which is frequently the source of stories like that, we've got a great concern about a concept called disparate impact, where regulators and the Department of Justice basically look at the result of their lending and, if they find a difference in treatment between various groups—and they don't have to be protected classes, but just different groups—then they can say that you basically have committed discrimination, even though you had no intent to do so. It was just by the nature of the way you extended credit to individuals. And that causes us a lot of problems and worry, and many of the anecdotes fall in that area.

Representative BUCK. Mr. Gagliardi, one question. I'm wondering what the effect, in the Affordable Care Act, of setting, defining the workweek at 30 hours was.

Mr. GAGLIARDI. Thank you, Representative Buck, Congressman Buck. That will result in loss of hours, slowness in hiring. Hiring will basically come to an end. NFIB has been very active in Congress, getting legislation to address that, restoring it to a 40-hour workweek. It, again, leads to the uncertainty. When we have uncertainty on Main Street, economic progress and growth comes to a stop.

Representative BUCK. How about setting the limit at 50 employees, avoid the employees who fall under the Affordable Care Act, what is the effect of that?

Mr. GAGLIARDI. It still creates—Congressman Buck, it still creates a great deal of uncertainty, because we know the way—and present company excepted—we know the way Congress works, that any time somebody gets a whim, that 50-employee threshold now becomes 10. We've seen that in Colorado the last three legislative sessions, that all of a sudden, regulation defining or providing for, for instance, 15 or more employees is now down to one, which, in some cases, put targets on the backs of small business owners.

Representative BUCK. I'll tell you, Mr. Gagliardi, you're the first person I've had a conversation with who used the words "Congress" and "works" in the same sentence.

Senator GARDNER. Thank you.

Reflecting on my service in the minority state legislature, this is the time of the hearing where my bills were defeated. So I just want to thank you, Congressman.

I want to thank this panel for your testimony and time today. Thanks to all of you for participating in this afternoon's committee hearing.

Thanks to Congressman Coffman and Congressman Buck for participating in this day.

With that, I will adjourn this Senate hearing of the Small Business Committee.

[Whereupon, at 3:28 p.m., the hearing was adjourned.]

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