Community banks anxious for Dodd-Frank reforms

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George W. Hermann, president and CEO, Windsor Federal Savings Bank, and treasurer, American Bankers Association

Shrinking Bank Footprints

Community bankers say higher costs and other difficulties related to complying with Dodd-Frank financial reforms have contributed to a consolidation wave in recent years, as smaller lenders find it difficult to keep up with the rules. Indeed, there are significantly fewer lenders today then there were prior to the financial crisis.

	2008	2016	% Change
Number of CT-based banks	56	42	-25%
Number of banks nationwide	8,534	5,980	-30%
CT banks w/less than $100M in assets	10	3	-70%
U.S. banks w/less than $100M in assets	3,440	1,589	-54%

SOURCE: FEDERAL DEPOSIT INSURANCE CORP.

Connecticut community banks swept up seven years ago in the Dodd-Frank financial reforms are anxiously waiting to see what emerges from President Donald Trump's demand to review and reform the massive, intricate law, which local bankers say has been overly burdensome and costly.

"Community banks have a very simple business model," says Martin Geitz, president and CEO of Simsbury Bank, which has $510 million in assets. "[They] are not involved in the kinds of activities that led to the 2008 crisis. So we should have a different and simpler regulatory oversight than a [large bank like] J.P. Morgan Chase or a Bank of America."

Passed in 2010 to address the mortgage lending and banking crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act put in place complex — and some say overreaching — laws that regulate how banks write mortgages, process customer overdraft and credit card fees and comply with a host of other rules.

In late January, Trump signed a vague but actionable executive order to review and overhaul Dodd-Frank, which he promised to dismantle during his campaign.

While Greater Hartford community bankers say they are not pushing for Dodd-Frank's outright repeal, they say reform is a welcome development — and something they'd like to see done in the next 12 to 18 months.

Lindsey Pinkham, president and CEO of the Connecticut Bankers Association (CBA), said Dodd-Frank is constricting community lenders' ability to conduct business.

He said regulatory compliance costs, including the additional manpower and outside advisors banks have needed to hire, have cut into profits, forcing some lenders to merge because they've had "trouble complying with all this stuff."

"And this is not a new message. The industry has been saying this since 2011 but the political climate has not been conducive to change," he said.

Broadly speaking, many local bankers say they want to see the federal rules adjusted based on a lender's size and scope. More specifically they'd like changes to how bank charters are written, mortgages are made and compliance is handled.

"The regulations should be tailored to the risk and business model of the institution instead of one size fits all," said George W. Hermann, president and CEO of Windsor Federal Savings Bank and treasurer of the American Bankers Association. "Well-intentioned legislation intended to stem systemic problems in the industry has trickled down and stifled the ability of community banks like ours to be able to meet the credit needs of our community."

A U.S. Senate bill that would create a tiered regulatory approach — called The TAILOR Act — was introduced last year but died in Congress, Hermann said. That legislation has been brought up again this year, in front of a Republican-led House, Senate and now executive branch.

The TAILOR Act would allow federal regulators like the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corp. (FDIC) to tailor regulatory action based on a bank's size and risk to the overall financial system, limiting compliance costs and liability risk to smaller institutions.

"In theory, Dodd-Frank wasn't intended to affect community banks but in practice it has," adds Rheo Brouillard, president and CEO of the Willimantic-based Savings Institute Bank & Trust ($1.6 billion in assets), noting that community banks pose less risk to the country's financial system than larger banks.

Shrinking bank landscape

Wayne Abernathy, executive vice president for financial institutions policy at the Washington, D.C.-based American Bankers Association, said Dodd-Frank rules have prevented new bank formation in the United States and forced some small lenders to merge.

Indeed, consolidation of U.S. banks, the vast majority of which are community lenders, has been dramatic since 2008, when there were 8,305 institutions in place, Abernathy said. As of the third quarter of 2016, that number dropped to 5,980, FDIC data shows.

The number of banks headquartered in Connecticut has fallen 25 percent since just prior to the financial crisis. There were 56 Connecticut-based banks at the start of 2008 compared to 42 at the end of Sept. 2016, according to FDIC data.

Smaller banks in particular, with less than $100 million in assets, have become a vanishing breed. There were three lenders in Connecticut in that asset-size range at the end of September, compared to 10 in 2008, FDIC data shows.

"More than 60 banks are disappearing every quarter," Abernathy said. "The trend for the past several years has been, one bank disappears every business day and that trend hasn't let up."

Of course, there are myriad reasons for the shrinking bank landscape, not all of which are attributable to tighter oversight.

And, while regulations may be adding to costs, it didn't stop Connecticut banks from enjoying one of their most profitable years ever in 2016. Through Sept. 30, the latest data available, the state's 42 FDIC-insured banks posted a collective $562 million in profits, up 7.4 percent from the year-ago period.

Meantime, there are many policymakers and others who support Dodd-Frank.

Connecticut Banking Commissioner Jorge Perez said his agency is "skeptical of efforts that would roll back any consumer protections," adding that his department has been exploring the potential impact of Trump's executive order on Connecticut consumers and the financial industry.

"The Department will oppose any measures that would adversely impact either Connecticut consumers or the institutions we regulate," he said. "The primary mission of the Connecticut

Department of Banking is to protect Connecticut financial-service consumers from unlawful or improper practices."

Changing criteria for qualified mortgages

One specific reform local bankers say is needed relates to mortgages. An unintended consequence of Dodd-Frank that can hamstring community banks is the strict criteria for identifying a home loan as a qualified mortgage, which is a mortgage that is highly likely to be paid back.

The change was made, bankers note, to help the industry avoid the risky mortgages made during the housing crisis that were sold off to other financial lenders (not necessarily banks) and resulted in homes being underwater and foreclosed upon.

If a loan doesn't meet qualified-mortgage standards, the borrower can turn around and sue the lender for making a loan that the borrower couldn't comfortably afford, bankers say.

For example, Geitz said, a first-time homebuyer who has a debt-to-income ratio above the current qualified mortgage limit of 43 percent, has no reserves and a FICO score just below 680 would not be eligible for a qualified mortgage, even though the bank likely considers that individual a safe bet. Ironically, in conjunction with a first-time homebuyer loan program, that individual would be viewed as a "safe buyer," Geitz said.

Of the 577 mortgage loans that Simsbury Bank made in 2016 totaling $138.5 million, as many as 10 percent were not qualified mortgages, Geitz said. It's not a big number, but it adds legal exposure, which the bank has taken steps to mitigate, he said.

What Geitz and others would like to see is new criteria stating that any mortgage made and held in a bank portfolio — not sold to another lender — should be considered a qualified mortgage.

"That should be the test because the bank has an incentive to make sure they're making a good mortgage," Abernathy said.

Savings Institute's Brouillard said he isn't turning mortgage prospects away because of the existing qualified-mortgage rule, but it has caused other lenders to stop making residential loans. Basing the rule on sound underwriting principles would solve that problem, he said.

Compliance costs

Geitz and Brouillard would also like to see changes that make oversight and compliance more manageable and affordable.

Today, Geitz spends $150,000 a year on salaries for the equivalent of three full-time compliance officers, and a "meaningful" amount he would not specify for auditors and legal oversight.

The complexity of Dodd-Frank is to blame, he said.

Brouillard said he spends $1 million a year on compliance, because he has had to double staff from two to four people and invest heavily in software and technology to comply with the rules.

Whether those costs can be alleviated as revisions are put into place remains to be seen, Brouillard said.

Bankers say they also want to see the repeal of the so-called Durbin amendment, which limited the fees banks can charge retailers for accepting credit- or debit-card purchases.

"All it did was penalize the banks," Brouillard said.

Finally, Brouillard said the Consumer Financial Protection Bureau should be focused on non-banking financial institutions, not just banks, and have oversight, which is now lacking.

In the end, Hermann concludes, the growth of his bank into an institution with more than $441 million in assets did not happen by abusing the system the way bigger banks did in 2008, so the system should work more effectively with community lenders.

"We're invested in our community," he said. "We live here. We see our customers in the grocery stores. We're not taking advantage of people."