PROSPERITY BANK

Testimony of

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St. Augustine, Florida

Before the

Congress of the United States

House of Representatives

Committee on Government Oversight and Reform

Subcommittee on Economic Growth, Job Creation

and Regulatory Affairs

Hearing on

"Regulatory Burdens: The Impact of Dodd-Frank on Community Banking"

July 18, 2013

Washington, D.C.

Chairman Jordan, Ranking Member Cartwright, members of the Subcommittee, and especially Representative DeSantis who made this testimony possible. My name is Eddie Creamer, and I am President and CEO of Prosperity Bank (Prosperity), a $748 million bank headquartered in St. Augustine, Florida, which serves the small counties of St. Johns, Flagler, Putnam, Volusia, and Bay. Thank you for convening this hearing and allowing me to share with you my experience.

As you will quickly learn, I am not an expert on the legislative process, nor in the interpretation of regulations and their intent. However, I have been a community banker in Florida for 31 years. I have successfully managed through three recessions, one "Great" recession, and untold numbers of regulatory changes impacting lending, depository accounts, disclosures, privacy, and money laundering. And as such, I am quite knowledgeable of how the overwhelming and ever-changing regulatory burden, as interpreted and enforced by field examiners, has affected my bank, my employees, my customers, and my community.

I am not testifying before you today in regard to the broad generalities of the importance of America's 7,000 community banks. Instead, I will share how important Prosperity is to St. Augustine, Panama City, Palatka, Palm Coast, and Ormond Beach, Florida. I will not discuss how the ever-changing, overwhelming, "one size fits all" regulatory approach has damaged the way America's 7,000 community banks serve their customers and communities. Instead, I will share how the ever-changing, overwhelming, regulatory burden has damaged the way Prosperity serves its customers and communities. And, perhaps in doing so, I can help you understand, even in a small way, the stress, uncertainty, fear, and concern that these regulations have imposed on the entire industry. I believe if you ask community bankers across this great Nation, they will share with you similar experiences.

THE TRUE ROLE OF A COMMUNITY BANK

Prosperity Bank was founded in 1984 by a group of local businessmen. It is very typical of community banks everywhere to have a board of directors made up of local business people who understand the need for community banking. These people know the value of relationships and have personal knowledge of individuals and businesses. They are people who know the local economy and the support that a strong community bank provides.

For more than 29 years, Prosperity, like all community banks, has become a central part of its communities' growth and success. I have been CEO of Prosperity for more than 13 years. During this time, our payroll totaled approximately $152 million and we made more than $4.2 million in charitable contributions. At our peak in January 2007, we employed 260 people. From 2001 to the present, Prosperity originated approximately $2.5 billion dollars of home and small business loans, and through a company-sponsored volunteer program, our employees gave back to the community 138,333 volunteer hours. I think you will agree that we significantly impacted our community in a very positive way.

As community bankers, we serve the financial needs of our towns. We are blind to race, religion, and social standing. While we do business with people and small businesses based on financial ability, we also consider relationships, personal character, and knowledge of the local market. We lend money to small businesses and individuals that the "too big to fail" banks overlook. In fact, in many rural markets, the "too big to fail" banks have no presence.

Our employees volunteer, coach, cook, teach people to read, mentor, counsel, run, walk, and ride to support many non-profit organizations. We sponsor numerous charitable events and youth teams. We are closely woven into the fabric of our small towns. Many events would not occur without the local bank's support.

THE BANK REGULATIONS

There are thousands of pages of state law and regulation and thousands more of FDIC law and regulations with which we must interpret and comply. In addition, there are The Federal Reserve regulations, commonly referred to as the "alphabet" regulations (Regulation A - YY), which address issues such as fair lending, equal credit opportunity, fair credit reporting, unfair and deceptive acts, community reinvestment, and funding of unlawful Internet gambling.[1] Furthermore, there is the Bank Secrecy Act, USA Patriot Act, and the Federal Flood Insurance Program enforced on community banks by the FDIC. And, as a small business with 165 employees, we also operate under Federal Labor Law, and of course, the Internal Revenue Code.

In response to the recession of the late 1980's, Congress passed the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). The purpose of this law, as stated in the Act, was "to reform, recapitalize, and consolidate the Federal Deposit Insurance system, and to enhance the regulatory and enforcement powers of federal financial regulatory agencies, and for other purposes,"[2] with the goal of preventing future banking crises. This resulted in new regulations which were imposed on all of the Country's banks regardless of size and

[1] Federal Reserve Board of Governors. "FRB: All Regulations". http://www.federalreserve.gov/bankinforeg/reglisting.htm.
[2] *Financial Institutions Reform, Recovery, and Enforcement Act of 1989.* FDIC Law.

complexity. Capital regulations were changed and the concept of risk-based capital was added. For a financial institution to be considered well-capitalized, it must maintain 5% Tier-One Capital and 10% Total Risk-Based Capital.

These capital regulations are complex, obscure, and ineffective as applied to community banks. They are applied generally in the same fashion to a $750 *million* dollar asset bank as they are to a $750 *billion* dollar asset bank. We cannot be expected to have the same capital regulations as larger banks, which do not serve the same purpose as we do. Community banks intermediate risk to foster growth in local economies. Larger banks serve a very different purpose, as they act as intermediaries to the global financial markets, providing services that are much more complex, and in most cases, have a higher risk than what community bank customers demand.

The risk ratings established by these regulations often have no correlation to actual inherent risk in a particular class of assets. For example, United States Treasury's carry the lowest risk-rating at 0%; Securities of the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) are risk-weighted at 20% (including Collateralized Mortgage Obligations (CMO) and Collateralized Debt Obligations (CDO)); residential mortgage loans are risk-weighted at 50% (including non-owner occupied, investment properties, second mortgages and home equity loans); and small business loans are risk-weighted 100%. A real estate secured commercial loan to an owner-occupied orthopedic surgery practice, which is properly underwritten, should theoretically have less inherent risk than a second mortgage on an investment residential property. However, under current capital regulations, less capital would be held on the second mortgage on investment residential property.

In 2009, Congress passed even more regulation. The Dodd-Frank Wall Street Reform and Consumer Protection Act has 1,601 sections of new rules and regulations of which 63% still remains unwritten.[3] Dodd-Frank authorized the creation of the Consumer Financial Protection Bureau whose examination manual alone is more than 900 pages. And, to the best of my knowledge, *none of the existing regulations were repealed or replaced*.

The Durbin Amendment to Dodd-Frank, was intended to affect banks of $10 billion in assets and greater. Instead, Durbin has affected the entire banking industry. To remain competitive in the marketplace, our vendors had to reduce their interchange fees. This resulted in a $150,000 annual loss of income to Prosperity, thus, further limiting our ability to provide the services needed by our customers.

Until 2007, banks maintained an allowance for losses on loans and leases (ALLL) consistent with the regulatory guidance and Financial Accounting Standards Board (FASB) pronouncements in effect at that time. Under this methodology, reserves were maintained based upon types of loans, concentrations of loan types, past due ratios, and internal loan grading systems. Individual loans showing weakness were specifically reserved for. Banks had latitude into the reserve adequacy calculations based upon their knowledge of the borrower, portfolio, and local market. Immediately prior to the "Great Recession", the FASB updated their loan loss reserve requirements, fully supported by the regulators. Under FAS 5

[3] Davis-Polk. "Dodd-Frank Progress Report, July 2013". http://www.davispolk.com/files/Publication/093bb6dd-6d24-4efb-a9fb-58b92085e252/Presentation/PublicationAttachment/974c57ea-eac4-4cc6-ae90-5d50991ca308/Jul2013_Dodd.Frank.Progress.Report.pdf

and FAS 114, loan loss reserve adequacy is now calculated using average loan losses over prior periods, loan impairment calculations, and environmental factors.[4,5]

The FAS 5 and FAS 114 pronouncements have placed additional pressure on community banks in meeting the loan needs of our customers. The calculation and methodology are flawed and not indicative of the current state of the banking industry or the economy. First, loan loss rates incurred over the past four years will very likely have no bearing on loan loss rates that will be incurred as the economy recovers. Second, loan impairment requires community banks to recognize losses based upon market values, which may not exist or are skewed before the losses are actually incurred. Finally, environmental factors such as unemployment rates, property sales, building permits, etc. are used to establish additional reserves.

EXAMINATION PROCESS

As a state-chartered non-member bank, Prosperity is examined annually by the FDIC and the State of Florida Office of Financial Regulation (OFR). These agencies are often at odds with each other on the interpretation and implementation of the regulations. Safety and soundness examinations focus on uniform bank rating standards commonly referred to as CAMELS: **C**apital, **A**sset Quality, **M**anagement, **E**arnings, **L**iquidity, and **S**ensitivity to market risk. These CAMELS were intended to be independent measures of a bank's health at a point in time. It has always been understood that weaknesses in one of the CAMELS could be offset by strengths in others. In fact, this is how we have managed community bank balance sheets.

[4] Federal Accounting Standards Board. "Accounting for Contingencies (Issued 3/75)". http://www.fasb.org/summary/stsum5.shtml

[5] Federal Accounting Standards Board. "Accounting by Creditors for Impairment of a Loan- An Amendment of FAS Statements No.5 and 15 (Issued 5/93)". http://www.fasb.org/summary/stsum114.shtml

However, beginning in 2008, the CAMELS were no longer independent indicators of a bank's health. The examiners in the field began to use only one measure, Asset Quality, as the primary indicator of a bank's stability with no consideration of the other factors. As a result, overall bank ratings were lowered, which led to the issuance of Memorandums of Understanding, Consent Orders, and Cease and Desist Orders. These public actions by the regulatory agencies cause undue negative publicity for the Bank.

During the "Great Recession", Prosperity's asset quality deteriorated. This deterioration is not unusual considering rapidly increasing unemployment and declining real estate values. At the same time, the examination process began to focus totally on asset quality and loan grading. Asset quality was no longer about the payment performance of a loan, the past due percentages of the Bank's loan portfolio, or the ALLL. Instead, the examinations became totally about the classification of loans, i.e., substandard, doubtful, or loss, and at the discretion of the examiner, which means that it was inconsistently applied from examiner to examiner, exam to exam. These loan grades, while sometimes arbitrary, have a significant impact on the Bank's profitability, capital, ALLL, and ability to lend.

The Overall Effect on Prosperity Bank

When I began my banking career in 1982, my staff and I spent 10% to 15% of our time understanding and complying with regulation and law. Today, my senior staff and I spend in excess of 35% of our time understanding and complying with law and regulation and responding to examination and reporting requirements. In addition, Prosperity employs a Chief Compliance Officer with a staff of five and three outside review firms to ensure compliance with law and regulation. This year, Prosperity's compliance cost will surpass $750,000. Our training budget is $90,000 annually with more than half of this amount ear-marked for compliance training. The majority of our staff are not accountants or attorneys, and it is becoming increasingly difficult to train them on the myriad of very complex regulation.

Prosperity exceeds the requirements to be considered well-capitalized. However, because of the field examiner's judgment, we currently operate under a Consent Order with the FDIC which requires Prosperity to achieve a Tier-One Leverage ratio of 8% and a Total Risk-Based Capital ratio of 12%. This is a direct result of the disconnect between the regulations and the examiners, who routinely place higher capital standards on community banks based upon asset quality without regard to the adequacy of the ALLL or other CAMELS. This impedes our ability to lend, and in doing so, will stifle the economic recovery and job creation which is desperately needed in our communities.

United States Representatives Barney Frank and Walt Minnick said as much in their letter to the Federal Bank Regulatory agency leaders (*dated October 2009*) where they stated:

"Individual examiners in some cases have unofficially moved these numbers to 8-9% and 12% respectively. The impact is that many community banks have to restrict their growth (lending activity) in order to shrink their balance sheets and meet these standards. Restricting lending activity, especially to small businesses counter-productive to helping the economy recover."[6]

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[6]The Honorable Barney Frank and the Honorable Walt Minnick. "Letter to Regulators" 29 October 2009. http://online.wsj.com/public/resources/documents/pressure-frank-minnick11042009.pdf

For Prosperity Bank, the increased capital requirement equates to approximately $11,000,000. And, as a small privately traded company whose stockholders are local and few, it is impossible to raise this additional capital. Furthermore, by virtue of the Consent Order, Prosperity pays an additional $943,256 annually in FDIC insurance premiums.

The FAS 5 and FAS 114 ALLL methodologies adopted and applied to community banks by the regulators is flawed and counter-productive to community bank lending. Past performance of the Bank's loan portfolio is not an indication of future losses. Early in a recession, the weakest loans normally default and create the largest losses. Later in the recession, default rates begin to contract, the loan portfolio starts to stabilize, and losses are reduced. Once the recovery begins, the loan portfolio has seasoned and been purged of weaker loans. Banks should begin to lend, therefore allowing businesses to begin expanding and hiring. However, under FAS 5, when a new loan is made, reserves must be held against that loan based upon the bank's average losses on that type of loan during the past 2-4 years regardless of new underwriting, the strength of the borrower, or the value of the collateral. This reserve requirement can drive up the cost of a new loan, thereby making it unaffordable for the borrower.

Throughout this recession, Prosperity has been called upon by its borrowers for payment relief to help them weather the economic storm. Under FAS 114, when a borrower asks for assistance, Prosperity is required to test the loan for impairment. For a home loan or small business loan this impairment test is usually performed by obtaining a new appraisal. The reduction in value indicated by the appraisal plus approximately 10% holding and selling costs are immediately charged to earnings regardless of the ultimate disposition of the loan.

Again, I quote from the 2009 letter:

"Banks are being forced to write assets, loans and Other Real Estate Owned down to current market value. The problem is that there is virtually no market for some of the assets (developed lots for example) at present, leading to artificially low prices for those assets that have to be sold under duress. However, many of these markets are expected to recover in the future, and the forced write-downs to fire-sale values now are making the banks' capital crunch artificially and unnecessarily worse."[7]

The third part of the calculation of the methodology under FAS 5 and FAS 114 is environmental factors. Indicators such as underwriting standards, past due ratios, real estate values, unemployment percentages, building starts, etc. are considered to either add or deduct from the amount of required reserves. These are totally arbitrary and subject to open interpretation. One can easily imagine a point in the future where the economy is recovering, borrowers are performing as agreed, loan losses are minimal, and environmental factors are strong. In this scenario, FAS 5 and FAS 114 could very well require banks to carry very small ALLL. Perhaps that is why FASB is now considering a new pronouncement, which would require banks to estimate loan losses in their portfolios for the future life of the portfolio and book that reserve in the current period. I dare to imagine the catastrophic affect that would have on community banks.

As a community bank, we do business based on strong relationships and trust. We do not deceive our customers or ever attempt to take advantage of them. We can't because we live and work with them every day. We see them in local restaurants, we sit beside them in church, we coach their children, and we belong to the same civic organizations. If we don't treat our customers fairly and honestly, we have to look them in the eye and tell them why we did not.

[7] 2009 Letter

Prosperity recently agreed to merge with a larger bank. While there are many reasons for the decision, a very important consideration is the regulatory burden and the increasing cost of that burden. We simply do not believe that a bank our size can attract and maintain the resources necessary for compliance with regulation going forward. I refer to this as "regulatory fatigue." We do not have a staff of 260,000, nor the resources to spend $5 billion annually on legal fees[8] to help me interpret the regulations, such as the large banks do. And, while we are confident that we have chosen an excellent merger partner, more than 65 jobs will be lost as a result of the transaction. This will not be good for our local economy.

I will close by again thanking you for this opportunity. I am passionate about what I do and about my profession, and I could have provided many more examples than I have here. Hopefully, the examples I have provided will foster questions from this committee. I know as a 31-year community banker, that clear, concise, logical regulation consistently applied by examiners is necessary. However, I know first-hand the negative impact regulation has had on my Bank, and ultimately my community. And, I know the void that will be left when Prosperity Bank has merged into another bank. I will leave you with one last quote from the 2009 letter, because they say it much more eloquently than I could:

"Community Banks became strong and viable players in the financial services industry because they fill an important need, and it would be short-sighted to weaken that role through over-zealous regulatory actions - actions based not on wrong doing or poor management practices at these banks, but on changes in the economic environment and toughening regulatory standards."[9]

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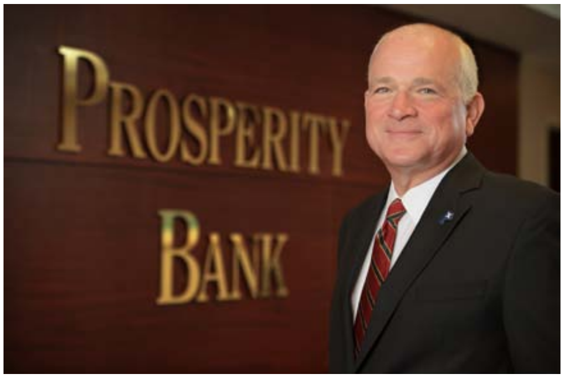
[8]JPMorgan Chase & Co., Annual Report Form 10-K for the Period Ending December 31, 2012 (Filed Feb. 28, 2013), From JPMorgan Chase & Co. website. http://investor.shareholder.com/jpmorganchase/secfiling.cfm?filingID=19617-13-221. Accessed July 15, 2013.
[9]2009 Letter



PROSPERITY BANK

Eddie Creamer

Biography

June 2013

Professional

Eddie Creamer is the current President and Chief Executive Officer of Prosperity Bank, a position he has held since 1999. Prior to this position, he was the bank's Chief Financial Officer.

Education

Eddie received his Bachelor's degree in Accounting from The University of West Florida. In addition, he completed the Graduate School of Banking from Louisiana State University. He is currently pursuing his MBA with a concentration in Accounting at Saint Leo University.

Community Interests

Eddie's community involvement is very extensive. He is a member of the Board of Trustees at Flagler College, a member of the Rotary Club, a Supervisor for the Marshall Creek CDD, a former Director for the Florida Banker's Association BankPac, Finance Committee member of the Cathedral Basilica of St Augustine, member of the Capital Campaign Leadership Committee for the Bailey Center for Living, Community Hospice of Northeast Florida, Former Member of the Board of Trustees of the Graduate School of Banking at Louisiana State University, an advisory council member for the Florida Highway Patrol, a former parents council member at Wake Forest University, a past Director and Instructor for the Florida School of Banking at the University of Florida, and the banking advisory board at the College of Technology and Management at St. Petersburg College. Eddie is the past Chairman of the Board of Directors for the St. Augustine Family YMCA and a past Director for the Betty Griffin House.

Personal

Eddie has held progressively responsible leadership positions throughout his thirty three year career. He is an outstanding leader and teacher. He builds strong cohesive teams and leads them to achieve very successful outcomes. His experience includes hands on responsibility in Accounting, Information Technology, Regulatory Management and Compliance, Human Resources and Audit.

He built Prosperity Bank into one of the largest most profitable banks in Florida. He then led the bank through the worst economic crisis since the great depression, returning it to profitability and negotiating the successful sale of the bank.

Originally from Port St. Joe, Florida, Eddie, 54, lives in St. Augustine with his wife Julie. They have two sons, John (22) & Daniel (28). His son Daniel is a graduate of Wake Forest University BA, and Georgia Southern University where he received his MS in Sport Psychology. His son John is a Graduate of The George Washington University BS and will be attending the University of Edinburgh for his MSC.

Eddie enjoys running and has completed six marathons. Most important, he treasures time spent with his family.

About Prosperity Bank

Prosperity Bank (www.prosperitybank.com) is a $748 million community bank with 12 banking offices located in Bay, Duval, Flagler, Putnam, St. Johns and Volusia counties. Prosperity Bank offers a complete line of banking and other related financial services to commercial and retail customers. Prosperity is the 32nd largest bank chartered in Florida, one of the 25 Companies That Care by Jacksonville Magazine ('04-'05, '07-'11), named Outstanding Corporation by the Association of Fundraising Professionals for National Philanthropy Day, voted "Best Bank" 13 times by the St. Augustine Record, a recipient of a Jefferson Award from HandsOn Jacksonville, a recipient of the Florida Governor's Business Partner Award for Excellence for our partnership with the Flagler County School District, and selected as the Clay County Business Excellence Award recipient by the Clay County Chamber of Commerce.

Committee on Oversight and Government Reform
Witness Disclosure Requirement – "Truth in Testimony"
Required by House Rule XI, Clause 2(g)(5)

Name: Eddie Creamer

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1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2010. Include the source and amount of each grant or contract.

N/A

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2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

The Prosperity Banking Company
Prosperity Bank

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3. Please list any federal grants or contracts (including subgrants or subcontracts) received since October 1, 2010, by the entity(ies) you listed above. Include the source and amount of each grant or contract.

N/A

I certify that the above information is true and correct.
Signature: Eddie Creamer   Date: July 15, 2013