

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON OVERSIGHT & GOVERNMENT REFORM

Hearing On

OVERSIGHT OF THE FDIC APPLICATION PROCESS

Wednesday, July 13, 2016

WRITTEN TESTIMONY OF MATT BROWNING

On Behalf of

National Association of Industrial Bankers

Utah Bankers Association

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

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

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

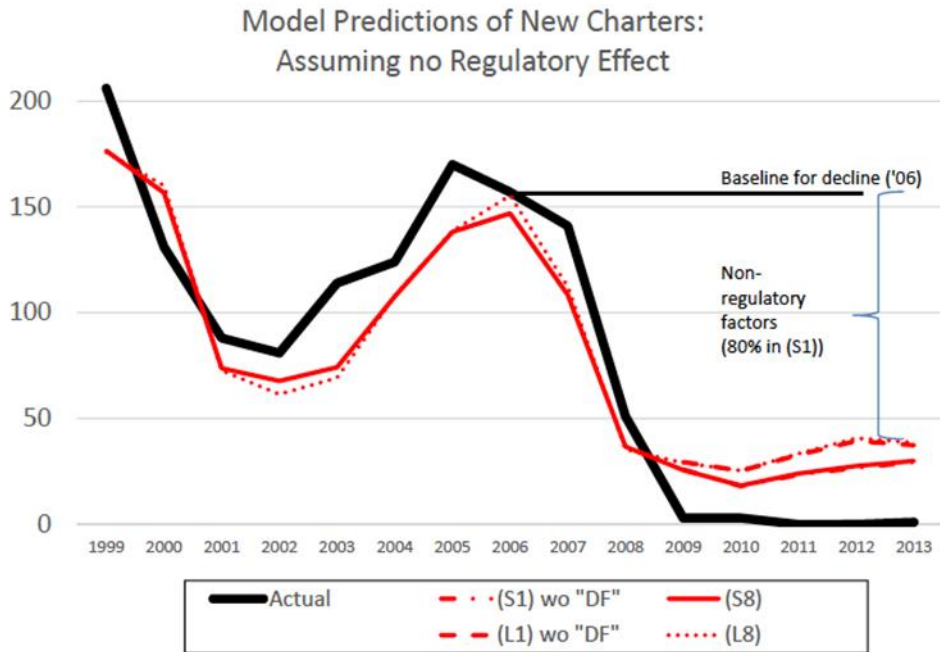
In recent years, however, banks' role as providers of credit has declined, and the absence of new bank approvals is one element of that decline. History suggests that banks have formed a core of credit providers in times of critical need, and we believe that studies would show these depository institutions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

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

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

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

Figure 8B



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

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

CHARTERING A NEW BANK: THE THEORY

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

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

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

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

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

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

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

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

CHARTERING A NEW BANK: THE REALITY

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

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

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

To date, Deere does not have a new charter.

Deere's plight is not unusual. From 2003 to 2007, an average of 126 new banks opened for business each year in the U.S. Since 2008, formation of new banks in the U.S. has virtually stopped. We are aware of only three *de novo* banks formed in the nation since 2009.⁵ Given the vital role banks play in our economy and our communities, this situation raises many concerns.

CHARTERING A NEW BANK: A PEEK BEHIND THE CURTAIN

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

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

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

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

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

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

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

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

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

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

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

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

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

⁶ See note 18 *infra*

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

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

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

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

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

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

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

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

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

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

In 2009, *American Banker* reported:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

WHO GETS HURT?

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

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

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

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

COMMUNITY BANKS

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

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

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

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

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

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

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

¹³ Economic Innovation Group. “The New Map of Economic Growth and Recovery.” May 2016

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

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

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

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

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

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

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

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

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

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

MINORITY BANKS

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

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

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

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

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

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

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

¹⁶ FDIC Minority Depository Institutions Report, Dec.

2015, <https://www.fdic.gov/regulations/resources/minority/mdi.html>.

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

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

¹⁹ Lee, Jeanne. "Black-owned Banks Fight To Bounce Back." NerdWallet. 19 Feb. 2016.

<https://www.nerdwallet.com/blog/banking/black-owned-banks-fight-to-bounce-back/>.

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

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

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

SPECIALTY BANKS

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

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

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

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

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

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

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

A GLIMMER OF HOPE?

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

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

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

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

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

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

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

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

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

He made no mention of new charters or underserved markets.

ONLY CONGRESS SHOULD DECIDE IF THERE ARE ENOUGH BANKS

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

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

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

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

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

²³ Senator Dean Heller. Letter to The Honorable Martin Gruenberg. 13 May 2016. MS. Washington, DC.

²⁴ Gruenberg, Martin. "The Impact of Post-Crisis Reforms on the U.S. Financial System and Economy." Exchequer Club; Washington, D.C. 15 June 2016. Speech.

²⁵ States chartered banks from 1780 until 1933 without the aid of the FDIC.

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

WHAT SHOULD THIS COMMITTEE REQUIRE FROM THE FDIC?

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

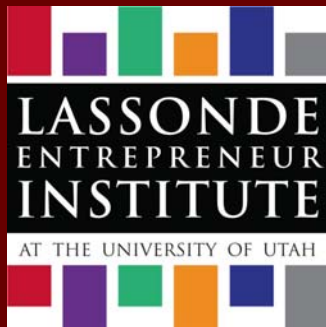
To make the FDIC accountable for its failure to charter *de novo* banks, we urge this Committee to require the FDIC to:

1. Outline, with specificity, what it is doing to align its actions with its stated policies and convince potential bank organizers that it will actually process applications promptly and fairly.
2. Designate the specific criteria used to approve a bank charter so that applicants know the rules and can legitimately evaluate their likelihood of success. Any unpublished differences or new creative interpretations from established statutory criteria need to be public and accessible.
3. Provide a plan and timeframe to return to the pre-crisis delegation of authority to the Regional Offices.
4. Describe how the FDIC plans to free states to resume their traditional role as innovators in the banking system, providing our economy with a vibrant, pro-growth banking system that meets the needs of communities and the nation.

*

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

Center
for Innovation
in Banking
and Financial
Services



De Novo Charters Research Review: Economic Environment and Regulatory Impediments

Jack Brittain

Pierre Lassonde Chair and Professor of Management
CIBFS Research Director

and

John Bessey

MBA Student
CIBFS Researcher



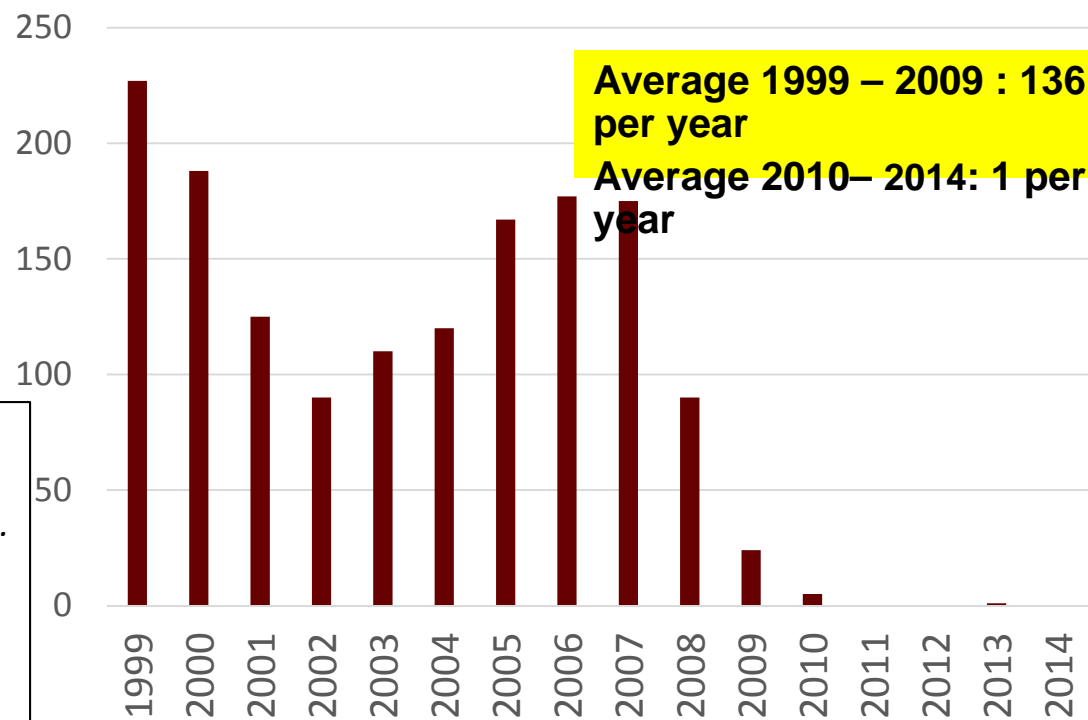
De Novo Charters: Unprecedented

What happened?

1. Banking became unprofitable after the Great Recession?
2. Dodd-Frank regulations made banking too expensive?
3. Regulatory over reaction to the Great Recession has impeded chartering?

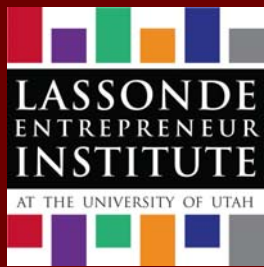
“Entry by newly created banks, commonly called de novo banks, has been minimal (since 2009) and was actually zero in 2012. This is unprecedented over the last 50 years. Even during the previous banking crisis of the late 1980s and early 1990s when large numbers of banks failed or merged, there was still substantial entry.”
(McCord and Prescott, 2014)

De Novo Bank Charters Since 1999



Source FDIC, Changes in Commercial Banks Table

Source: McCord, Roisin, and Edward Simpson Prescott. “The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks.” *Economic Quarterly*, Volume 100 Number 1: 23-50. (2014). Federal Reserve Bank of Richmond

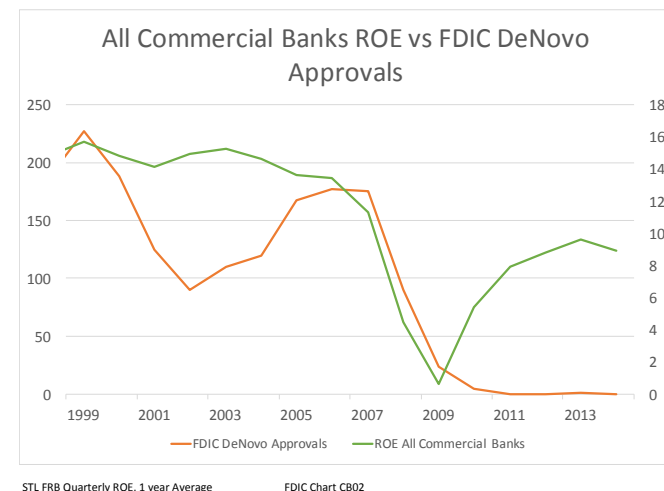
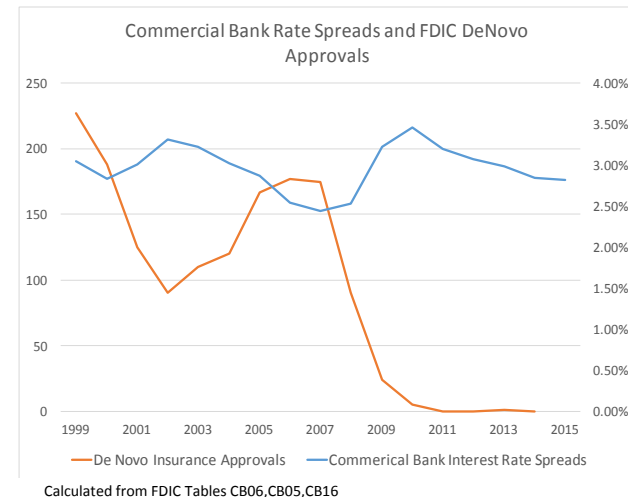


1. Is bank profitability limiting interest in new bank charters?

Is banking unprofitable because of unprecedented “low interest rates?”

- Banking business success depends on interest rate spreads, the difference between the:
 1. interest paid on deposits and
 2. interest income from loans.

“Low interest rates” lower the cost of deposits; spreads determine profits.
- **Interest rate spreads have remained relatively stable for banks.**
- Banking profits recovered quickly in 2010-11 and are robust relative to other investment options. ROE did fall sharply during 2007-09 and could explain a decline in charter requests, but in prior recessions chartering returned within 2 years (McCord and Prescott, 2014).



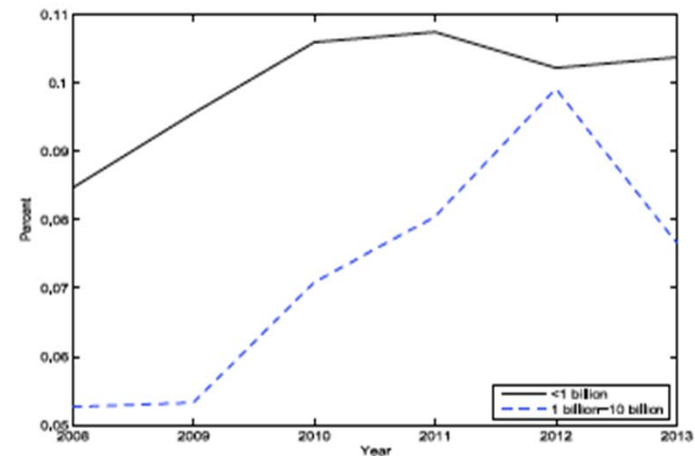
2. Did Dodd-Frank hamstring banks with regulatory costs?

Richmond Federal Reserve Bank Study

Did increased regulatory expenses cause the decline in de novo charters?

- “There is an increase in these expenses from 2008 to 2011, but the increase is relatively small and, more importantly, the size of these expenses is just too small to have a big effect on bank profitability. For example, **entirely eliminating these expenses would only increase the return on assets by 10 basis points.**” (pg 42)
- Operating expenses as reported by banks are relatively constant for community banks under \$1 billion in assets.

Figure 8 Legal Fees, Accounting, Auditing, Consulting, and Advisory Expenses to Asset Ratio



Source: McCord, Roisin, and Edward Simpson Prescott. “The Financial Crisis, the Collapse of Bank Entry, and Changes in the Size Distribution of Banks.” *Economic Quarterly*, Volume 100 Number 1: 23-50.

(2014). Federal Reserve Bank of Richmond.

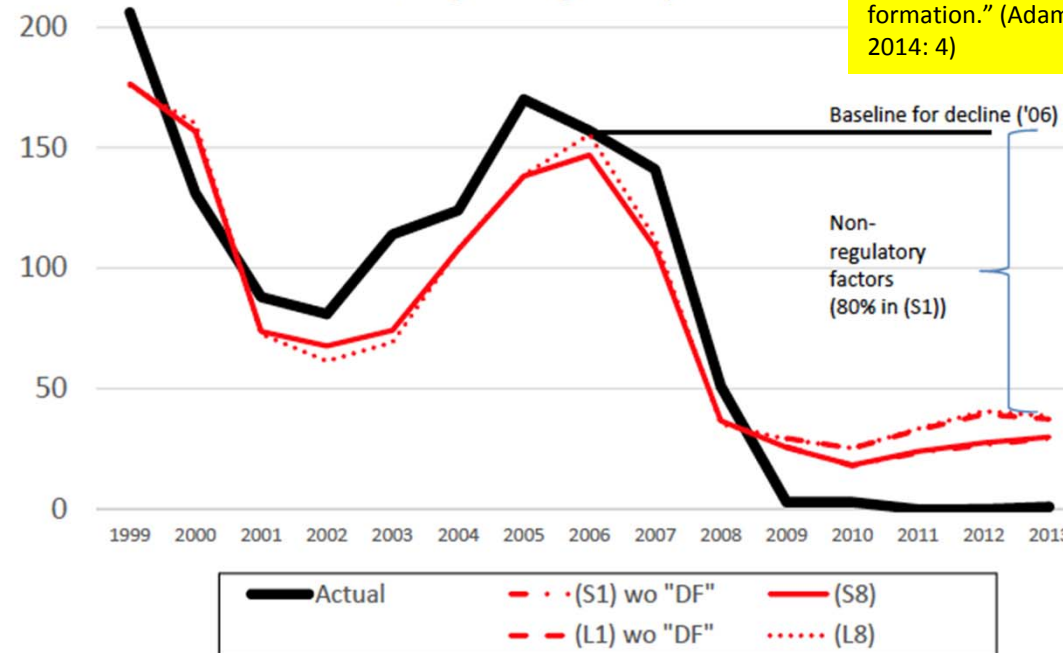
3. Regulatory Changes?

Economic conditions partially explain the decline. *Models predict an average of 30 banks per year should have been chartered 2009-2015.*

Where are these 210 banks?

Figure 8B

Model Predictions of New Charters:
Assuming no Regulatory Effect



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

30 de novo banks per year

Source: Adams, Robert M., and Jacob P. Gramlich. "Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation." *Finance and Economics Discussion Series* (2014). Federal Reserve Board of Governors.



What happened starting in 2009/2010?

Adams and Gramlich (2014) used model to ask “***was something different starting in 2010?***” Answer is “yes,” de novo charter authorizations by the FDIC dropped to unprecedented low levels.

- Richmond FRB study found no evidence of regulatory compliance effects associated with Dodd-Frank (McCord and Prescott, 2014).
- Investment continued in acquisition of existing charters.
- Banking profits were recovering by 2010, which should attract entrants.
- Applicants report *FDIC operational impediments beginning in 2009* and continuing to present (Fajit, *American Banker* 2009; Rehm, *American Banker*, 2010; Long, *Harvard Law School Forum*, 2013).

Where are the 210 banks that were predicted since 2009 after accounting for business/economic factors?

Source: Adams, Robert M., and Jacob P. Gramlich. "Where Are All the New Banks? The Role of Regulatory Burden in New Charter Creation." *Finance and Economics Discussion Series* (2014). Federal Reserve Board of Governors.



Center for Innovation in Banking and Financial Services

The Center for Innovation in Banking and Financial Services (CIBFS) was founded in 2015 by the University of Utah's David Eccles School of Business to support research on state-chartered community banks, innovation in financial services, and policies and regulatory practices that impact the U.S. dual banking system. In addition to funding academic research, CIBFS, in partnership with the Pierre Lassonde Entrepreneur Center and Lassonde Studios, supports student innovation programs focused on social groups who are unserved and underserved by current financial services. By supporting the development of new business models and mobile technologies, the CIBFS's goal is to provide access to financial services that contribute to all people's economic life success and provide economic security for all families and individuals.

website: <http://lassonde.utah.edu/cibfs>

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

Name: Matthew S. Browning

1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2012. Include the source and amount of each grant or contract.

None

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

National Association of Industrial Bankers - Former member of the Board and Executive Committee

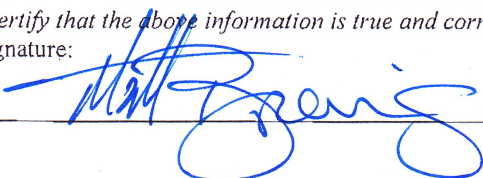
Utah Bankers Association - Former member of the Board and Executive Committee

3. Please list any federal grants or contracts (including subgrants or subcontracts) received since October 1, 2012, by the entity(ies) you listed above. Include the source and amount of each grant or contract.

None

I certify that the above information is true and correct.

Signature:



Date:

7/10/16

MATT BROWNING

Matt Browning is COO of Snap Finance, a digital retail finance company where he leads strategy and operations.

His prior position as CEO of Stern Agee Bank & Trust (in formation) gives him unique insight into the bank chartering process and the role of FDIC policy and conduct relating to new applicants.

Before the bank chartering effort, Matt was President of Target Bank which issued a range of credit cards and prepaid cards sold in Target stores. In conjunction with the Bank, Matt also lead Target's financial product development team in Minneapolis, which focused on new products and services, such as mobile payments, loyalty programs, gift cards, etc.

Before moving to Utah to lead Target Bank in 2007, Matt served in Target's corporate strategy group in Minneapolis, MN, where he managed a variety of strategic and operational initiatives.

Earlier, he helped lead the turn-around effort for Culligan international's private equity owner. Before joining Culligan, he was a consultant in the Strategy Practice of A.T. Kearney, where he managed strategy, operations, post-merger integration and restructuring engagements for Fortune 500 and early stage companies across a range of industries, e.g. software, healthcare, private equity, transportation, financial services, utilities, and automotive.

Before his consulting career, Matt was Vice President, Investment Banking at A.G. Edwards in Los Angeles, CA, where he sourced, structured, and executed financing transactions for public and private entities along the west coast.

Matt holds an MBA from the University of Chicago Booth School of Business, and a B.S. in Business Administration from University of Southern California. He has also completed the Stonier Graduate School of Banking program at Wharton.

Matt has served on the Boards of state and national banking trade associations as well as a number of non-profit organizations.