Haverhill Bank

Community Bank Regulatory Issues

All stakeholders in a bank, the board, management, employees, depositors, and the community at large have an interest in ensuring that the bank remains safe and sound. Parties associated with a bank that have little interest in its well-being are Congress and those that regulate it (other than the exposures to the insurance funds), yet they have the power to significantly influence the fiscal performance of the institution. Congress and the regulators are more interested in consumers, terrorism, drug dealers, a healthy economy, and risks to the taxpayer. These are all valid and noble interests that must be addressed. However, there must be room for moderation and a way for community banks to continue to function. By perpetuating the continued trend of over-regulation, small community banks will continue to be consumed by their larger peers. It cannot be overlooked that the avoidance of oligopolies is the essence of free enterprise, the very system that sustains us. More competition in an industry ultimately benefits the consumer.

I am aware of the higher cost associated with the regulation of numerous small banks as opposed to few large ones, but small banks provide a significant value which cannot be disregarded. Examples of this are responsiveness to customers' demands, fulfillment of community needs, and ethical, congenial personal relationships with and convenience for the customers. Mega-banks may possess these qualities to some extent, but not to the degree of smaller community banks. As a means of understanding some of what we do for our community, I have attached a copy of our annually published "Report to Our Community".

A community bank must remain solvent and run its business at a profit or it will disappear very soon. Many have become unprofitable and disappeared over recent years for a variety of reasons. Inarguably the most prevalent among those reasons is the burden of over-regulation. The home mortgage business, which was a staple of community banks for over 100 years, has been commandeered by mortgage companies. These companies are not subject to many regulations imposed on banks, nor are they effectively policed on those regulations with which they ostensibly should comply.

Our bank having made at least one purchase money mortgage (we made 19) last year is subject to HMDA. Any mortgage company that made less than 100 purchase money mortgages is not subject to HMDA. Leaving our data out would have less impact on the validity of FFIEC HMDA data than mortgage companies' data. In 2004 we were the third largest bank in our community in terms of deposits yet we had only 2.1% of the mortgage market. In 2004, 667 lenders closed loans in our market.

With the existence of two unrelated, regulatory bodies overseeing banks and mortgage companies as if they were two separate and distinct industries, the playing field becomes further unbalanced. If community banks are in competition with these brokerages, why should both competitors not be required to adhere to the same regulatory standards? The

fact is that banks, particularly small banks, incur a greater cost, and the brokerages reap the benefits. Note that the Fair Trade Commission, which regulates mortgage companies across the country, maintains an annual budget allocation, for that purpose, of a meager $1 million. Considering the modern proliferation of mortgage companies in recent years, this certainly does not indicate thorough scrutiny of the lending practices of brokerages. Also note the recent "Ameriquest" penalty for fraudulent practices of $385 million.

A cynic might suspect that there is incentive for large banks to support more regulation rather than less because it consequently forces smaller competitors to seek larger merger partners that can effectively curtail their burden by spreading the costs of regulation over more accounts. A cynic might also suspect that a congress that experienced the S&L crisis might be inclined to over-regulate financial institutions that they feel exposed the taxpayers to undue risk. (Ultimately the taxpayer lost no money from the S&L crisis.)

Two particularly onerous sets of regulations that should be suspended for community banks at least for a trial period are CRA (Community Reinvestment Act) and HMDA (Home Mortgage Disclosure Act). Some reasons for this are: Today virtually all lenders would make any loan that is possible to close; few if any community banks have ever been accused of discrimination; the cost of compliance vs. the benefits of the information gathered is prohibitive; the rules do not apply equally to mortgage companies who close about 80% of the loans; examiners can review our small number of loan files for signs of discrimination; signs in our lobbies tell consumers where and how to complain if discrimination is perceived; and we have never had a request for our CRA folder other than from an examiner. Any bank that makes less than 100 purchase money mortgages or has less than 3% of the market in their community should not be subject to these regulations unless they demonstrate discriminatory practices.

Logic would indicate that at some point the cost of maintaining the infrastructure needed to comply with all of the home mortgage regulations to make a small number of loans will make it impossible to offer the service.

The number of banks with less than $1 billion in assets, within the state of Massachusetts, declined from 251 to 178 in the decade from 1994 to 2004. This is a decrease of nearly 30%. The most salient causes of this urgent problem, among others, are regulatory burden, and loss of mortgage business. A recent article in the "Boston Globe" spoke about the migration of business from community banks and credit unions to mortgage companies. The article said that community banks and credit unions had **78%** of the mortgage market in 1990 and **22%** in 2004. While we now make only one mortgage in five, we are still subject to CRA and HMDA laws, with which some mortgage companies need not comply. This is not reasonable or logical, and this situation must be addressed lest community banks disappear.

Some areas of regulatory burden are listed below. Some provide value and should remain in place. Some should be eliminated for smaller institutions and some should be suspended unless oversight of a bank is warranted based on examiner review or consumer

complaint. In more than 129 years of lending, our bank has never been accused of discrimination or any unscrupulous activity for that matter.
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Regulatory Burden:

Sarbanes-Oxley Act: regulates corporate governance issues.

Reg Z: Truth In Lending – requires disclosure of terms and costs of credit

RESPA: Real Estate Settlement Procedures Act - requires disclosure of costs associated with real estate settlement process

Reg C: Home Mortgage Disclosure Act (HMDA) – requires disclosure of loans made in market place. Addresses redlining.

Flood Disaster Protection Act: requires notification of flood hazard area etc.

Reg B: Equal Credit Opportunity Act – prohibits discrimination in lending based on race, religion etc.

Fair Credit Reporting Act: - disclosure requirements of banks as users of credit reportsand duties as furnishers of information.

Reg CC: Expedited Funds Availability Act – regulates time a bank can use check holds and has rules to speed check clearing process

Reg Q and Reg D: prohibits paying interest on checking accounts and reg D covers time deposits and MMDAs transaction limits etc.

Reg DD: Truth In Savings Act – Covers calculation of interest, account disclosures, maturity notices, advertising, etc.

Bank Secrecy Act: covers reporting of cash transactions ($3,000 & 10,000 limits etc) and Suspicious Activity Reports.

Reg E: Electronic Funds Transfer Act – covers electronic transactions such as ATM, direct deposit etc and consumer liability limits and error resolution procedures.

Right To Financial Privacy Act: covers confidentiality of bank records, subpoenas, government agency requests etc.

Reg 0: Loans to insiders and reporting of same.

Americans with Disabilities Act: covers accommodations for employees & customers.

Privacy: covers privacy of transactions, COPPA (Children's Online Privacy Protection Act) commercial web services to children under 13 etc.

Information Technology Rules: cover customer privacy and operational issues.

Various other rules & regulations apply because they are "best practices" by whoever may determine what they are.

Sarbanes-Oxley: should not apply unless examiners note abusive practices actually affecting operations.

Predatory Lending Regs: cover high risk loans that are priced aggressively.