Testimony of

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On behalf of the

Independent Community Bankers of America

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Hearing on

"Promoting Inclusive Lending During the Pandemic: Community Development Financial Institutions and Minority Depository Institutions"

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Chairman Meeks, Ranking Member Luetkemeyer, and members of the Subcommittee, I am James Sills, CEO and President of M&F Bank in Durham, North Carolina. I testify today on behalf of the Independent Community Bankers of America where I serve as Vice Chairman of the Minority Bank Advisory Council. Thank you for the opportunity to testify at today's hearing on "Promoting Inclusive Lending During the Pandemic: Community Development Financial Institutions and Minority Depository Institutions." M&F Bank is an MDI as well as a CDFI, and I am pleased to provide our perspective to this important discussion.

We must ensure that the pandemic does not set back the critical policy goal of promoting credit and financial opportunity and prosperity in America's minority communities. The social unrest and protests we are witnessing today – not only in our cities but in our suburbs and smaller towns as well – only raise the stakes for achieving this goal. This hearing is well timed.

With the 1989 FIRREA, Congress recognized the importance of preserving and promoting MDIs, not for their own sake but for their role in promoting economic prosperity in the historically marginalized communities they serve. MDIs are diverse in terms of the ethnic communities they serve, asset size, market demographics (urban, suburban, rural), and other defining characteristics. MDIs face unique challenges, including (as discussed below) access to capital, in addition to the challenges that face all community banks, which include: regulatory compliance expense disproportionate to any systemic or consumer risk they pose; historically low interest rates; and competition from larger banks, tax-exempt credit unions and less regulated, non-banks. These are the challenges we face in "normal times." The pandemic presents the added risks of poor credit quality, stunted economic growth, and historically high unemployment, though, with well-crafted economic policy, I believe these conditions can be reversed and economic growth restored in the near term.

I would like to thank Chairman Meeks and this committee for bipartisan passage of the Ensuring Diversity in Community Banking Act (H.R. 5322). We are pleased that this legislation has advanced as part of the HEROES Act. It is appropriate that a legislative package designed to mitigate the impact of the current pandemic should include provisions to strengthen MDIs so that we may better promote the economic recovery and ensure that it is broad and inclusive.

We were grateful for the opportunity to offer input on this bill at a hearing before this committee last October. We hope to continue to work with you as it advances through the process.

Our Story

M&F Bank is a $265 million asset state-chartered bank with over 70 employees. We are headquartered in Durham and serve the five largest urban markets in North Carolina: Charlotte, Durham, Greensboro, Winston Salem and Raleigh.

M&F was founded in 1907 by a group of nine successful businessmen in Durham who were active community builders in a thriving district of Durham that came to be known as Black Wall Street. Their goal was to create a bank to serve African Americans who had few opportunities to obtain financing for their business ventures or homes and few places to safely deposit their money and earn interest. Many MDIs have similar stories. ICBA President Rebeca Romero Rainey led an MDI in Taos, New Mexico, Centinel Bank, founded in 1969 by her grandfather after he was declined a loan for a mere $500 to setup a law practice. The challenge of banking minority communities continues today.

Today M&F Bank serves a diverse customer base. We serve everyone in our communities and have had a Community Reinvestment Act rating of Outstanding for 25 years. Our primary customer base is the African American community. Approximately 45 percent of our individual customers are 50 years old or older, though we have begun to target a younger demographic in the 30 to 49 age range.

Our business is focused on various forms of commercial lending: commercial and industrial loans (C&I), Small Business Administration loans, commercial real estate, multi-family mortgages, as well as lending to nonprofits and churches. Commercial lending constitutes about 90 percent of our loan portfolio, while consumer lending constitutes about 10 percent.

Our rich history continues to inform our values and our mission today: To promote personal and community development in the communities we serve. The future of the bank is to continue to provide access to capital to diverse small and medium size businesses and continue to be a financial literacy leader to help customers make the right financial decisions.

Paycheck Protection Program

The primary response of Congress and the Administration to the economic challenges presented by the pandemic is the Paycheck Protection Program (PPP). This program has played a critical role in helping small businesses in my markets and across the country maintain their employment, survive, and prepare for the reopening of the economy. I thank this committee for your role in crafting the program.

Like many MDIs and community banks, M&F Bank has strongly leaned into the PPP. We were an active SBA lender before the PPP and have long used the agency's programs to serve small and medium sized businesses. The PPP fit our lending process and our customer profile perfectly. What's more, as an MDI and a CDFI, we enjoy strong connections to our communities and our small businesses. Solid relationships and a feedback loop were already in place before the launch of the PPP. When there was a doubt or a question, our borrowers simply picked up the phone to resolve it.

Overall, the PPP is definitely working as intended to help businesses and other employers retain and pay their employees. We estimate that M&F's PPP loans have supported the retention of some 1,200 employees. I'm confident that other MDIs and community banks generally have had similar results.

Perhaps one of the most important achievements of the program is that it is forcing some businesses to pivot or change their business models to the new normal of life under pandemic restrictions and the possibility of future pandemics. Small and medium sized businesses are investing and leveraging technology to better serve their customers and position their firms for increased growth in a post-COVID-19 environment.

I'd like to share with this committee some data on our PPP lending. To date, we have closed 130 loans totaling $12.6 million. In Phase 1 our average loan size was $155,000, and in Phase 2 it was $57,000. Why the stark difference in loan size? From what I have observed, the larger and more technically proficient businesses were ready to submit their applications in Phase 1, while the smaller, "mom and pop" Phase 2 businesses, with fewer technical resources, needed more time to prepare their applications. We plan to continue to process PPP applications until the funding runs out. Currently, we are receiving on average one to two applications per day. Any criticism of the program, though warranted, should be kept in perspective. The PPP has had a significant positive impact and we are undoubtedly in a better place economically because of the program and because of the thousands of community banks that worked heroically and around the clock to process a flood of applications in a very short time frame.

Recommendations for Improving PPP

ICBA is supportive of provisions in the Paycheck Protection Program Flexibility Act (H.R. 7010) which passed the House last Friday. Two provisions in particular will help borrowers.

First, replacing the rigid requirement that 75 percent of loan proceeds be spent on payroll as a condition of loan forgiveness with a 60 percent payroll spend requirement. ICBA continues to advocate for a 50/50 split, but 60/40 is a significant improvement.

Second, H.R. 7010 extends the timeframe in which PPP funds must be spent as a condition of forgiveness from 8 weeks to 24 weeks. The 8-week timeframe was simply unrealistic and unworkable. Many non-essential businesses are just now reopening and have not had the opportunity to spend their PPP funds.

While these two provisions are very helpful, ICBA supports additional changes to the program as discussed below.

Easy-to-Use Forms and Procedures for PPP Forgiveness

It is my fear that as bankers we will be working with borrowers on the forgiveness application for the remainder of 2020. This will be a distraction from the critical and fundamental task of lending money to help rebuild local economies, working with troubled borrowers, and reopening our branches in a way that is safe for our customers and employees. The certainty provided by a simplified process would allow borrowers to focus on sustaining the viability of their businesses. Complex calculations are an unnecessary distraction in a challenging environment. Borrowers should not have to hire accountants at expensive fees to assist with loan forgiveness. What's more, borrowers whose first language is not English are struggling with the forgiveness forms and procedures and would greatly benefit from simplification.

We recommend the following changes:

- For all loans with an original balance of $1 million or less, allow a presumption of compliance based on the borrower's certification that the funds were used in accordance with the terms of the program. A threshold of $1 million for presumed compliance would be consistent with Secretary Mnuchin's intention to focus audit resources on loans in excess of $2 million.

- Require Treasury and the Small Business Administration (SBA) to promptly provide a straightforward, easy-to-apply approach to loan forgiveness. The 11-page loan forgiveness application released by Treasury on May 15 is overly complex and detailed. Nearly all community bank PPP loans are less than $1 million and the vast majority are less than $100,000.
- Provide a PPP loan forgiveness calculator to allow the borrower and lender to easily determine the forgiven amount.
- Create a streamlined form, comparable to the IRS Form 1040 EZ, for self-employed borrowers and independent contractors with few resources to complete a complex form.

The Carve Out Has Worked and Should be Replicated in Future Loan Programs

In our view, the $30 billion carve out of Phase 2 funding for MDIs, CDFIs and community banks with assets of less than $10 billion was a strong success. Last week, SBA set aside an additional $10 billion specifically for CDFIs, an action we welcomed. We support Chairwoman Waters' call for an additional $10 billion to be set aside for MDIs. The carve out or set aside has made a real difference in terms of channeling funding to minority firms and, in retrospect, should have been available in Phase 1 as well.

If there is another phase of PPP or a similar lending program, I urge you to consider replicating the carve out to ensure the program is effective in promoting inclusive lending.

Recommendations for Strengthening MDIs and CDFIs

In addition to the PPP, an emergency program created in response to unprecedented circumstances, Congress should consider permanent measures to strengthen MDIs and CDFIs. H.R. 5322 contains important provisions, but more is needed.

Capital

MDIs and CDFIs need access to new, non-traditional ways of raising capital. With limited or no access to the capital markets, MDIs and CDFIs are forced to rely on retained earnings, which makes it difficult to compete with larger institutions. Access to capital is critical for our preservation and to ensuring that fair and equitable access to the financial system is preserved for the communities we serve.

Resources for CDFI Fund

ICBA recommends $1 billion in funding for the CDFI Fund of the U.S. Department of the Treasury. CDFIs are one of the best market-based strategies for leveraging and channeling needed resources to distressed communities. In response to the last financial and economic crisis, the 2009 American Reinvestment and Recovery Act included funds for the CDFI Fund, and this proved to be a very effective investment which supported the resiliency of small business and consumers. The CDFI Fund should be a part of the solution to today's crisis, and we were pleased to see it included in the HEROES Act.

Application and Recertification Process for Community Development Financial Institutions

ICBA believes that many MDIs that are eligible for CDFI status choose not to apply because of the burdensome application process. CDFI status would allow these institutions to use more flexible underwriting standards, potentially attract outside capital, and become eligible for competitive and technical assistance grants to offer new programs and services to customers.

For these reasons, ICBA proposes that the agencies create a streamlined CDFI application in which, at the bank's option, the FDIC, OCC or Federal Reserve would perform initial loan portfolio analyses on behalf of the bank.

According to ICBA surveys, community banks view loan portfolio analysis as the most burdensome aspect of the CDFI application. If the prudential regulators were to perform the analysis on behalf of the banks, we believe many MDIs and other community banks would take advantage of the streamlined process and obtain the benefits of CDFI status. This would be similar to a National Credit Union Administration program in which the agency analyzes a credit union's loan portfolio and produces a report for the credit union to use in their CDFI application. If a bank does not want the prudential regulator to conduct the analysis for them, the bank can still use the current, non-streamlined application to become designated as a CDFI.

By the same token, banks such as mine that have obtained CDFI status should not be burdened by annual recertification. This process is a distraction from the business of serving my customers and communities. I recommend that we return to a three-year cycle for recertification. The Fund should be able to use data that we supply to other agencies to streamline the process.

Lower Capital Requirements for De Novo MDIs and CDFIs

We have seen a dearth of de novo MDIs in the last 10 years. Only one has been approved by the FDIC. Changes are needed to encourage more applicants and replenish the reduction of charters in recent years.

One of the biggest hurdles to creating a new bank is the high capital requirements imposed by the FDIC. At present, the FDIC expects the initial capital of each de novo institution to be sufficient to provide a tier-one-capital-to-assets leverage ratio of not less than 8 percent throughout the first three years of operation. In addition, the institution must maintain an adequate allowance for loan and lease losses. In short, the de novo institution must have capital on day one equal to 8 percent of what it projects its assets will be three years from the opening date.

To ease the burden of raising capital and encourage the formation of new de novo minority depository institutions, the FDIC should lower its tier-one-capital-to-assets leverage ratio and phase it in for minority de novo banks. Specifically, the FDIC should only require de novo MDIs to have 6 percent capital on day 1, 7 percent at the beginning of the second year, and 8 percent at the beginning of the third year. This would give new MDIs additional time and a more gradual on-ramp to meet the its capital requirements.

Regulatory Relief

MDIs could be helped by the same policies that would help all community banks: additional regulatory relief. As smaller institutions with limited access to outside capital and limited legal and compliance resources, MDIs are disproportionately and adversely impacted by the surge of new regulations which began before the financial crisis and only intensified in its wake. Our size and niche markets effectively insulate us from systemic risk, and the stake we hold in our communities, where our reputation for fair dealing can make or break our franchise, make consumer mistreatment or abuse impossible. We ask this committee's support in further tiering of regulation, which would provide relief for MDIs and for all community banks.

In this regard, I want to thank this committee for passage of two regulatory relief bills. The first is the SAFE Banking Act (H.R. 1595), sponsored by Rep. Ed Perlmutter, which creates a safe harbor for financial institutions that serve cannabis-related businesses and their service providers in states that have legalized cannabis. The safe harbor created by H.R. 1595 will give us the assurances we need to operate without fear of retaliation from our regulator, the OCC, or other federal authorities.

The second bill I wish to mention is the Corporate Transparency Act of 2019 (H.R. 2513), sponsored by Rep. Carolyn Maloney, which would require companies to disclose their "beneficial owners" to the Financial Crimes Enforcement Network (FinCEN). The current Customer Due Diligence Rule requires financial institutions to collect this information from company account holders. However, FinCEN collection of beneficial owner information, as opposed to its collection by banks, would provide uniformity and consistency across the United States. Making the formation of an entity contingent on receiving beneficial owner information more directly would create a strong incentive for equity owners and investors to provide such information and ensure its accuracy.

Conclusion

Thank you again for convening today's hearing and for the opportunity to offer our perspective. We look forward to continuing to work with you to strengthen MDIs and CDFIs and promote inclusive lending for the duration of the current crisis and into the recovery.

I'm happy to answer any questions you may have.