Testimony of

John K. Sorensen

On Behalf of the

Iowa Bankers Association

Before the

Senate Committee on Finance

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Chairman Baucus, ranking member Grassley, and members of the committee, my name is John K. Sorensen, President and CEO of the Iowa Bankers Association. The IBA exists to assist our members in serving the needs of their customers and communities. The IBA counts 95% of the 386 banks and thrifts in Iowa as members. The median size of an Iowa bank is $100 million in assets. Iowa is primarily a community banking state, but we also have a regional and money center bank presence representing 20% of $64 billion in state-wide deposits. Iowa's financial diversity has benefited consumers and businesses alike.

Financial and Economic Environment

It is a combination of financial diversity, responsible lending and educated consumers that have produced more favorable financial and economic results for our state during this challenging period. Iowa's home ownership rate, at 74%, exceeds the national average. Just 8% of our existing mortgage loans are considered subprime and our rate of foreclosure is less than 1% of all loans. Just 9% of our loans have negative equity and our home values have declined just 4% over the past two years and are back on the rise. Iowans also have the distinction of having the lowest per capita credit card debt in the country.

Economically, although not without challenges, Iowa has been faring better than most of the country. Our unemployment rate, at 6.7%, is 4th lowest in the country and well below the 9.7% national average. And, our personal income was up 5.7% in 2009. Agricultural land values fell slightly in 2009, reflecting a similar drop in net farm income, although both remain well above historical averages.

Iowa bank performance reflected that of our economy in 2009. Although net income was down 6% from the prior year, nearly 90% of Iowa banks and thrifts were profitable. Our banks remain liquid, well capitalized, and ready and able to lend to credit-worthy borrowers. Despite an uncertain economy, bank lending was off just 2% from 2008 to 2009. And, the recent enhancements to Small Business Administration loan programs have resulted in 174 loans totaling $5.7 million during the first five months of the federal fiscal year.

Despite financial and regulatory pressures, Iowa banks have continued their tradition of providing financial and human resources for economic and community development organizations. A 2008 survey of Iowa banks found that bank staff contributed an aggregate 1.6 million hours in volunteer time and banks contributed another $40 million in financial support to community organizations.

Traditional Iowa bankers continue their work; leading charitable fundraisers, coordinating economic development initiatives, sponsoring little league teams, lending to local businesses, facilitating the dream of homeownership, purchasing local government bonds, and leading financial literacy efforts at local schools. This work happens, not because of a federal mandate, but because a bank's success is tied directly to the creation of a healthy, thriving community. It's the piece of the financial system that doesn't require reform.

The Dubuque Telegraph Herald recently penned an editorial summarizing the importance of their local Iowa banks to the community. In it they said:

> *Healthy financial institutions create and sustain success in all sectors of our community. From their loans toward initiatives vital for economic and civic growth to their charitable donations to their leadership in various community endeavors, our local financial institutions play a significant role in our success. That so many of our institutions have deep roots in this community – with decision-makers here – has helped the tri-state area in incalculable ways.*

Financial Regulatory Reform

Iowa banks are weathering the economic fallout from the financial crisis, the larger question may be can we weather the policy response.

Bank regulators have already reacted in significant and severe ways to rein in certain practices and increase disclosures. Since January 1, 2009, the Federal Reserve alone has issued no less than 31 new or revised regulations. Each carries with it a significant allocation of bank time and money and builds upon volumes of existing regulation. This is putting a strain on bank compliance staff and for smaller banks it is becoming a nearly insurmountable burden.

It is particularly frustrating to many bankers who entered the field to creatively help people achieve their dreams, only to have more of their time devoted to checking the box on the next mandated procedure. This growing burden threatens the future of community banks and innovation in the industry.

Financial regulatory reform is important and necessary. Many lessons have been learned from the experience of the last two years. We should take steps to close the gaps in financial regulation, better manage risks posed by large systemically important institutions, and develop a government housing policy that doesn't result in undue risk-taking. But, most of all, we should not burden the very institutions who've been responsibly serving their communities.

Proposed "Financial Crisis Responsibility Fee"

The Obama Administration proposes to assess an annual fee on liabilities of banks, thrifts, bank and thrift holding companies, brokers and security dealers, as well as U.S. holding companies controlling such entities as of January 14, 2010. The fee, which would apply to firms with consolidated assets of more than $50 billion, would be approximately 0.15 percent of a firm's total liabilities – excluding deposits subject to assessments of the FDIC and certain liabilities related to insurance policies (in the case of insurance companies). According to the Administration's January 14 press release, the fee would be in place for at least 10 years, but longer if necessary to recoup the costs of the Troubled Asset Relief Program (TARP). The Iowa Bankers Association opposes the fee proposal for the following reasons:

- The projected losses in TARP were from non-bank investments. Banks should not have to pay the cost to support other recipients.
- Actual losses from TARP investments are still unknown.
- Consumers and small businesses will be impacted by the fee.
- The fee fails to help community bank competitiveness.

I will address each of these points in turn.

I. Losses from TARP were from non-bank investments.

The Emergency Economic Stabilization Act (EESA) of 2008 was passed by Congress and signed into law by the President on October 8, 2008. It is important to remember that the legislation contemplated acquisition of troubled assets from financial institutions by the U.S. Treasury, in order to restore liquidity and stability to the financial system. As we now know, the bulk of the TARP program took a very different approach, making preferred stock investments in healthy financial institutions to bolster capital and free up dollars for lending. Many believe the program was helpful to restoring confidence and stability. If so, the benefits were shared by all participants in the national and global economy.

Of the $245 billion the Treasury invested in banks of all sizes through the Capital Purchase Program (CPP), $176 billion has been repaid and Treasury officials estimate an eventual profit of as much as $19 billion. As of March, the U.S. government had collected $14.5 billion in dividends, interest and other income, along with $5.6 billion in warrant proceeds.

At the end of 2009, Treasury issued a press release stating, “Every one of its programs aimed at stabilizing the banking system…..will earn a profit thanks to dividends, interest, early repayments, and the sale of warrants.” According to the Treasury, these bank programs: “that were initially projected to cost $76 billion are now projected to bring a profit of $19 billion”. Treasury also said that: “profits could be considerably higher as Treasury sells additional warrants during the weeks ahead.”

The Administration created no less than seven additional programs within TARP to accomplish various policy goals. The most significant investments were directed to the Automotive Industry Financing Program (AIFP), AIG and the Home Affordable Modification Program (HAMP). These non-bank investments amounted to $191 billion. Since the first of the year, the Administration has announced two additional TARP programs, the Community Development Capital Initiative (CDCI) to support lending through Community Development Financial Institutions and the Small Business Lending Fund.

As reported by the Special Inspector General to this committee last week, although TARP is expected to result in a loss to the taxpayers ($127 billion according to the Office of Management and Budget as of February 2010), the expected loss is far lower than previous estimates, and is concentrated in the programs designed to support American International Group, Inc (AIG) ($50 billion), the automotive industry ($31 billion), and housing ($49 billion).

To charge banks for losses generated by non-banks would be unfair and, I believe, inconsistent with spirit of section 134 of EESA that costs should be borne by those who benefit from the program investments.

II. Actual losses from TARP investments are still unknown.

Section 134 of the EESA provides that on October 4, 2013, the Director of the Office of Management and Budget, in consultation with the Congressional Budget Office, shall submit to Congress a report on the net amount within TARP. Following such report, the President is to submit a plan to recoup any shortfall.

The Administration's "responsibility fee" comes a full three years before the date contemplated in the statute to assess losses. With the economy showing signs of gradual improvement, Treasury is likely to experience a further appreciation from TARP investments and a corresponding reduction in losses.

The "responsibility fee" proposal also comes prior to a report from the Financial Crisis Inquiry Commission due later this year. The bi-partisan Commission was established to "examine the causes, domestic and global, of the financial and economic crisis in the United States." It would seem logical that any "responsibility fee" be delayed until this panel opines on the root causes of the crisis.

III. Consumers and small businesses will be impacted by the fee.

The Congressional Budget Office (CBO), in their March 4 letter to Senator Grassley, confirmed the cost of the proposed fee would ultimately be borne to varying degrees by an institution's customers, employees, and investors. Even in Iowa, where people invest in banks directly and through their 401k; where two of our largest employers - Wells Fargo and Principal

Financial Group – are impacted; and many Iowans purchase financial products from affected firms; the impact of the proposed fee will be felt. Nationally, at least 70 percent of all financial assets, including 64 percent of loans, were attributable to institutions that are members of affiliated groups with assets over $50 billion.

The CBO also predicts the fee would have a negative impact on the availability of credit to small business. Small businesses are the engine for job growth in our economy. We should avoid any policy that dampens credit availability at this critical time.

IV. The fee fails to help community bank competitiveness.

Some view the proposed fee as being helpful to the competitive position of community banks. Yet, if the fee assessment base were to exclude insured deposits as proposed, any benefit would be at least partially offset by increased competition for insured deposits as large banks more aggressively pursue this funding source.

The fee or tax also sets an unwelcome precedent of assessing a "crisis responsibility fee" on institutions Congress deems responsible for a disruption to the U.S. economy or financial markets. Such a determination is subjective at best. Assessing blame in a complex and interconnected world can be difficult enough, let alone when political forces become intertwined. A similar fee on mid-western banks following the agricultural crisis of the 1980s would have exacerbated the economic recovery and caused even more community banks to fail.

The proposed fee could also impact the Federal Home Loan Bank (FHLB) system, an important source of funding for community banks. Large banks subject to the proposed fee currently hold approximately $327 billion in advances, resulting in a fee of $491 million per year on these advances. Because the fee would not be assessed on deposits and repurchase agreements, large banks would have an incentive to shift their funding sources away from advances to deposits.

The shift would increase competition for deposits and reduce earnings at the FHLBs, which are cooperatively owned by more than 6,000 FDIC-insured community banks. The reduction of income would also reduce the FHLBanks' contributions (10% of annual earnings) to the Affordable Housing Program (AHP).

The proposal also arbitrarily applies the fee to an insurance company that happens to have a small bank subsidiary, but exempts an otherwise similarly situated insurance company that does not have a bank subsidiary. This is unfair.

Conclusion

Mr. Chairman, Ranking member Grassley, and members of the committee, it is clear American taxpayers will not incur a loss on their bank investments through the CPP. Rather, Treasury projects a double-digit return on bank investments. Although losses are projected in non-bank TARP investments, even these may subside as we approach the EESA loss assessment date in 2013.

The proposed fee accomplishes little in the way of altering behavior that caused the financial crisis. The country would be much better served by focusing on how we maintain a dynamic and responsible financial sector where the rules of the game are consistently applied to all players.

Thank you for the invitation to testify today.