INDEPENDENT COMMUNITY BANKERS of AMERICA

Testimony of

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On behalf of the

Independent Community Bankers of America

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Committee on Financial Services

Subcommittee on Consumer Protection and Financial Institutions

Hearing on

"An Examination of the Decline of Minority Depository Institutions and the Impact on Underserved Communities"

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Chairman Meeks, Ranking Member Luetkemeyer, and members of the Subcommittee, I am Jill Sung, CEO and President of Abacus Federal Savings Bank ("Abacus Bank") in New York, New York.

I testify today on behalf of the Independent Community Bankers of America where I serve as Chair of the Minority Bank Council as well as Chair of the Consumer Financial Services Committee. Thank you for the opportunity to testify at today's hearing on the decline of minority depository institutions (MDIs) and the impact of this decline on underserved communities. I am pleased to provide the perspective of MDIs such as ours that strive to remain prosperous and independent so that we can best serve our communities.

I appreciate you raising the profile of this critical issue and urge this committee and Congress to pursue policies to strengthen MDIs. 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.

I would like to thank Chairman Meeks for his work on a thoughtful and constructive discussion draft. We are pleased to have the opportunity to offer input on this draft and hope to continue to work with you as it advances through the process.

Our Story

Abacus Bank is a $350 million asset, privately held, federal savings and loan association, regulated by the Office of the Comptroller of the Currency. Our headquarters is located in Chinatown in lower Manhattan, and we have additional branches in ethnic Chinese communities in Brooklyn and Queens, as well as Edison, New Jersey and Philadelphia – six locations altogether.

Abacus was founded in 1984 by my father, Thomas Sung, who immigrated from China as a teenager through Ellis Island. After working in farming in Florida, and then as a financial analyst in a large print media company, he decided to go to law school and to open his immigration law practice in Chinatown to help others like him find a better life in this country. After several years successfully practicing law, he decided to purchase a small real property, but when he applied for a mortgage, he was surprised to find out that while his bank was more than happy to take his deposits, it was not willing to give him a loan. He went to several banks in Chinatown and faced the same challenges and quickly learned that many others in Chinatown shared the same experience. Not willing to accept this as business as usual, my father decided, along with a couple of small business owners in the community, to create Abacus Bank for the purpose of not only providing depository services, but also to lend money to our community.

From its inception, Abacus has focused on financing real estate, a natural fit for our community, where the aspiration of owning your home was and continues to be almost sacred. The majority of our lending is on residential mortgages, particularly with first-time homebuyers. Over the years, as our customers start to build their assets, we also lend on small multi-family and mixed-use properties. Our lending policy is extremely conservative. Our delinquency rates have always been under 1%, in most years less than ½%. During the Financial Crisis of 2008, the residential mortgage portfolio we originated and serviced for Fannie Mae, which at its height reached over

$1 billion (almost 6,000 loans), never had a delinquency rate higher than 0.60%. We attribute these unusually low delinquency rates to our deep understanding of our customers and our belief that to build a lasting and strong community, homeownership must be sustainable. Accordingly, we have built very conservative credit practices both at the origination and portfolio management level.

The work we do for our community is reflected in the multiple "Outstanding" CRA ratings we have received. We are very proud of how we have helped our community over the past 35 years and look forward to serving future generations. 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.

Despite all of this, in 2009 we found ourselves being prosecuted by the Manhattan District Attorney's Office for mortgage fraud. Some of you may already know the story of our five-year legal battle as told in the acclaimed documentary, *Abacus: Small Enough to Jail*. This prosecution was, without a doubt, an attack on our community. We fought heart and soul against those baseless charges for our family's honor and reputation, but mostly for our community. Although we were fully exonerated after a 5-month jury trial, it was at great economic loss to both our small bank and to our community. We estimated that the cost to us to defend ourselves was at least $10 million which all came out of our own capital. Using a leverage capital ratio of 10%, the cost to our community was $100 million of loans not given to first-time homebuyers and small businesses. To this day, our bank, a small, minority-owned bank serving a minority population, is the only bank ever charged in the wake of the Financial Crisis of 2008.

MDIs Face Unique Challenges

You have asked for examples regarding the challenges facing MDIs in a rapidly consolidating banking landscape, accelerated by developments in technology and access to capital, as well as changes in regulatory policy and supervision. Below are examples of how these challenges directly impact Abacus Bank and my customers.

The community we serve remains dominated by first-generation immigrants, a customer base that creates at least three challenges for us. The first is the language barrier. For most of our customers, English is a second language; others don't speak English at all. This raises multiple issues, from the necessity to hire and fully train staff from within the community who have language skills but likely no experience or background in banking, to the challenge of explaining to our customers complicated regulatory concepts and forms, such as the Loan Estimate and Closing Disclosure. The fact that our customers' primary language, Chinese, is a character-based written language, versus English which has an alphabet, makes the translation process all the more difficult.

The second challenge is the socio-political and economic cultural background of many of our customers. They have chosen to leave their country of birth where the government (the "State") is all-powerful, controlling many aspects of their lives. Hence, they have a natural distrust of government and institutions in general. This increases the burden on us with respect to financial education. At the same time, we recognize the tremendous responsibility we carry, as one of the "trusted" advisors of this highly vulnerable population, to balance between providing them all of the information required for them to make their own responsible financial decisions, while also trying to explain that the context in which they are making these decisions is quite different than what they experienced in their country of birth.

The third challenge is our customers' understanding of money and the building of wealth. Many of them are merely trying to survive on a daily basis. They view money as currency enabling one-time transactions to pay for basic necessities: shelter, food, education. They save a lot, but they are saving for the rainy day, the day when their lives will be disrupted again by forces they cannot control. As a result, they are supremely conservative with their savings, preferring to keep their funds in cash. This stops them from truly building-up wealth, as holding cash does not pay the returns that other investments have. Eventually, if they build up enough funds, they will invest their savings in the one tangible investment they trust – a home. But this can take a very long time and much sacrifice and struggle.

Technological Solutions Not Always Suitable

Unfortunately, we are constrained in our ability to reap efficiencies from recent technological advances in financial services. A significant portion of our population demands traditional banking products that cannot be offered over technological platforms. Without access to these products, this population is at risk of slipping into the un-banked population.

A prime example of this is the safe deposit box. Our immigrant community is migratory. In order to survive, they often seek jobs all over the country. Moreover, New York City is of course not known to be the most affordable living community. As a result, they are often forced to share tight living quarters with others, not necessarily family, and may not feel secure enough to leave their personal belongs at home. For this reason, they prefer to keep their important documents in safe deposit boxes – passports, other identity papers, etc. To meet this demand, Abacus maintains many safe deposit boxes, more than other banks of similar asset size. However, safe deposit box services are labor intensive, requiring bank personnel to escort customers to and from their boxes. We offer this service because it is important to our community.

Similarly, many of our elderly and new immigrant customers prefer to use passbook savings accounts, an "old school" banking product most people today have not even heard of. It is literally a paper bound book, resembling a passport, which is used to record the balance in a savings account. Deposits and withdrawals must be made through a teller, and transactions are noted in the passbook. Online or ATM transactions are not permitted because there is no mechanism on such platforms to note transactions in the passbook. Instead of receiving mailed statements or viewing the balance online, the customer tracks their balance through the physical passbook. This is a solution for a person who may not have a stable address at which to receive statements, and/or people who want personal contact with bank employees. This product cannot be automated, and thus the cost of providing such product is high. These are examples of services we offer to accommodate our unique community that squeeze our profit margins.

State and Condition of MDIs

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.

Agency reporting as required by FIRREA provides comprehensive analysis of MDI data, though it is difficult to draw generalities. Nevertheless, in considering policy initiatives to address the unique challenges faced by MDIs, it is helpful to make the observations noted below.

- The total number of MDI charters has declined in recent years from a high of 215 in 2008 to 155 today, though total assets have recovered following a dip in the wake of the recession and stand at a nominal high of $223 billion today.
- Relative to non-MDIs, MDI originate a greater share of their mortgages in low-to-moderate income census tracts.
- Performance has not been equal among MDI segments. Asian American, Hispanic American, and Native American MDIs have declined modestly in numbers since the recession, while increasing assets. However, African American MDIs have declined sharply in both numbers and assets. Since 2001, the number has declined from 44 to just 22 today, with the largest decrease coming in the years following the recession. Total assets have declined from $6.8 billion in 2008 to $5.3 billion today.
- Considerable size variation exists among MDIs. Native American MDIs have average assets of $166 million, and African American MDIs average $228 million, while Asian American MDIs have average assets of $1.7 billion, and Hispanic American MDIs have average assets of $3 billion.
- MDI lending is concentrated in commercial real estate, an asset class that fared poorly during the 2008-2009 recession. As a result, MDI net earnings fell more than other banks during that period, with fully half of MDIs suffering losses. Since that time, MDI asset quality has improved, and MDI noncurrent loans and net charge-offs are now at new lows.
- MDIs generally enjoy strong gross revenues relative to non-MDI community banks. However, these revenues are accompanied by higher expenses, especially among small MDIs.
- MDI overhead expense ratios, which reflect salaries, premises, and other fixed assets, have been historically higher than those of other banks. This is particularly true for smaller MDIs and MDIs that operate in urban areas where property values are higher.
- Due primarily to these higher expense ratios, MDI return on assets have historically been lower than those of larger banks or comparable community banks.

Lack of De Novo MDIs: A Troubling Indicator

Preservation and strengthening of existing MDIs – as important as this goal is – is not enough. In order to offset the loss of institutions through consolidation and acquisition by non-MDIs, the MDI sector must be continually fed by a stream of new entrants in order to live up to its potential for supporting the economic prosperity of minority communities.

Unfortunately, the FDIC has approved only one de novo MDI – and very few non-MDI de novos – since the financial crisis. In January of this year, the FDIC granted conditional approval to Moxy Bank to operate as an MDI in the District of Columbia, though Moxy has yet to open. We need to see more of these. Congress and the agencies should pursue policies to promote de novo MDIs.

New Sources of Capital are Needed

As I noted above, Abacus Bank's first priority is serving our community with its unique characteristics. In this we are typical of MDIs. We have a service-focused mission, where a primary measure of our success is how well we serve our community. We do not have access to the public capital markets. For that matter, private capital would mostly likely contravene our business model, as investors may demand higher returns than we can offer. For these reasons, Abacus and other MDIs have limited-to-no access to the capital markets.

Without access to outside capital, our only reliable source of capital is retained earnings. For this reason, we have never paid dividends to our shareholders since the bank was formed. Our retained earnings is our capital. This has made us very conservative in how we approach risk, particularly in our lending and, as I noted above, helps explain our unusually low loan default rates. This distinguishes us from larger banks who, given their easy access to capital, can afford to leverage that capital and take on much more risk to increase their potential for return.

For these reasons, MDIs truly need access to non-traditional ways of raising capital. This is critical for our preservation and to ensuring that fair and equitable access to the financial system is preserved for all.

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 all community banks and be that much more impactful for MDIs.

Earlier this year, I provided Chairman Meeks with our perspective on the Current Expected Credit Loss standard, and I will not repeat those comments here, except to say that it is an example of a policy that might make sense for a larger bank with a robust accounting department and technical resources, but it has been misapplied to Abacus and our peer 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, such as New York, that have legalized cannabis. As a New York bank, it is often impossible for us to know whether some of our business customers are also serving cannabis-related businesses. 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.

I understand that H.R. 2513 will be considered on the House floor this week, and I urge all members of this committee to support it.

ICBA Comments on Chairman Meeks' Discussion Draft

I would like to reiterate my thanks to Chairman Meeks and his staff for their work on this discussion draft. It is a constructive document that could form the basis of important legislation. Below are comments on specific sections of the draft.

Section 8: Application Process for De Novo Community Development Financial Institution Applicants

ICBA supports the intent of Section 8 of the discussion draft, which would streamline the application process for de novo MDIs to also become CDFIs. We recommend expanding this section to streamline the process by which an existing MDI applies to become a CDFI.

ICBA believes that many MDIs that are eligible for CDFI status choose not to apply because of the burdensome application process. Abacus Bank, for example, is not currently a CDFI. While we believe we would qualify, we simply cannot spare the resources at this time to perform the required analysis. CDFI status would allow us 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 our 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.

Section 11: Qualified Opportunity Fund Investments in Community Development Financial Institutions

ICBA supports Section 11 of the discussion draft which would provide that a CDFI, including a CDFI bank, may be a "qualified opportunity zone business" (QOZ).

The Opportunity Zone program seeks to encourage economic growth and investment in qualified opportunity zones by providing Federal income tax benefits to taxpayers who invest in QOFs. The benefits include: (1) a temporary tax deferral for capital gains reinvested in a Qualified Opportunity Fund (QOF,) (2) a step-up in basis for any investment in a QOF held for at least five years (10% basis increase) or seven years (15% basis increase), and (3) a permanent exclusion of capital gains from the sale or exchange of an investment in a QOF held for at least 10 years.

The Opportunity Zone program can be a key mechanism to break the cycle of poverty and give distressed communities an opportunity to leverage new resources. Allowing CDFI banks to be QOZs will provide a further incentive for community banks, including MDIs, to become CDFIs.

Section 12: Sense of Congress on Funding the Loan Loss Reserve Fund for Small Dollar Loans

ICBA supports Section 12 of the discussion draft which expresses the sense of Congress on appropriating funds for the loan loss reserve fund and technical assistance programs as mandated by Dodd-Frank Act Title XII. We are pleased to note that this funding is included in the version of the 2020 Financial Services and General Government Appropriations bill that passed the House of Representatives in June.

Title XII was enacted to provide millions of low-to-moderate income individuals living in the United States the opportunity to access and use appropriate mainstream financial products and services.

Title XII authorizes the Secretary of the Treasury to create multi-year grant programs designed to encourage the targeted group to establish accounts at federally insured banks. Title XII also authorizes participating institutions to issue small-dollar loans to targeted individuals and provide recipients with the financial counseling and education. These loans provide low-cost alternatives to non-traditional forms of financing that often impose excessive interest rates and fees.

ICBA Recommended Addition to Chairman Meeks' Discussion Draft

Lower Capital Requirements for De Novo Banks

Need for Change:

As noted above, only one de novo MDI has been approved by the FDIC in the last 10 years. Changes are needed to encourage more applicants.

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.

Recommendation:

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.

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 to create incentives for a new generation of de novo MDIs.

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