

Invited Testimony of

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Chairman-Elect, Texas Bankers Association

*Before the*

The Sub-Committee on Financial Institutions and Consumer Credit  
United States House of Representatives

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## **Invited Testimony**

### **U.S. House of Representatives The Sub-Committee on Financial Institutions and Consumer Credit**

*By*

**Jeff Austin III**

**Vice Chairman, Austin Bank Texas, NA, Jacksonville, Texas  
Chairman-Elect, Texas Bankers Association**

Good morning Mr. Chairman and fellow Committee members. My name is Jeff Austin III and I am Proud to be a Banker!

I am Vice Chairman of Austin Bank Texas, NA which is a community bank in East Texas with 28 locations and \$1 billion in assets. I am also affiliated with three other banks, First State Bank of Athens, Texas (\$330 million in assets), First State Bank of Frankston, Texas (\$145 million in assets) and Capital Bank outside of Houston, Texas (\$230 million in assets). Each bank was profitable last year because of a great team we have in place and because we did not take excessive risk on our balance sheet. In addition to my bank duties, I am also Chairman Elect of the Texas Bankers Association. The TBA is one of the largest State Associations in the country with over 600 members composed of FDIC Insured depository institutions of all sizes with the majority being community-minded traditional banks. 85% of all the banks in Texas are members of the Texas Bankers Association and they comprise approximately 95% of the assets in the State.

It is an honor to be before you this morning as our Country tries to make sense of a financial debacle and out of control perceptions of what has happened and is happening to our country's banking system. I share my perspective with you this morning as a fourth generation banker, whose family and related institutions have survived many economic cycles. In 2009, our family celebrated 100 years in the Texas banking industry.

My first message is stated simply this:

**"I am proud to be a Banker and Please, and Do not shoot the survivors!"**

This theme is an underlying and frustrating tone among the thousands of traditional and community minded and traditional banking entities and hundreds of thousands of employees, all across the country. It is important for the purposes of my comments that we separate a traditional bank from the FIGS (the new name for investment Banks -Financial Institution Groups). The investment banking activities of some Wall Street giants, that are sometimes loosely referred to as banks, and the shadow banking system which includes many non traditional banking activities have been inappropriately blended with the activities of banks like ours.

One of the issues of today's hearing is the closure of FBOP and its subsidiary banks. One of our related banks contacted the FDIC to attempt to bid on one of the single banks in Texas and we were discouraged since the FDIC wanted to sell all the banks in the Holding Company to a single purchaser. This discouraged local and area banks who know the customers and the region from submitting a bid. The ultimate purchaser then sold three Texas banks to another Texas based institution.

Community banks, traditional banks, are perplexed by regulatory practices that often seem to disadvantage us and favor much larger institutions or even non-banks, making it harder for us to serve our communities. We are also negatively impacted by public attitudes, often fed by less than careful reporting in the media that in practice harm our ability to serve our customers and communities. I will discuss some examples in my remarks.

Let me turn to an example of lending issues. **There seems to be a populist view that banks are not lending and do not want to lend.** This is like saying McDonalds does not want to sell Hamburgers. My bank is still in business, as are many of my colleagues throughout the country, because our doors are still open to lending and because we follow the injunction to make good loans, with a good likelihood of repayment. My grandfather reminded customers that there is a preamble to every promissory note: "I do hereby promise to repay."

While many small businesses and consumers are faced with declining credit scores, loss of jobs, loss of income and declining collateral values, banks still are statutorily required to make prudent lending decisions to protect the safety and soundness of the bank and the Deposit Insurance Fund. When a bank goes out of

business, it provides no more services to its customers. Staying in business means earning a profit and continuing to serve our communities because we make a profit.

It seems, however, that bank regulation, economic forecasts, and the general attitudes in the public are almost intend to make banks scared to lend money. Our shareholders get nervous when the examiners get nervous. Overregulation and aggressive enforcement actions by regulators and new costly mandates by Congress are- intentionally or not- are directly affecting the ability of banks to do what they were created to do – loan money and provide other important financial services in their communities. Traditional banks are the cornerstone in every community and in the Nation’s economy.

The banking industry has been hit by the recession, no doubt about it. Over 140 banks failed last year, and the FDIC predicts that the situation this year could be equally grim. But regulatory action can make it harder for the survivor banks to do their jobs. Today, the survivors are being shot. With the proposed new bank tax, increased FDIC insurance premiums, excessive regulations and far reaching practices by many of the regulatory agencies that make decisions above stated regulatory minimums – such as dramatically higher capital requirements, harsh valuation requirements on performing loans (the return of the non-performing performing loan that made the 1990s credit crunch famous) and the like—these practices are feeding a potential credit crunch that we as community bankers are working hard to avoid. All banks struggle to achieve profitability in such uncertain times.

I have been exposed to recent exams from the OCC, the Federal Reserve, the FDIC and the Texas Department of Banking. While there are a lot of similarities, there are many differences from what is said in Washington DC and the interpretations we face from local and regional examiners. No examiner or agency wants to be caught not enforcing consumer protections or stated regulations because of the real fear of criticism from the Inspector General’s Office.

This problem is reinforced because of the forensic exams performed after banks have been closed by the FDIC. Specifically, we can point to the valuation of real estate. For example, if a loan has been performing and paying as agreed for a few years and was a “PASS” or satisfactory credit in previous exams, the post-closure

valuation is drastically different. Bankers and investors alike have shared stories that the FDIC is requiring an immediate liquidation value to be applied which further deteriorates an institution's values for its 1-4 family and commercial real estate portfolios. The examiners are then using those distressed valuations to apply to the other performing loans resulting in banks being required to allocate additional and unnecessary reserves for subjective valuations. Appraisers have no choice but to use those appraisals as "comps" which hurts even healthy properties. This factor alone is one of the main detractors from banks wishing to make loans in their community.

**Restated: over regulation and aggressive stances by regulators are resulting in distressed earnings among the traditional banks.** Coupled with the large FDIC insurance premiums collected from the "survivors," which lowers an institution's liquidity position, a bank's capital position also comes under increased risk and pressure which takes away from the ability to make loans. The real heartbreak is when a customer is asked by their bank to pay down the loan to meet the new valuation, or put up additional collateral to reduce the over loan-to-value to the new valuation amount. This comes at a time when our borrowers and homeowners cash reserves and liquidity depressed. If this continues, it will be a death spiral that will be hard to reverse.

In the next couple weeks when you go back home, may I encourage you to visit with the bankers in your district to validate these same concerns. Let them tell you their stories in their own words.

Banking is, and always has been, at the foundation of our economy. Banks that believe in small businesses want to invest in new technology, expand their locations or invest in new equipment, etc. Bankers will continue to believe in small businesses and invest in them. In return, the multiplier effect of their investments creates jobs within their community. One of my colleagues has just committed to loan \$6 million to construct a manufacturing facility that will create 350 jobs in Texas.

I would like to turn to the shadow banking system, and its impact on traditional banking. In recent decades, the auto industry created financing arms that created special incentives-including such products like "zero-percent financing" offers (where at least in some cases the credit buy down was paid for in the price of the

cars)— to move and sell the products from their manufacturing units. All too often, many people qualified for loans that they normally could not. These large captive finance companies like GMAC, Chrysler Credit and Ford Motor Credit assumed larger risks, but in doing so also took away some of the “bread and butter” consumer loans from traditional banks. I might point out that in recent months TARP money has been channeled to automotive financing to keep this unfair practice going, a practice which the Administration is now proposing that the banking industry pay for.

I bring this up because many in the housing industry created in-house finance operations by working with the shadow banking industry to create low teaser-rates and adjustable rate and hybrid mortgages for consumers who could not otherwise qualify for a loan through a traditional bank. Their financing units in many cases sold loans in packages to Freddie (FHLMC) and Fannie (FNMA) who securitized and sold them. The large investment banks also assisted with the packaging of these sub-prime loans and finding buyers for these securities. **The overwhelming majority of the sub-prime and risky mortgages with minimal down payments and questionable qualifications were made outside the traditional banking system.** The traditional banking system should not be held responsible for the failures of the investment funds, the investment banks, the auto companies or the mortgage servicing companies. Again, the survivors are being shot!

It is important to discuss again the differences of traditional banks vs. the Wall Street investment banks, captive finance companies and other “want-to-be financial institutions.” Traditional banks are depository institutions that are insured by the FDIC. We are also different in the types of activities we pursue. Traditional banks are invested in the long-term and are more likely to engage in lending and in long-term financial relationships with our customers. In short, traditional banks have deep roots.

That affects the attitude of our business. A traditional bank is a deposit taker, a loan maker and a facilitator of payment systems. We know our customers. Banks will continue to be the first responders to the call for volunteers for civic organizations and for financial support for numerous non-profit organizations in their communities.

Our challenges are real, both internal and external. First, the internal issues are things that we used to be able to control but which are progressively being taken out of our control, such as how to manage our balance sheet risk, our liquidity position, and our products. Increasingly, control of these are being handed to people outside of the bank, whether regulators or external professionals, such as external auditors following new mandates from the Financial Accounting Standards Board (FASB).

This trend is increasing with the possible creation of the proposed (CFPA) Consumer Financial Protection Agency, banks will be regulated across the country like a Utility and the free market system will not prevail because banks will have to pay more attention to the new consumer regulator than they will to their own consumers.

If you have ever seen a pre-exam package from any of the bank regulatory agencies, you would be amazed at what they review and examine during the course of a regular examination. This includes all stated regulations whether consumer or compliance related. For decades, bank Boards and management have faced the possibility of fines for non-compliance with such items as the newly implemented Reg. Z requirements, BSA, Call-Report revisions, Reg. DD, Fair lending issues, and Truth-in-lending issues and on and on. In essence – the whole alphabet soup of regulations. Increasingly, however, **we are being asked to become the Police agency for the Government** by collecting Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs), and yet often it seems as if we bankers are more at risk to enforcement action than the crooks are. When the \$10,000 limit was put in place in 1972 that was a relevant amount. Today, if deflated, that is an equivalent amount of about \$3,500. Did you know that when each of you go on vacation or give out a Christmas bonus, that your bank is required to record information about any transaction that is over \$3,000?

Additionally, the growing likelihood of intrusion into the compensation practices of banks has created a real fear among traditional bankers. With the camel's nose under the tent, bankers are afraid that it will go too far. We do not object to concern with anything that raises valid safety and soundness issues. We are afraid that new regulations will affect what we can even pay a teller. Would Congress trade their pension plans for a government implemented and managed Social Security system?

Continuing on the issue of compensation, many banks are using a “Stakeholder Model” which is similar to Robert Kaplan’s “Balanced Scorecard.” It factors in and balances the key drivers of earnings, quality, efficiency, growth and loss mitigation based on actual results. For example, it has deductions for past dues, declining credit quality, and charge offs. Too much intrusion and excessive micro-management of capitalistic markets can only do more harm.

Another example of an external threat is that of GMAC’s Ally Bank. They have been allowed to run nationwide television ads offering above market deposit rates driving up all banks’ cost of funds. For example, on 1/19/10, Ally was offering a 1.74% APY for a one year certificate of deposit. This compares with the cost of an average bank’s 1 year CD rate of 0.65%. It appears the GMAC and Ally Bank continues to need to raise cash, regardless of the cost or consequences. The FDIC has issued guidance against this practice but it seems that it is ignored. GMAC, as a ward of the government, is bringing more risk to the DIF Deposit Insurance Fund by offering ridiculously high rates that we cannot compete against to protect the safety and soundness of our bank. We can’t compete against you- the Government. You are killing us!

Other impacts of the recent regulatory overkill include the recent FAS 5 requirements from the SEC and FASB regarding the valuation of Loan Loss Reserves. It does not allow banks to build up reserves in the good times to a reasonable amount based on the banker’s good judgment. We were taught by our parents to save for a “rainy day.” Reserves are built by improving credit quality, reducing past due loans, and through stable earnings. The overkill and swinging of the pendulum has now caused banks to take a larger hit to earnings, when times are tougher, to replenish the reserves at the bottom of the cycle. It is clear to all of us, that SEC’s and the accounting industry’s position were off-base by not allowing banks to build loan-loss reserves in the good times.

In years past, banks would ask the examiners at the conclusion of the exam for a Certification letter. This letter would basically state that they agree and certify that the level of loan loss reserves is adequate and necessary. In return, the bank would furnish this letter to their accountants so the entire amount of the provision could be deducted for income tax purposes. In reality today, banks can

only deduct the amount of actual losses against the provision, not the excess allocations base on future or unrealized losses.

The impact of FAS 166, implemented by the FASB which addressed loan participation agreements, will hurt banks ability to find a participating partner for larger loans for their customers. You will hear this again when businesses say “My bank will not make loans” because they are not big enough. We partner with fellow banks to assist with the lending needs of our larger customers. FAS 166 will drive that business away from community banks who will not be able to compete with larger banks for the middle business lending market.

Should lawmakers pass the proposed bank tax legislation, it will result in higher fees to the consumers and small businesses. Any ongoing business pays all of its costs from the money that it earns from its customers; you cannot get around that without going out of business. Moreover, why is the proposed tax exempting banking competitors in the shadow banking world? Why are we exempting GM, AIG, and Chrysler? Instead, the Administration is looking to the banks; the very banks that are the leaders in business, construction, consumer and small business lending, and whose lending operations are still under severe pressure from the recession, with loan delinquency and default rates at very high levels?

Some have said that the big firms on Wall Street have a big share of the blame and it s fair for them to pay – but what about those of us as survivors on Main Street? Does anyone really believe that these taxes will not continue to be extended and will not find their way down to community banks?

I believe that the Treasury Department itself has reported, when the decision was made last month to extend the TARP program, that the government isn’t expected to lose money on TARP aid to banks. The losses are coming from the auto companies and AIG, banking competitors in the shadow banking world. The banks are paying back their investment, at an expect \$20 billion profit to the government, and now the banking industry is being called upon to pay the beer tab for our competitors. Not only is that unfair, but it is likely to make it harder for banks of all kinds to attract the capital needed to fund increased lending.

I want to point out that while the proposed bank tax is initially aimed at penalizing larger banks, it will also have an impact on smaller ones. When the big

banks sneeze, we run the risk of catching pneumonia. We rely on them for correspondent services – check clearing, wire transfers, letters of credit and many other services and this will only increase the prices for these services which will be passed on to consumers and small business. Moreover, by exempting insured deposits, it increases the incentive for large banks to increase their competition with community banks for scarce deposits. Community banks traditionally rely upon deposits as our chief form of liquidity, while larger banks have raised as much as 50% or more of their funding from non-deposit sources. Taxing those sources will just drive the largest banks, with their large advertising resources, right into community bank markets.

Traditional bankers and smaller banks are fearful that this tax will soon be expanded to include all banks – again, “shooting the survivors!” Why should this be a special tax on one industry that is so punitive, and not include the largest culprits such as GM, Chrysler, Freddie & Fannie? Yes, this may exempt the small banks outside the top 50 – but we need to separate the traditional banking model from the investment banking model.

Finally, allow me to list some of the key challenges to the continuation of the traditional banking role of community banks. Many challenges traditional banks are facing include:

- An uncertain and constantly changing regulatory environment;
- New regulatory burden imposed by Congress;
- New regulatory burden imposed by the FASB;
- Greater internal compliance costs from FDIC, and other regulatory agencies;
- The Excessive bookkeeping and record keeping requirements that are redundant and unnecessary;
- Proposed new taxes on the banking industry; and
- Negative public perception caused by the media and other public commentators and public officials.
- Members of Congress have had to cast votes during a crisis before all the facts were brought forth.

As I said earlier, traditional banks have a depth of management and expertise coupled with knowledge of THEIR customers and the ability of those customers to perform over the long haul and through challenging economic cycles. This

overrides any national statistics, predictions or perceptions. We know our customers. We know their character, their capacity, their collateral, and their cash flow. Let us serve them and work with them.

In summary, YES, I AM PROUD TO BE A TRADITIONAL BANKER! Thank you Congressman Hensarling and to the Committee for inviting me here today and the opportunity to share with you the views of this community banker, which I believe are reflective of views of my many colleagues all across the nation. I will be happy to answer any questions.

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