Testimony
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"Hurricane Katrina:

The Financial Institutions' Response"

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Financial Institutions and Consumer Credit

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What Community Banks Will Need to Assist in Hurricane Recovery

Mr. Chairman, Ranking Member Sanders, and Members of the Subcommittee, my name is C.R. (Rusty) Cloutier. I am President and CEO of MidSouth Bank, N.A. in Lafayette, Louisiana. I am also past chairman of the Independent Community Bankers of America[1]. MidSouth Bank is located about 100 miles west of New Orleans and our town of Lafayette is providing for many Hurricane Katrina evacuees.

ICBA and the banks of the Gulf Coast region devastated by Hurricane Katrina appreciate your intense interest and quick response to our plight, as evidenced by this hearing and by legislation being drafted by Chairmen Bachus and Baker to provide indemnification for cashing government and “not on us” checks and permit lenders to provide flexibility to borrowers by refinancing loans, rolling interest into principal. This legislation will address some of our most immediate concerns. I also understand that subcommittee members and their staffs participated in a number of briefings and meetings with regulators and industry representatives last week to assess the situation and make plans for action.

I commend the hard work of John Ducrest, John Allison, and John Harrison, the state commissioners of financial institutions in Louisiana, Mississippi and Alabama, and the federal regulatory agencies. Their efforts have provided essential support for our industry’s effort to restore banking services to the citizens of the affected states. The regulators have pledged to be flexible in enforcing regulatory requirements and in supervising affected institutions. Many of these are included in ICBA’s recommendations submitted to members of Congress, the Treasury, and the agencies last week. An updated version of this list is attached to this statement.

We also appreciate the statement of FDIC Chairman Don Powell making clear that the FDIC stands behind the banks in our region. I was particularly pleased by his comment that no bank has ever failed because of a natural disaster. I hope this will continue to be true, but I believe that the government must monitor the situation closely and be prepared to do more in this instance if necessary to ensure that result.

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[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

Responses of Community Bankers

There are more than 100 community banks with offices in areas that were directly affected by Hurricane Katrina. Of those, about 20 have offices in the greater New Orleans area. The community banks I have been working with are reporting unprecedented damage to the New Orleans and Gulf Coast area.

The resiliency of community banks, like that of the banking industry as a whole, in responding to this disaster has been impressive to see. Community bankers have taken extraordinary measures to get up and running, resume operations and serve customers in the aftermath of the storm. While many are fully operational, others are doing this even when they cannot open at their original locations.

The cooperation and coordination among banks to ensure service to customers and persons displaced by the storm has been unprecedented. My bank and others have stepped into the breach to assist those community banks with damaged offices—many times providing facilities to our competitors. Right now, MidSouth is providing shared space and computer equipment for two banks that had no offices outside the New Orleans area. A third that was operating out of my bank has found alternative facilities. We have done this with no thought to profitability. We are focused on providing service and doing all we can to aid in the recovery.

Here are some other examples of specific actions community banks have been taking to deal with the crisis in the short term:

- A number of community banks that are not fully operational are operating from planned back-up sites.

- Community banks are setting up tables and serving customers out of temporary buildings and warehouses when regular branch facilities are not usable. Until electricity could be restored to run computer systems, bankers often used paper receipts to complete banking transactions if needed.

- Community banks in surrounding areas outside hardest hit areas are lending their facilities, including computer capacity and personnel, to affected banks so customers can be served.

- Community banks around the nation are pitching in with support both financial and personnel. Notably, community banks from outside the area are sending in their trained personnel where needed, providing technical and computer support.

- Community banks are taking steps to ensure that all customers have access to cash. One Louisiana community bank solicited $20 million in brokered deposits to ensure liquidity to be in a position to meet the cash demands of its community.

- Community banks, both in the storm-affected areas and in other areas accommodating evacuees, are cashing customer and non-customer checks whenever possible, often assuming significant risks when personal identity or validity of the check cannot be verified.

- Community bankers who know their customers personally can provide services to customers without identification.

- Community banks are setting up Web postings for financial services and the location of those services.

In addition, ICBA has established a special task force to address short- and long-term challenges Hurricane Katrina left in her wake. The work of this task force will focus on the most recent disaster, but also help community banks deal with any new disasters that arise in the future. We recognize that no city or region is immune.

More is Needed

Despite these extraordinary efforts, community banks and their communities may not be able to rebuild without additional help.

Mr. Chairman, your statement last week that, “If an institution is failing because of this disaster, the federal government will stand behind that institution” was especially welcome. While it is too early to tell, it is possible that Congress may have to take specific action to implement that pledge, because banks face potentially serious losses on loans that were good before the storm hit, but now may be severely impaired.

We agree fully with Rep. Barney Frank’s comment that, “I do not think we want this hurricane to … [result in] greater and greater concentration and fewer and fewer community banks.”

We will work with you Mr. Chairman, Ranking Member Frank, and this subcommittee to ensure the health of community banks affected by the disaster.

Depending on the amount of insurance payments and government assistance to their customers, a few banks may need direct government assistance in addition to regulatory flexibility to remain viable. Many bankers have customers like a bulk fuel distributor that is in full operation and fulfilling high demand for its product, but is challenged by the fact that $5 million in its receivables may be a total loss.

Ensuring the health of community banks that were operating in and providing service to communities before Hurricane Katrina is not just a matter of fairness. Community banks will be essential to the survival of communities in the affected areas. Small businesses will only be able to rebuild if community banks are healthy and able to respond to their needs. Community banks are much more than offices, computers, and ATMs. Offices and bank equipment can and will be replaced; the banker/community relationships cannot.

Community banks built many of the local communities that were hardest hit, and can be relied on to rebuild those communities. When community banks resume full operations, they will be serving the people they have always known, and focusing on their local communities as they have always done.

Strong community bank management should be able to survive, if policy makers exercise enough flexibility. FDIC Chairman Powell, a former Texas community banker, and I have compared our experiences in the oil bust of the 1980s in bringing undercapitalized banks back to health. I am convinced my colleagues in the New Orleans and Gulf Coast area can do the same.

ICBA Recommendations

There is enormous economic and social value in maintaining these communities and the community banking relationships that existed before Hurricane Katrina. That is why ICBA is recommending that you pass legislation authorizing the appropriate agencies to provide community banks with some form of direct assistance.

There are a number of ways that this could be done, direct financial assistance, government purchases of loans with storm-impaired collateral, or disaster assistance through the SBA.

In addition to our urging that you provide for direct assistance where needed, ICBA makes the following broad recommendations, as more fully detailed in the attached list:

Maintain Public Confidence:

- Public officials should continue to make strong statements about the safety and soundness of all FDIC-insured institutions. This will bolster public confidence and avoid unnecessary deposit drains or liquidity pressures on financial institutions in the disaster area.

Assure Liquidity:

- The Federal Reserve should assure cash availability as well as security for transportation and storage of cash, especially in temporary bank facilities.
- The Federal Reserve – through its discount window – and the Federal Home Loan Banks – through advances – should be as flexible as possible to assure liquidity.

Keep Payments Flowing:

- Payments system needs to keep flowing with special clearing and settlement arrangements for banks in the affected areas.

Address Lending/Safety and Soundness:

- Regulatory agencies must exercise flexibility on past due and otherwise classified loans that are impaired by the disaster.
- Agencies must be flexible in enforcing prompt corrective action and least cost resolution requirements.

Many of the steps outlined in our attached recommendations, especially regulatory flexibility, must last longer than a few months. A community banker in Florida reported to ICBA that his bank is still dealing with the capital and liquidity challenges from the influx of insurance proceeds into his bank after last year's hurricanes. Until depositors spend that money, the bank's capital ratio is reduced and it needs to maintain a high liquidity level to support potentially large withdrawals. He recommends that the regulators exercise flexibility for at least 18 months.

Hurricane Katrina is the worst natural disaster in our nation's history, with a long recovery period anticipated for the hardest-hit areas. To maximize the ability of community banks to fulfill their role in rebuilding their communities, it will take unprecedented flexibility from regulators and the close attention of this committee and the Congress.

With appropriate governmental action and support community banks should be well-positioned to spur the revitalization of their communities.

Hurricane Katrina: ICBA Relief Suggestions

September 6, 2005
Revised: September 13, 2005

Congressional Action

Recovery

- **Establish special liquidity fund for banks in affected areas through the Federal Home Loan Bank System**, with flexible terms and minimal collateral requirements.

- **Waive restrictions and collateral requirements for advances through the Federal Reserve discount window.**

- **Raise current bank-qualified municipal bond issuance limit** to $30 million (and index for inflation).

- **Create a special fund** to allow the federal government to purchase impaired loans of borrowers affected by the disaster.

- **Special bond issuance** (similar to NYC Liberty Bonds) - establish $10 billion in tax-free "Katrina redevelopment bonds," allowing financial institutions to invest in Katrina bonds as triple tax exempt/bank-qualified bonds.

- **Appropriate special Small Business Administration (SBA) disaster funds for banks** in the affected areas (community banks are small businesses too).

- **Authorize $10 billion in Small Business Administration disaster loan authority** for use by financial institutions in disaster areas (loan limits up to $250,000 for an individual and $2 million for a business; up to 30-year term; maximum 4% interest; 85% SBA guaranty).

- **Appropriate $150 million to SBA 7(a) loan program** to help lower fees on lenders and borrowers.

- Enact and fund **special fee waivers for SBA and USDA borrowers** in affected areas.

- **Increase funding for USDA's *Interest Assistance* program** (allows a reduction of up to 4% from the interest rate of farm operations loans).

- **Increase funding for guaranteed farm loan programs** – increase guarantee level to 95% for one year (as opposed to the current 90%) – streamline current loss claims procedures to expedite processing of claims.

- Waive offset requirements for **agricultural disaster aid.**

- **Apply 20% and 50% community bank tax credits** detailed in H.R. 2061 and
S 1568 ("Communities First Act").

- **Allow 5-year net operating loss (NOL) carry back** for financial institutions in disaster areas.

- **Provide 25% tax credit for all interest earnings on SBA disaster loans** in designated Katrina disaster areas.

- **Waive taxes on interest earned from rural mortgage loans** (similar to provision in Communities First Act).

Regulatory Relief

- **Indemnify financial institutions for uncollectible third-party checks** cashed for hurricane victims.

- **Waive affected banks' liability for cashing Federal benefit checks or disbursing direct deposits** after the death or legal incapacity of a benefit recipient or for cashing forged U.S. Treasury checks for a minimum of 6 months.

- **Grant regulators broad authority to waive *any* regulatory requirements** for banks in affected areas.

- **Waive certain consumer disclosures and protection requirements** in affected areas for depository institutions, such as Truth in Lending (TILA), especially the three-day right of rescission, APR disclosure, advance APR disclosure, to allow banks to provide funds to affected customers ASAP and to use manual processing of note forms (when there is no or limited access to computers).

- **Extend all monthly and/or quarterly federal tax filing requirements** by 6 months and all annual filing requirements by one year and waive any tax penalties in this duration (provide waiver form to request further additional filing extension period).

- **Defer all withholding tax deadlines.**

Safety and Soundness

- Allow banks in affected communities **additional latitude in cases of reduced capital levels,** e.g., under FDICIA prompt corrective action or for other purposes (especially those classified well-managed and well-capitalized prior to the disaster).

- **Relax prompt corrective action standards to avoid closing banks with temporarily impaired capital levels.**

- **Provide FDIC the flexibility to provide open bank assistance and waive "least cost resolution" requirement under FDICIA.**

- To address the influx of deposits expected from insurance/FEMA proceeds, **enact deposit insurance reform ASAP or relax hard 1.25% designated reserve ratio hard target** to allow the FDIC more flexibility in managing the FDIC fund.

Regulatory Action

While the September 1, 2005 press release from the regulatory agencies is helpful for banks in peripheral communities, banks in more devastated areas, will need additional support from the regulatory agencies to survive and provide customer service—before the bank can provide assistance to its customers, the bank itself must be viable, and it is critical that regulators provide as much assistance as possible for these institutions.

Immediate Steps

Recovery

- **Provide banks with lists of resources and offer advice, guidance,** and any other necessary assistance to help them resume operations.

Liquidity

- **Waive restrictions and collateral requirements for advances through the FHLB system**.

- **Waive reserve requirements** for banks in the affected area.

- **Expand the Federal Reserve Seasonal Liquidity program** time period to allow funds to be borrowed for longer periods.

- Provide **mechanisms to furnish currency and coin** to banks in the affected areas ASAP **and ongoing onsite security.** ***Done, but additional security measures may be needed***

- **Facilitate the clearing and settlement of checks by extending the check deposit deadlines and servicing alternate presentment points.** ***Done***

- **Waive check-encoding requirements** for affected banks to facilitate check clearing and settlement and improve liquidity.

- **Reinstate original availability schedule** for banks normally clearing through the Federal Reserve Bank of Atlanta's New Orleans Branch, which are now clearing elsewhere. ***Done***

Regulatory Relief

- Grant banks **additional latitude to identify customers under Customer Identification Program requirements** (Bank Secrecy Act), since many customers may have lost all identification (especially since community banks already know their customers) – this applies to all instances requiring customer identification**.** ***Done in part - additional, more specific guidance needed.***

- Provide additional **flexibility to allow banks in affected areas to open temporary branches and share resources** (lobbies, data processing, office space, other backroom support).

- **Defer reporting deadlines for regulatory reports**, e.g., call reports, and Report of Transaction Accounts, Other Deposits, and Vault Cash (FR 2900).

- **Allow flexibility on classified loans and collateral requirements** (to give banks sufficient flexibility to work with borrowers who may have lost homes, cars, jobs) and **defer enforcement action due to credit quality**.

- **Allow banks to make credit policy exceptions and re-age accounts** that go past due as appropriate to help impacted borrowers without regulatory repercussions.

- **Grant banks additional time to address errors under TILA and Regulation E** (allow at least 60 to 90 days for banks in affected areas).

- **Ease/waive CRA examination requirements** for period of time (to allow banks to provide services to their communities without having to document their activities).

Longer Term Steps

- Offer **flexibility on examination cycles** – and allow additional latitude for banks in affected areas during their first exam, recognizing that they have been impacted by elements outside their control.

- Examiners need to clearly understand the impact of the disaster and **allow all affected banks sufficient flexibility for at least 18 – 24 months to recover** – technical application of requirements within 6 months does a great disservice to the local communities affected – especially for liquidity levels and plans.

- **Relax prompt corrective action standards to avoid closing banks with temporarily impaired capital levels.**

- **Provide FDIC the flexibility to provide open bank assistance and waive "least cost resolution" requirement under FDICIA.**

- **Appropriately define "temporary" when granting relief** (six months is insufficient – **18 months minimum** needed).

- Issue forward commitments that the FDIC will not **increase deposit insurance assessments for banks in affected areas that have a temporary decrease in capital levels due to sudden influx of deposits** from insurance/FEMA payments.