Testimony
of
Jeffrey L. Gerhart
President, Bank of Newman Grove

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services

Hearing on
"Examining the Link between Fed Bank Supervision and Monetary Policy"

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Chairman Frank, Ranking Member Bachus, Members of the Committee, I am Jeffrey Gerhart, President of the Bank of Newman Grove, Newman Grove, Nebraska. The Bank of Newman Grove is a state member bank, supervised by the Federal Reserve, with $32 million in assets. Newman Grove is an agricultural community of 800 in the rolling hills of Northeast, Nebraska. We work hard to make Newman Grove a strong and vibrant community through loans to the community's farmers, small businesses and consumers. The bank was chartered in 1891, and I am the fourth generation of my family to serve as bank president. The fifth generation is already represented on our board of directors.

I am pleased to testify on behalf of the Independent Community Bankers of America and its 5,000 community bank members nationwide at this important hearing on the link between the Federal Reserve's bank supervision and monetary policy.

During the financial regulation restructuring debate, some in Congress have proposed the Federal Reserve's supervision of state member banks be eliminated and that its supervision of holding companies be eliminated or limited to the very largest holding companies. Although the primary responsibility of the Federal Reserve is to conduct monetary policy, the ICBA opposes separating the Federal Reserve's monetary policy role from its role as financial supervisor. We support maintaining the Federal Reserve's authority to supervise state member banks and holding companies.

Supervision of State Member Banks and Holding Companies

For decades, the Federal Reserve has played a critical role in the banking regulatory system as the supervisor of state member banks and holding companies. ICBA believes the local nature of the regional Federal Reserve Banks, working in harmony with state bank regulators, gives them a unique ability to serve as the primary regulator for state member banks, the vast majority of which are community banks serving consumers and small businesses. This also gives the Federal Reserve an efficient means for gauging the soundness of the banking sector and local economies, information that is critical to developing and implementing sound monetary policy.

Importance of Community Bank Supervision for Monetary Policy

In testimony before Congress recently, Federal Reserve Chairman Ben Bernanke noted the importance of the Federal Reserve's relationship with community banks. "The Federal Reserve – although we've been very focused on large institutions over the last couple of years because of the crisis – that (sic) we also supervise a large number of community banks, state member banks, and they provide us very important information about the economy," he said. "We can learn from them what's happening at the grassroots level, what's happening to lending, and that kind of information is very valuable for us as we try to understand what's going on in the economy."

Federal Reserve Needs a Comprehensive View of the Small Business Lending Environment

The supervision of community banks provides the Federal Reserve important information on the small business sector, which is vital to our economic recovery. Small businesses represent 99% of all employer firms and employ half of the private sector workers. The more than 26 million small businesses in the U.S. have created the bulk of new jobs over the past decade. With many of the largest firms stumbling and the U.S. unemployment rate at nearly 10 percent, the viability of the small business sector is more important than ever.

Community banks serve a vital role in small business lending and local economic activity not supported by Wall Street. For their size, community banks are prolific small business lenders. While community banks represent about 12 percent of all bank assets, they make 40 percent of the dollar amount of all small business loans less than $1 million made by banks. Notably, nearly half of all small business loans under $100,000 are made by community banks. In contrast, banks with more than $100 billion in assets -- the nation's largest financial firms – make only 22 percent of small business loans. By supervising community banks, in addition to larger institutions, the Federal Reserve has a more comprehensive view of the availability of small business credit and the health of the small business sector. If Federal Reserve monetary policy is to promote this important sector of the economy, the Federal Reserve's supervision of community banks must be maintained.

Community Bank Supervision Provides a View of Local Economies

One of the strengths of the community banking industry is its geographic diversity. Community banks have played a vital role in the stability and growth of each of the fifty states by providing a decentralized source of capital and lending. Through supervision of community banks throughout the country, the Federal Reserve is better able to determine the health of the vast array of local economies served by community banks. Large banks do not operate in many of the communities served by community banks. If the Federal Reserve no longer supervised community banks, it would lose valuable information about local economies needed to formulate comprehensive and effective monetary and economic policies.

Limiting the Federal Reserve's Supervision Authority to the Largest Institutions would Bias Monetary Policy

The unique insight gained from supervising both large and small banks and holding companies allows the Federal Reserve to identify disruptions in all sectors of the financial system in order to meet its statutory goal of ensuring stability of the financial system. ICBA is very concerned that limiting the Federal Reserve's oversight to only the largest or systemically dangerous holding companies could lead to a bias in monetary and regulatory policy in favor of the largest financial institutions. This is a risky approach to financial reorganization.

Federal Reserve's Track Record as Community Bank Supervisor

Moreover, state chartered community banks played no role in the current financial crisis, and no one has criticized the Federal Reserve's supervision of community banks as lax. It is not logical to strip the Federal Reserve of its authority over community banks and their holding companies when the record shows it has been a very effective regulator of community banks.

Expertise of the Federal Reserve Bank of Kansas City

My bank was a national bank for over one hundred years until **2005,** when it became a state chartered bank, maintaining its membership in the Federal Reserve Bank of Kansas City. The bank was well-regulated by the Comptroller of the Currency and is well regulated today by the Nebraska State Department of Banking and the Federal Reserve Bank of Kansas City. The Federal Reserve Bank of Kansas City brings to its bank supervisory role a highly regarded expertise in the agriculture economy of Nebraska and other Midwestern states. The Federal Reserve's expertise in the agriculture economy of the Midwest enhances its ability to supervise Midwestern community banks, like mine, with a significant farm loan portfolio. It would be a mistake to remove the Federal Reserve Bank's economic expertise from the country's financial supervisory structure.

Federal Reserve Supervision Enhances Important Regulatory Diversity

Having multiple federal agencies supervising depository institutions provides valuable regulatory checks and balances and promotes best practices among those agencies. The collaboration that is required by these agencies on each interagency regulation insures that all perspectives and interests are represented, that no one type of institution will benefit over another, and that the resulting regulatory or supervisory product is superior. The contributions and views of the Federal Reserve have been an important part of this regulatory diversity, which would be significantly diminished if the Federal Reserve were stripped of all or most of its current supervisory authority.

I appreciate the opportunity to testify on this important subject. I would be glad to answer any of your questions.