CONSIDERATION OF REGULATORY RELIEF PROPOSALS

S. HRG. 109–993

CONSIDERATION OF REGULATORY RELIEF PROPOSALS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

EXAMINE REGULATORY RELIEF PROPOSALS TO REMOVE REGULATORY BURDEN FROM THE BANKING INDUSTRY

MARCH 1, 2006

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C O N T E N T S

WEDNESDAY, MARCH 1, 2006

WITNESSES

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

CONSIDERATION OF REGULATORY RELIEF PROPOSALS

WEDNESDAY, MARCH 1, 2006

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:19 a.m., in room SD–538, Dirksen Senate Office Building, Senator Michael Crapo, presiding.

OPENING STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. This hearing will come to order. This is the hearing of the Banking Committee on Consideration of Regulatory Relief Proposals. We apologize to everyone that we got a late start, but we had a vote down on the floor, and got tangled up down there for a few minutes, but we are now under way there. Before I make my opening statement or get it started, I want to turn the time over to Senator Enzi from Wyoming, because he has another urgent joint session of Congress to attend over in the House side, and we need to get him on his way over there.

So, Senator Enzi, would you like to make any opening statement that you would like to give?

STATEMENT OF SENATOR MICHAEL B. ENZI

Senator ENZI. Thank you, Mr. Chairman. Us Italians have to help out the Prime Minister of Italy.

[Laughter.]

So, I appreciate this opportunity.

Senator CRAPO. Give him my best regards.

Senator ENZI. Okay. I also want to thank you for your hard work on this issue. I appreciate the way that you have waded through all the stakeholders' interests and worked to get some balance, and also to take care of over 200 different suggestions for ways that we can improve the banking system for banks and credit unions, and I really admire the work that you have put in on it.

I would ask that my entire statement be a part of the record.

Senator CRAPO. Without objection.

Senator ENZI. A lot of fantastic comments in here about the way that this will affect Wyoming that I want to be sure is part of the record.

Senator CRAPO. Then we will make sure that it is included.

Senator ENZI. But the part that I want to concentrate on this morning is the part that is important for an industry that is familiar to me, which is the accounting industry. When this Committee considered the bill that became the Gramm-Leach-Bliley bill of 1999, we knew it would drastically change the way our financial industry operated. For example, Title V of the Act enumerated the obligation of financial institutions to protect their customers' private information, something that had never been done on such a large scale before.

But for those in the accounting industry, this was old news. Certified public accountants are bound by privacy laws older and stricter than Gramm-Leach-Bliley. However, with the passage of Gramm-Leach-Bliley, CPA's were required to disclose privacy notices the same way as everyone else. So what difference does that make? State-licensed CPA's in all of the States are prohibited from disclosing personal information unless specifically allowed by the customer. Now, under Gramm-Leach-Bliley, institutions can share information unless prohibited by a customer, a much looser standard. There is a significant difference here, and one that makes annual privacy disclosures for CPA's unnecessary.

I have been working closely with Congressman Mark Kennedy from Minnesota on an exemption of this annual disclosure for State-licensed CPA's who follow the stricter privacy laws. While the cost of this annual disclosure can be annoying for larger firms, it can be deadly for small firms or sole proprietors. An exemption could save these firms valuable resources, and their clients lots of dollars.

I look forward to working with my Banking Committee colleagues on this issue, and the other meaningful reforms of our Nation's small financial institutions.

I thank the Chairman for his tremendous work on this, and also for the opportunity to make my statement early. Thank you.

Senator CRAPO. Thank you very much, Senator, and we appreciate your attention to these issues. I know that even though you have to leave, you are very engaged on these matters, and we appreciate that.

Senator Shelby will not be able to make the hearing today, and frankly, this is a very busy time. There is a Joint Session of Congress going on at this very moment, which probably will impact our attendance here for at least a period of time, as well as many other matters. I had three hearings myself scheduled at 10 o'clock this morning. So he has asked me to chair the hearing this morning, and I was very pleased to be able to do so.

An effective regulatory system appropriately balances due costs and benefits of public laws and regulations. All of us want to protect consumers and ensure that the system's safety and soundness are protected. However, excessive regulation increases the cost of producing financial products. It stifles productivity and innovation, and misallocates resources. Responding to the steady stream of new regulations, while complying with the existing ones, has been a challenge for all financial institutions.

Rule changes, particularly for smaller institutions with limited staff, can be costly, and these changes are inevitably passed on to consumers. It is also important for us to understand that the resources that are expended working to meet governmental compliance and paperwork requirements are time and effort that are not available to serve customers and communities.

In Idaho, one of the specific issues that I have been told that results in high cost for community banks and credit unions with little benefit to consumers, is the mailing of annual privacy notices when the institution does not share information with third parties or make changes to its privacy policies. One community banker in Idaho told me that his community bank spends an estimated $15,000 a year per mailing, approximately 50,000 privacy notices. In 2004, his bank received one customer call in response to his bank's privacy notice mailing, and received no customer responses at all in 2005. Another community banker in Idaho said that most customers do not read the annual privacy notices. Most end up in the garbage. This is one of the obvious provisions that we need to look at.

Compliance costs for the financial services industry costs billions of dollars each year. For smaller institution, one out of every four dollars in operating expenses goes to pay for the cost of Government regulation. While much of this is necessary to assure the soundness and the safety of our financial system, it is obvious that there are many unnecessary and outdated provisions that should be eliminated to reduce the costly burdens imposed on our financial institutions. If this burden were reduced by even 10 to 20 percent, and those funds were made available, billions of additional lending would be made available that would have a direct and positive impact on the economic growth and on consumers.

The bottom line is that too much time and money is spent on outdated and unnecessary compliance and paperwork, leaving less time and less resources for actually providing financial services.

The House Financial Services Committee has recognized this problem, and in December 2005, it passed its own regulatory relief legislation by a vote of 67 to 0. In 2004, the Banking Committee held hearings on proposals regarding regulatory relief for banks, thrifts, and credit unions. The hearing covered all points of view and was made up of three panels of witnesses, Members of Congress, regulators and trade associations, and consumer groups.

The Office of Thrift Supervision, Director John Reich, as leader of the Interagency Economic Growth and Regulatory Paperwork Reduction Act—and we have an acronym for that, EGRPRA—the task force was asked to review the testimony presented at the hearing and prepare a matrix which listed all the recommendations and positions presented to the Committee. The results brought forward 136 burden reduction proposals. By the second hearing held in June, the list of proposals had grown to 187 items, many of which are in the House passed bill, H.R. 3505.

This was a huge undertaking, and I appreciate the hard work and cooperation of so many involved, especially the OTS Director Reich, for his perseverance in leading this effort.

To ensure transparency in the process, the matrix of 187 items was then circulated among regulators, trade associations, and consumer groups, and all the various viewpoints have been recorded. We have hard witnesses' testimony in two previous hearings, and numerous meetings have been held with all interested parties throughout the process. Witnesses have thoroughly detailed the ever-increasing number of requirements and outdated restrictions placed on our financial institutions. Each requirement, restriction, report, and examination imposed, may individually have been justified when adopted, but as time passes and markets and consumer demand changes, the necessity for imposing some of these requirements and restrictions become outdated or subsides.

I think that all of us want to try to turn this around, and I know that the witnesses we are going to hear from today will help us identify where we can trim the regulatory fat without adversely impacting regulatory oversight.

I look forward to working with all of my colleagues as we quickly move to a markup after this hearing, and I would encourage them to identify which proposals they support or oppose. Some Members have expressed interest in proposals that have both defenders and detractors here today, and which we will hopefully have an opportunity to explore with our witnesses.

With that, let me go to the panel. As you can see from the panel, we have a large panel, and we also have a second panel following which is even larger, so we have our work cut out for us here today. I would encourage everybody to remember the instructions that you have received, and that is, we have asked you to keep your presentation to 5 minutes. There is a clock in front of you. It does not have a bell or anything, so you are going to have to try to be sure to pay attention to it. If I understand how this thing works, the sum-up button will come on at one minute. So when you see the light go from green to yellow that means you have one minute to start summing up. When it hits red, which is stop, we ask you to finish your thoughts. You will have an opportunity during questions and answers to get further into your testimony, and your written testimony will be presented and made part of the record, which all of us will review very carefully.

Now let me go to our panel and introduce them. John Reich, who is the Director of the Office of Thrift Supervision is our first panelist, followed by Gavin Gee, Director of Finance of the Idaho Department of Finance; Donald Kohn, who is a Member of the Board of Governors of the Federal Reserve System; Douglas Jones, Acting General Counsel for the FDIC; Julie Williams who is the First Senior Deputy Comptroller and Chief Counsel for the Office of the Comptroller of the Currency; JoAnn Johnson, Chairman of the Board of Directors of the National Credit Union Administration; and Linda Jekel, Chair and Director of Credit Unions for the National Association of State Credit Union Supervisors.

Ladies and gentlemen, we will go through the panel in that order, and I do not know if I said this already, but if you do start forgetting the clock, I will just lightly tap this. So that means look at clock if you hear that sound.

[Laughter.]

Director Reich.

STATEMENT OF JOHN M. REICH

DIRECTOR, OFFICE OF THRIFT SUPERVISION

Mr. REICH. Thank you very much, Senator Crapo. I appreciate the opportunity to be here, and I deeply appreciate your leadership on regulatory burden relief in the Senate, and your willingness to push this along.

As the nominal leader of the Interagency EGRPRA Project, I am gratified that all of the agencies that are represented at this table are supporting numerous regulatory relief provisions for the institutions that they supervise, as well as for the industry as a whole.

My written statement highlights several important provisions for saving associations on behalf of the Office of Thrift Supervision, where I now sit, and I ask that you consider these, but in my remarks today I am going to address the larger picture, and the importance of moving forward on regulatory relief legislation.

I think we all recognize the substantial additional burdens that have been placed on the industry in recent years with increased responsibilities under the Bank Secrecy and the USA PATRIOT Act, as well new accounting adjustments and changes to privacy laws, to name just a few.

As I have said in previous testimony before this Committee, the Federal Bank and Thrift Regulatory agencies have promulgated more than 850 regulations or amendments to existing regulations since FIRREA was enacted in 1989. In light of this formidable number, I strongly believe that it is incumbent upon us to carry out the purpose of the EGRPRA legislation to eliminate any regulatory requirements that are outdated, unduly burdensome, and no longer necessary.

Accumulated regulatory burden is suffocating the industry, despite the fact that the industry is doing and has done so well in recent years with successively record profits. However, to characterize the entire banking industry as enjoying record profits, in my opinion, is misleading, in that not readily known is the fact that only 7 percent of the industry accounts for 87.6 percent of the industry earnings. That is 670 banks with over a billion dollars in assets account for 87 percent of industry earnings. The remaining 8,200 institutions represent 93 percent of the number of institutions, and they share in the remaining 12.4 percent of industry profits.

Furthermore, there are 3,863 community banks under $100 million in assets. They represent almost 44 percent of the industry in terms of total number. They account for less than 1½ percent of industry earnings.

Record profits in the industry is a label not shared by smaller institutions. Community bank return on assets are generally declining over the past 10 years. Their efficiency ratios are relatively flat during the same period of time, while large bank return on assets are generally increasing with their efficiency ratios declining.

Make no mistake, regulatory burden impacts all institutions, large and small. I believe it has a potentially greater competitive impact, however, on smaller institutions. There is considerable anecdotal evidence around the country that regulatory burden has risen to the top of the list of reasons why banks sell out. Investment bankers at recent M&A conferences confirm this fact.

To those who say let market forces determine the future of community banking, my response is that our industry is not a free market. It is a highly regulated market, and this fact is having a great influence on market behavior of bank managements and shareholders of smaller community institutions. Regulatory forces that unduly impact industry competitiveness are not good for institutions of any size when they skew market forces, and that is what we are faced with today.

It is my fear that smaller institutions will continue to disappear from our landscape, and local communities and consumers across the country will be the losers, for they will continue to lose their local independent banks with their local directors, who are business owners with vested interests in their banks and in their local communities.

The loss of these human resources not only impacts local banking relationships with small businesses and individuals, but it also reduces human resources available for leadership of community service organizations on which senior bank officers and directors frequently serve. There is definitely an unquantified social cost to industry consolidation that is attributable to the weight of accumulated regulatory burden. A growing problem in communities across the country with implications that I fear are largely ignored by many policymakers.

Ten years ago, Congress passed the EGRPRA statute, the Economic Growth and Regulatory Paperwork Reduction Act, which required all Federal regulators to review all of our regulations in an effort to reduce the regulatory burden on the industry. We have taken this mandate seriously, and are approaching the conclusion of this effort in the next few months.

Over the past 3 years, the regulatory agencies have published more than 125 regulations for comment, received more than 1,000 comment letters with suggestions for change, and held 16 banker and consumer group outreach sessions around the country. Pursuant to Senator Sarbanes' suggestion the last time I appeared before this Committee, we made a concerted effort to engage community and consumer groups in the process. Based on the suggestions received, we have made the changes that we could to our own regulations, policies, and procedures to reduce regulatory burden, and testified on a number of occasions on things that can only be changed by legislation.

I believe we have a limited window of opportunity this year to make the most significant progress ever made with regulatory relief legislation. I am committed, as is OTS, to reducing regulatory burden wherever we have the ability to do so, consistent with safety and soundness and in compliance with law, and without undue impact on existing consumer protections.

We strongly support proposed legislation that advances this objective.

I want to thank you again, Senator Crapo, for your leadership on this effort, and I look forward to continuing to work with you.

Senator CRAPO. Thank you very much, Director Reich.

Mr. Gee.

STATEMENT OF GAVIN GEE
DIRECTOR OF FINANCE, IDAHO DEPARTMENT OF FINANCE
ON BEHALF OF THE
CONFERENCE OF STATE BANK SUPERVISORS

Mr. GEE. Good morning, Senator Crapo, and thank you for the opportunity to be here today. I am Gavin Gee, Director of the Idaho Department of Finance. I am pleased to be here today as past

Chairman of the Conference of State Bank Supervisors, or CSBS. Thank you for inviting us to discuss strategies for reducing unnecessary regulatory burden on our Nation's financial institutions.

CSBS is the professional association of State officials who charter, regulate, and supervise the Nation's approximately 6,240 State-chartered commercial banks and savings institutions, and nearly 400 State-licensed foreign banking offices nationwide.

My colleagues and I are the chartering authorities and primary regulators of the vast majority of our Nation's community banks. Senator Crapo, we applaud your longstanding commitment to ensuring that regulation serves the public interest without imposing unnecessary regulatory burdens on financial institutions.

At the State level, we are constantly balancing the need for oversight and consumer protections with the need to encourage competition and entrepreneurship. We believe that a diverse, healthy financial services system serves the best public interest.

A bank's most important tool against regulatory burden is its ability to make meaningful choices about its regulatory and operating structures. A bank's ability to choose its charter encourages regulators to operate more efficiently and effectively, and in a more measured fashion. A healthy State banking system curbs potential Federal excesses and promotes a wide diversity of financial institutions.

While our current regulatory structure and statutory framework recognize some differences between financial institutions, too often it demands a one-size-fits-all approach. Overarching Federal requirements are often unduly burdensome on smaller or community-based banks. We suggest that Congress and the regulatory agencies seek creative ways to tailor regulatory requirements for institutions that focus not only on size, but also on a wider range of factors that affect consumer needs and business practices. As the chartering agencies for the vast majority of community banks, CSBS believes that a State bank regulator should have a vote on the Federal Financial Institutions Examination Council, or the FFIEC. The FFIEC's State Liaison Committee includes State bank, credit union, and savings bank regulators.

The chairman of this committee has input at FFIEC meetings, but is not able to vote on policy or examination procedures that affect the institutions we charter and supervise. Because improving coordination and communication among regulators is one of the most important regulatory burden initiatives, we ask that Congress change the State position in FFIEC from one of observer to that of full voting member.

The Conference of State Bank Supervisors also endorses approaches such as in Senate Bill 1568, Communities First Act, that recognize and encourage the benefits of diversity within our banking system. The CFA includes several of the changes CSBS recommends to help reduce regulatory burden without undue risk to safety and soundness.

The first of these is extending the examination cycle for well-managed banks with less than $1 billion in assets from 12 months to 18 months, as proposed in Section 107 of the CFA. Advances in off-site monitoring, combined with the help of the banking industry, make annual on-site examinations unnecessary for the vast majority of health financial institutions. Changing the safety and soundness examination cycle for these banks would have no effect on the cycles for the Community Reinvestment Act and compliance examinations, which are scheduled separately.

We also see the benefits of Section 203, which would exempt certain banks from provision of the Gramm-Leach-Bliley Act that require banks to send annual privacy notices to all their customers, the very point that you made about Idaho banks, Senator, a very important regulatory burden relief issue.

In addition, we support CFA's provisions in Sections 102 and 204, to allow well-capitalized and well-rated banks with assets of $1 billion or less to file a short-form call report every other quarter. In addition to these provisions, my colleagues and I ask that Congress grant the Federal Reserve the necessary flexibility to allow State-chartered banks to take advantage of State-authorized powers, codify the home State, host State principles and protocols for the supervision of multi-State, State-chartered institutions, allow for pass-through tax treatment for State-chartered banks that organize, as limited liability corporations, allow all banks to cross State lines by opening new branches, and review the growing disparity in the application of State laws to State and nationally chartered banks and their subsidiaries.

Senator Crapo, the regulatory environment for our Nation's banks has improved significantly over the past 10 years, in large part because of your diligence and other Members of this Committee and other Members of Congress. As you consider additional measures to reduce burden on our financial institutions, we urge you to remember that the strength of our banking system is its diversity. This diversity is the product of a consciously developed State-Federal system. Any initiative to relieve regulatory burden must recognize this system's values.

Again, we commend you, Senator Crapo, and the Members of the Committee for their efforts in this area. Thank you again for the opportunity to testify before you, and I look forward to answering any questions that you might have.

Senator CRAPO. Thank you very much, Gavin.

Governor Kohn.

STATEMENT OF DONALD L. KOHN, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. KOHN. Thank you, Senator Crapo, for the opportunity to discuss regulatory relief. As you noted so nicely, unnecessary regulatory burdens hinder the ability of banks to meet the needs of their customers, operate profitably, innovate, and compete. That is why the Board periodically reviews its own regulations and why it is so important for Congress to periodically review the Federal banking laws to determine whether there are any provisions that may be streamlined or eliminated without compromising the safety and soundness of banking organizations, consumer protections, or other important objectives that Congress has established for the financial system.

The Board, working with the other banking agencies, has been and will continue to be a strong and active supporter of Congress' regulatory relief efforts. In that process, the Board has reviewed numerous proposals that may affect the Federal Reserve or the organizations we supervise. We now support more than 35 proposals that we believe would meaningfully reduce regulatory burden, improve the supervision of banking organizations, or otherwise enhance banking laws. A complete listing of the proposals supported by the Board is included in the appendix to my testimony. We believe these proposals provide an excellent starting point for regulatory relief legislation. The Board's three highest regulatory relief priorities have remained constant over time. These items would allow the Federal Reserve to pay interest on balances held at Reserve Banks, provide the Board greater flexibility in setting Reserve requirements, and permit depository institutions to pay interest on demand deposits. Together these changes would allow for a substantial reduction in regulatory burdens on banks and small businesses and an increase in the efficiency of our financial system.

My written testimony highlights some of the other legislative proposals we believe would provide meaningful relief to banking organizations, as well as some steps that the Board has taken on its own to reduce regulatory burden for community banks. Two of the more important amendments would: Remove outdated barriers to interstate branching by banks; and raise to $500 million the asset level at which an insured depository institution may qualify for an extended 18-month examination cycle.

Interstate branching is good for consumers and the economy, as well as banks. The creation of new branches results in better banking services for households and small businesses, lower interest rates on loans, and higher interest rates on deposits. The Board's proposed exam cycle amendment is unanimously supported by the Federal banking agencies. It would provide regulatory relief to small, financially strong institutions without compromising safety and soundness.

Although the Board supports allowing depository institutions to pay interest on demand deposits and freeing banks to open interstate branches, the Board opposes amendments that would grant these new powers to industrial loan companies that operate outside the prudential and legislative framework applicable to other insured banks.

Our position on these matters is longstanding and based on the broad policy issues presented by the special exemption for ILC's. This special exemption allows any type of company to acquire an FDIC-insured bank and avoid the activity restrictions that Congress has established to keep banking and commerce separate. The exemption also allows a company or foreign bank to acquire an insured bank and avoid the consolidated, supervisory framework that applies to the corporate owners of other insured banks. Consolidated supervision provides a supervisor the tools needed to understand, monitor, and when appropriate, restrain the risks associated with an organization's group-wide activities.

ILC's have expanded rapidly in recent years outside the prudential framework established by Congress, and beyond the intent of the original exemption. We believe that the important principles governing the Nation's banking system should be decided by Congress after full debate and consideration, and not in the context of proposals that would provide needed regulatory relief to many institutions, but would also expand the special status of only one type of institution chartered in a handful of States. Once determined, Congress' judgment on these matters should apply to all banking organizations in a competitively equitable manner.

Thank you for this opportunity. We look forward to working with the Committee in developing regulatory relief legislation that is consistent with the Nation's public policy objectives.

Senator CRAPO. Thank you, Governor Kohn.

Mr. Jones.

STATEMENT OF DOUGLAS H. JONES
ACTING GENERAL COUNSEL,
FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. JONES. Thank you, Senator Crapo and Senator Hagel. I appreciate the opportunity to present the views of the FDIC on regulatory burden relief for the financial industry. The FDIC shares the Committee's continuing commitment to eliminate unnecessary burden, and to streamline and modernize laws and regulations as the financial industry evolves.

We would like to thank you, Senator Crapo, and your staff, as well as the Committee staff who have worked with us to review the proposals. In addition, the inclusion of consumer groups in reviewing and commenting on many burden relief proposals has provided a wider range of perspectives and beneficial analysis.

The Federal bank and thrift regulatory agencies have been working together over the last few years to identify regulatory requirements that are outdated, unnecessary, or unduly burdensome in accordance with the Economic Growth and Regulatory Paperwork Reduction Act of 1996, EGRPRA. The agencies have identified numerous proposals to reduce regulatory burden, and the FDIC continues to work with the other agencies in an effort to achieve further consensus and, as required by law, we will submit a final report to Congress with legislative recommendations later this year.

The FDIC and the other regulatory agencies are committed to improving the quality and efficiency of financial institution regulation and to reducing administratively unnecessary regulatory burden where it is identified and where changes to current practices do not diminish public protections. We also are examining and revising our regulations, procedures, and industry guidance to improve how we relate to the industry and its customers. My written statement briefly describes a few examples of recent FDIC and interagency initiatives which are expected to relieve regulatory burden, clarify regulatory requirements, or assist financial institutions to improve their operations.

As a result of the interagency EGRPRA effort led by former FDIC Vice Chairman John Reich, now Director of the OTS, a consensus among the banking agencies has been reached on 12 regulatory burden relief proposals. One of these items, reform of the Flood Insurance Program, has been overtaken by the devastation and aftermath of Hurricane Katrina. So clearly, the need for comprehensive flood insurance reform is apparent and is being addressed through separate legislative efforts. We withdraw our earlier proposal regarding flood insurance and stand ready to assist the Committee in their review of the program. Thus, as detailed in my written testimony, the FDIC is pleased to join with the other banking agencies to support 11 specific proposals.

In addition, the FDIC respectfully recommends the consideration of a number of additional regulatory relief items that would help improve our supervisory efforts. These items also are detailed in my written statement.

In conclusion, thank you for the opportunity to present the FDIC's views on these issues. The FDIC supports the Committee's continued efforts to reduce unnecessary burden on insured depository institutions without compromising safety and soundness or consumer protection. I will be happy to answer your questions on these matters.

Senator CRAPO. Thank you very much, Mr. Jones.

Ms. Williams.

STATEMENT OF JULIE L. WILLIAMS
FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. WILLIAMS. Mr. Chairman, Senator Hagel, on behalf of the OCC, I appreciate the opportunity to be here this morning to discuss unnecessary regulatory burden and its debilitating impact on our Nation's banking institutions. I also want to express particular appreciation to you, personally, Senator Crapo, for your commitment and your dedication to tackling this very real problem.

Senator CRAPO. Thank you.

Ms. WILLIAMS. Unnecessary burden exacts a heavy price on banks, bank customers, and our economy. For our Nation's community banks, unnecessary burden can actually imperil their competitive viability.

My written testimony covers in detail some of the initiatives being pursued by the Federal banking agencies to identify and reduce burden on our Nation's banks. One major initiative is the EGRPRA process that is being so ably led by OTS Director John Reich. This 3-year effort is drawing to a close and will result in a report to Congress later this year.

My written testimony also recognizes that, in certain areas, burden relief cannot be achieved through the regulatory process alone, but requires action by Congress. And my testimony discusses in detail several of the OCC's priority legislative items.

This morning, I would like to briefly highlight just three areas. First, we all need to look for ways to reduce the cost and improve the effectiveness of consumer disclosure requirements. Today, our system imposes massive disclosure requirements and costs on our Nation's financial institutions, but little is known about whether these are necessary costs that yield commensurate benefits for consumers.

We believe that it is possible to provide the information that consumers need and want in a concise, streamlined, and understandable form, but that requires us to change how we go about establishing those disclosure requirements. The Federal banking agencies have undertaken an important initiative by employing consumer testing as an integral part of an interagency project to simplify the Gramm-Leach-Bliley Act privacy notices. Through consumer focus groups and testing, consumers have been asked about what they most want to know about the treatment of their personal information, and what style of disclosure is most effective in communicating useful information to them. This project has the potential to be a win-win for consumers and financial institutions, and also to lay a foundation for other similar initiatives in other areas.

Second, it is important to seek out ways to ease burden on our community banks. Our proposed legislative amendments include two provisions that I would like to note briefly here. Both of these amendments may enhance the ability of community national banks to take advantage of pass-through tax treatment and eliminate double taxation—that is, where the same earnings are taxed both at the corporate level as corporate income, and at the shareholder level as dividends.

One amendment would expand the availability of Subchapter S treatment for national banks by allowing directors of national banks to purchase subordinated debt instead of capital stock to satisfy the directors' qualifying shares requirements in national banking law. This may allow more national banks to meet the Subchapter S shareholder limits.

Another amendment would clarify the OCC's authority to permit a national bank to organize in an alternative business form, such as a limited liability company, which may be eligible for pass-through tax treatment.

A third item that has the potential to provide relief for a meaningful number of national banks is an increase in the asset threshold from $250 million to $1 billion to permit more national banks to qualify to be examined on an 18-month rather than an annual exam cycle. Under current law, banks that have $250 million or less in total assets and that satisfy other strict standards, such as being well-capitalized, well-managed, and having high supervisory ratings, may be examined on an 18-month cycle rather than on a 12-month cycle. Increasing the asset threshold to $1 billion, but not changing any of the other qualifying criteria, would ease the examination burden and associated examination costs for approximately 340 community national banks.

While we believe that increasing the threshold to $1 billion provides relief without endangering safety and soundness, we note that an increase to $500 million, which has also been suggested for the Committee's consideration, would still be an important and valuable step.

In conclusion, Mr. Chairman, Senator Hagel, we very much appreciate the opportunity to work with you, other Members of the Committee, and staff, on the important initiatives under consideration to reduce unnecessary regulatory burden. I would be happy to try to answer any questions you may have.

Thank you.

Senator CRAPO. Thank you very much, Ms. Williams.

Ms. Johnson.

STATEMENT OF JoANN M. JOHNSON CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Ms. JOHNSON. Senator Crapo, Senator Hagel, on behalf of the National Credit Union Administration, I am pleased to be here today to present our views on regulatory reform initiatives. The reform proposals being considered by Congress will benefit consumers and the economy by enabling financial institutions and their regulators to better perform the role and functions required of them.

In my oral statement I will briefly address some of the proposals that are of greatest importance to NCUA.

Prompt corrective action capital requirements for credit unions, enacted in 1998, as part of the Credit Union Membership Access Act, are an important tool for both NCUA and credit unions in managing the safety and soundness of the credit union system and protecting the interests of the National Credit Union Share Insurance Fund.

Our 7 years of experience with the current system, however, have shown there are significant flaws and need for improvement. PCA, in its current form, establishes a one-size-fits-all approach for credit unions that relies primarily on a high-leverage requirement. This system penalizes low-risk credit unions and makes it difficult to use PCA, as intended, as an incentive for credit unions to manage risk in their balance sheets.

NCUA has developed a comprehensive proposal for PCA reform that addresses these concerns. Our proposal establishes a more reasonable leverage requirement to work in tandem with more effective risk-based requirements. Our proposal accounts for the 1 percent method of capitalizing the Share Insurance Fund and its effect on the overall capital in the insurance fund and the credit union system.

The result is a leverage requirement for credit unions that averages 5.7 percent under our proposal, as compared to 5 percent in the banking system. As you know, we have submitted our proposal for Congress' consideration, and it has been included in the new CURIA proposed legislation in the House of Representatives. I urge the Senate to include our proposal in any financial reform legislation that is considered and acted upon this year.

As I have previously testified, an important technical amendment is needed to the statutory definition of net worth for credit unions. FASB has indicated it supports a legislative solution, and that such a solution will not impact their standard-setting activities. Last year, the House unanimously passed a legislative solution to this problem, H.R. 1042, and I urge the Senate to give it prompt consideration.

Federal credit unions are authorized to provide check cashing and money transfer services to members. To enable credit unions to better reach the unbanked, they should be authorized to provide these services to anyone eligible to become a member. This is particularly important to furthering efforts to serve those of limited means who are often forced to pay excessive fees.

The current statutory limitation on member business lending by federally insured credit unions is 12.25 percent of assets for most credit unions, which is arbitrary and constraining. Credit unions have an historic and effective record of meeting the small business loan needs of their members, and this is of great importance to many credit unions that are serving consumers, including those in underserved and low-income communities.

NCUA's strict regulation of member business lending ensures that it is carried out in a safe and sound basis. NCUA strongly supports proposals to increase the member business loan limit to 20 percent of assets, and raise the threshold for covered loans to a level set by the NCUA Board, not to exceed $100,000.

NCUA continues to support other provisions in the previously considered regulatory relief bills, such as improved voluntary merger authority, relief from SEC registration requirements for the limited securities activities in which credit unions are involved, lifting certain loan restrictions regarding maturity limits, and increasing investments in CUSO's.

Also we have reviewed the other credit union provisions included in the previously mentioned bills and in Senator Crapo's matrix, and NCUA has no safety and soundness concerns with these provisions.

Thank you, Mr. Chairman, for the opportunity to appear before you today on behalf of NCUA to discuss the public benefits of regulatory efficiency for NCUA, credit unions, and 84 million credit union members. I am pleased to respond to any questions the Committee may have, or to be a source of any additional information you may require.

Thank you.

Senator CRAPO. Thank you very much, Ms. Johnson.

Ms. Jekel.

STATEMENT OF LINDA JEKEL
DIRECTOR OF CREDIT UNIONS,
WASHINGTON DEPARTMENT OF FINANCIAL INSTITUTIONS,
DIVISION OF CREDIT UNIONS AND CHAIRMAN,
NATIONAL ASSOCIATION OF
STATE CREDIT UNION SUPERVISORS

Ms. JEKEL. Good morning, Senator Crapo and Senator Hagel. I am Linda Jekel, Director of the Credit Unions for the State of Washington Department of Financial Institutions. I appear today as the Chair of the National Association of State Credit Union Supervisors, NASCUS.

NASCUS' priorities for regulatory relief focus on the reforms that will strengthen and further enhance the safety and soundness of our State credit union supervision.

State-chartered credit unions need capital reform. To begin, credit unions need an amendment to the definition of net worth, in the Federal Credit Union Act. Currently, net worth for credit unions is limited to retained earnings.

Additionally, a change would address amendments to FASB Standards 141, that require the acquisition method for business combinations, and eliminates the pooling method. The FASB method creates a potential dilution of statutory net worth, and is an impediment to credit union mergers. Mergers are a safety and soundness tool used by both Federal and State regulators.

The House passed H.R. 1042, legislation amending the definition of "net worth," to include the retained earnings of a merging credit union with that of the surviving credit union. We understand that H.R. 1042 has been forwarded to this Committee for review. We ask for your support and passage of this bill.

NASCUS supports risk-based capital. It is a system that provides increased capital levels for financial institutions with complex balance sheets, while reducing the burden for institutions with less complex assets. We further believe that credit unions should have access to alternative capital. NASCUS created a white paper demonstrating that alternative capital debt and equity models are viable methods for credit unions to safely build net worth. The white paper is attached to our NASCUS testimony.

From a regulatory perspective, it makes economic sense for credit unions to access other forms of capital to improve safety and soundness. We request your support for capital reform.

NASCUS believe that the Federal Credit Union Act should be amended to require that one National Credit Union Administration, NCUA, Board member have State credit union regulatory experience. We believe that this will result in a stronger and safer credit union system. About 40 percent of credit unions are State chartered. The majority have Federal insurance provided by the National Credit Union Share Insurance Fund, managed by the NCUA.

NASCUS believes experience regulating State-chartered credit unions would provide a balanced regulatory perspective. This is not a new idea. A similar provision requiring State bank supervisor experience is included in the Federal Deposit Insurance Act. We ask for your support to make that change to the structure of the NCUA Board.

Federally insured credit unions have access to Federal Home Loan Banks, while privately insured credit unions do not. Membership in the system should not be predicated on an institutions type of insurance. Permitting non-federally insured institutions to join the Federal Home Loan Bank System would not establish a new precedent.

Finally, we would like to highlight the ongoing debate about State and Federal powers. I can imagine our Founding Fathers debating how to protect the powers of State. The question confronting our Founding Fathers back then was how to limit the central government's power so it did not take away the people's rights.

Today, preventing Federal preemption of State laws and regulation continue to be a priority for State legislatures and State regulators. NASCUS believes States are in the best position to decide the laws and regulations for the consumers in their States. Each time a Federal agency acts to preempt State law, it is a chink in the armor of State protections that our Founding Fathers sought to preserve. This threatens the dual-chartering system.

There have been preemption conflicts in the past among Federal regulators, State regulators, some legislators. Congress should resolve conflicts rather than delegate these fundamental issues to the Federal regulators to determine. One preemption issue confronting the credit union system is credit union conversions to mutual savings banks. NASCUS believes State law should dictate the conversion process for State-chartered credit unions. Chartering a State credit union is an issue determined by State law. Approval authority for conversion is determined likewise by State law. A conversion is a function of a credit union's original charter, separate from insurance oversight. NASCUS asks for this Committee's support in placing the responsibility of conversion rules within chartering authority.

In conclusion, NASCUS appreciates the opportunity to testify here today. We present additional provision in the regulatory relief matrix and in our written testimony that protect and enhance the viability of the credit union dual-chartering system. We welcome questions from the Committee Members.

Thank you.

Senator CRAPO. Thank you very much, Ms. Jekel.

We have been joined by Senator Hagel and Senator Carper, and before we go to questions, I would like to ask if either of the two of you have an opening statement you would like to make.

Senator Hagel.

STATEMENT OF SENATOR CHUCK HAGEL

Senator HAGEL. Mr. Chairman, thank you. I do have an opening statement. I would ask that it be included in the record. Thank you very much.

Senator CRAPO. Without objection.

Senator Carper.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. I also have an opening statement, and rather than enter it in the record, I will just say it briefly.

Thank you all for coming today and for sharing your perspectives with us, and for the second panel as well.

I want to say to our Chairman, to Senator Crapo——

Senator CRAPO. I am sorry. I was talking.

Senator CARPER. I know. I want to thank you for bringing us together and I know investing a couple of years of your life and your staff's life in trying to identify the regulations. Obviously, we have a heavily regulated financial services industry, and we ought to, and we also know that it is appropriate from time to time for us to come back and revisit those regulations and see which ones make sense, which are duplicative, and which, frankly, do not add much to safety and soundness, or to the interest of consumers.

So with that in mind, welcome. We have, I think, 187 or so ideas that have stepped forward, and looking at the size of this room and the number of people here, I would say there are about 187 people in the room, just a coincidence.

Senator CRAPO. Each with a new idea too probably.

[Laughter.]

Senator CARPER. Thank you, Mr. Chairman, and to all of our witnesses.

Senator CRAPO. Thank you very much, Senator Carper.

I will start out the questioning. There are literally 187 plus questions I could probably ask, and do not worry, I will not go into all of those because we do have another big panel we need to get to.

But one of the big issues that we have dealt with, and which a number of you raised in your testimony—by the way, let me stop and say I have reviewed the testimony of each of you, the written testimony, and I just want to congratulate each of you, that in addition to putting forward very well-prepared oral statements, the written testimony that has been provided by each of you is outstanding, and has an incredible amount of additional insights, support, and information that you were not able to go into in your presentations, but which will be of great help to us. So, thank you very much for the work that has gone into preparation for your testimony here at this hearing.

One of the issues that a number of you raised, and which is important to me, is the filing of currency transaction reports as the top—in fact, that has been identified by a number of financial institutions as the top regulatory expense issue that they face. U.S. Treasury regulations implemented in 1994 allow certain exemptions for certain types of customers of currency transactions, and I understand it, these exemptions allow banks to exempt correspondent banks, Government agencies or departments, public or listed companies and their subsidiaries, and smaller businesses that meet specific criteria under FinCEN's regulation.

And perhaps there need to be more exemptions or clarifications here, but the question I have is, is there a reason why these exemptions are not widely used by the banks, and can these exemptions be better adjusted to enable banks to economically take advantage of them? I toss this out to anybody on the panel who is interested. Any takers?

Director Reich.

Mr. REICH. I will try to address the issue. I think that many bankers feel that the exemption process is not effective, it is labor intensive, it is cumbersome, and it is subject to second guessing by bank examination personnel. Some people have been burned by requesting exemptions, and later were admonished for doing so. I think the exemption process can be improved. Perhaps there is room for considering it in connection with the seasoned customer rule that has been proposed, that is, finding a process that is not so burdensome as the exemption process currently is. But bankers do not feel that the exemption process is effective.

Senator CRAPO. Do they just feel the risk is too high?

Mr. REICH. I think that is part of it, yes.

Senator CRAPO. Ms. Williams.

Ms. WILLIAMS. I guess I would just add complexity in the exemptions, in some cases the need to reprogram software systems in order to comply with the scope of the exemptions, and a recertification-type process that needs to occur on a periodic basis.

Senator CRAPO. Anybody else want to jump in on this one? Let me expand my question just a little bit, and Director Reich addressed it a little, but what are your thoughts, if any, about the proposed seasoned customer rule?

Mr. REICH. I am supportive of the seasoned customer rule so long as FinCEN is supportive of it. It is my understanding that they are. And we would be supportive of any proposal that would improve the currency transaction reporting process that FinCEN and law enforcement would support.

Mr. KOHN. The Federal Reserve Board agrees with the sentiments of Director Reich. We are supportive of a process in which FinCEN and law enforcement come to an agreement that both relieves regulatory pressure on the banks and serves the needs of law enforcement. We think it is important that this process work through so that law enforcement is comfortable with the results.

Senator CRAPO. Anybody else want to jump in there?

Ms. Williams.

Ms. WILLIAMS. I would just echo what Governor Kohn has said. It is very important that the law enforcement community have a seat at the table in resolving how we approach this issue.

Senator CRAPO. All right, thank you.

Mr. Gee.

Mr. GEE. Senator Crapo, I would just weigh in that the State Bank Supervisors also support that exemption. I think one of the important things for any of these exemptions is that we provide certainty. One of the big problems in this whole area is when we create uncertainty, particularly for the smaller institutions, that in and of itself is a huge regulatory burden, and if the examiners play "gotcha" or write them up for violations——

Senator CRAPO. And the penalty for guessing wrong or making the wrong decision is too high to risk.

Mr. GEE. Exactly. But we would support that effort.

Senator CRAPO. I assume your comments, Mr. Gee, would apply not just to the seasoned customer rule, but also to the exemption issue, and in fact, that is probably more directly what you are discussing?

Mr. GEE. Yes, that is true, Mr. Chairman.

Senator CRAPO. Let me go on. Governor Kohn, I have one question that is probably more specific to you, and so let me get that one out of the way here before I turn the microphone over to Senator Carper.

One of the matrix items, actually Item No. 105.1—sounds pretty regulatory.

[Laughter.]

That matrix item increases the existing HMDA recordkeeping and reporting exemption to $250 million in assets. While I understand that this proposal is controversial, and there is actually opposition to the proposed threshold of $250 million, the footnotes in our matrix indicate that there is also support for a lower increase in the exemption level. Since the Federal Reserve collects the HMDA data and supports an increase in the threshold, I was just going to give you a chance, if you would, to discuss with us what threshold does the Federal Reserve believe we really should adopt here?

Mr. KOHN. The Federal Reserve does not have a view as to exactly what the right threshold is to relieve this burden. Another portion of the matrix talks about relieving reporting requirements for those institutions that make fewer than 100 mortgage loans. We agree that there is some relief that is possible here. The HMDA data are very useful for tracking developments in mortgage markets, for comparing one lender to its competitors in the same market, for looking at disparities in treatment among race, ethnicity, gender, by loan, by institution, by geographic area that might be a flag for further investigation. We would be very concerned about doing something that would undermine the usefulness of the HMDA data in this regard.

Our preference would be for the Congress to instruct the Federal Reserve to go through a rulemaking process so that we could weigh the issues, go out for public comment, find out what the pros and cons are of either raising the exemption amount from the current $34 million and/or exempting a minimum number of loans that institutions making those loans would not have to report. We do not know right now what the right balance is, but we agree that the balance is not correct at this point. We just do not know quite where to go.

Senator CRAPO. All right, thank you.

Would any of the other regulators like to comment on this issue? You do not have to, but if you want to, now is your chance?

Mr. REICH. I have spoken in the past of recommending an increase in the minimum from $35 million, where it is today, to banks over $100 million in assets.

Senator CRAPO. Okay. I have gone well over my time for our first run at this.

Senator Carper, would you like to ask questions?

Senator CARPER. Yes, I would. Thank you, Mr. Chairman.

The first question I am going to ask, I am going to telegraph my pitch, and I am going to tell you what my second question is, because it is going to be for you, and you can be thinking about it while I ask my first question. But I want to ask you to, in my second question, I am going to ask you just to elaborate, if you will, on some of the steps that have been taken recently to encourage credit card issuers to increase the minimum payments on the credit cards. If you would be thinking about that, I would appreciate it.

This could be really for any witness. Director Reich, you may have heard something about this before. Some of you may have, some of you may not, but I would be interested in your thoughts. I recently learned about something that is called, I think it is called a pretrial diversion for people who write board checks, and this is not people who bounce checks, but people who write bad checks, and when notified by the merchant to whom they have written the bounced check, they simply refuse to make good on the check, and they have a history of doing this thing.

As I understand it, a for-profit group works with district attorneys from around the country in order to collect on bad checks that have been written to merchants when those checks exceed a certain dollar amount. The group provides a class, I think it is about $100 per person, to people who have written bad checks, to teach them about financial and personal responsibility. I think I spoke with Senator Crapo about this a couple of weeks ago, and I do not know if it among the 187 ideas that are before the Committee, that will be before the Committee, but if any of you have heard about this idea, have any thoughts on it.

I think in order to do anything, provide for—waited to address this issue across the board rather than on a piecemeal basis, State-by-State, community-by-community, there may be a need to go in to take a look at the Fair Debt Collection Practices Act.

So if anybody has a thought on this, I would welcome your thoughts. If you do not, I will go to my second question for Ms. Williams. Anybody at all?

[No response.]

All right. Ms. Williams.

Ms. WILLIAMS. Senator, thank you for the heads-up.

Senator CARPER. Sure.

Ms. WILLIAMS. As you know, the issue of minimum payments on credit cards is one that all of the banking agencies, not just the OCC, have been looking at for several years, and one which led to the interagency account management guidance that was issued several years ago. It dealt with a package of issues ranging from minimum payment requirements on cards to work-out programs and how losses needed to be written off or otherwise dealt with.

In response to the guidance, we at the OCC found that a number of our credit card issuing banks were in compliance with many of the requirements very quickly, but were slow to move ahead with implementation of the requirement to have a minimum payment that, together with the payment of any fees and charges, would have some element of reduction in the principal so that the aggregate principal would be repaid within some reasonable period of time. Over the course of the last 18 months, at least with the national banks that we supervise, we have gotten banks on tracks to fully implement that account management guidance. Some of it was done mid-year last year while some of the adjustments were concluded at the end of this past year. Because of some systems integration issues, there are some adjustments that may have just been finished.

But the goal for us was to get all of the banks that we supervise in full compliance with that credit card account management guidance, including the minimum payment requirements. What this does for consumers is to provide a mechanism, in the aggregate minimum payment that the card issuer requires, that will cause their principal balance to amortize or pay down over some foreseeable period of time. It is not necessarily quick, because we are not requiring a gigantic minimum payment, but it does——

Senator CARPER. What are we requiring?

Ms. WILLIAMS. It is 1 percent of the principal, plus fees and charges.

Senator CARPER. So far, how do you feel about how it is going?

Ms. WILLIAMS. I think that it has been going fairly well. What we found with different banks is that they have different issues depending on the makeup of their credit card portfolios, and some of them need to make more adjustments with their customers. We also have said that banks certainly should work with their customers if they need to reduce their fees or make other adjustments in what they are charging in order to implement this minimum payment requirement, and that they should be flexible in working with customers to accomplish that.

Senator CARPER. Are you mindful of any institutions that have done a particularly good job of reaching out to their customers and trying to comply with this regulation in an especially admirable way?

Ms. WILLIAMS. Well, I would not want to name names here, but there are institutions that——

Senator CARPER. Could you mention initials?

[Laughter.]

Ms. WILLIAMS. There are institutions that both did it promptly, which is good, and those that used this as an opportunity to provide better disclosure to their customers, and that is good, and also institutions that used it as an opportunity to actually change some of the terms in their relationship with customers in a way that is more favorable to customers, and that is good, as well.

Senator CARPER. Good. Anybody else have a view on this matter before I relinquish the microphone?

Ms. Johnson.

Ms. JOHNSON. Senator, the only thing that I would add is that the credit unions, in their role of financial education, have made a concerted effort to bring credit card usage and management into part of their financial education program, and our understanding the needs, in particular of young people, of learning that management early on, and so it has become a part of the financial education programs in many credit unions across the country.

Senator CARPER. Good, good. Thanks.

Thanks, Mr. Chairman.

Senator CRAPO. Thank you, Senator.

I would like to ask a question that relates to the SEC Regulation B. I suspect a few of you know a little bit about that. As you know, in Section 201 and 202 of the Gramm-Leach-Bliley Act, we amended the definition of "broker" and "dealer" under the Securities and Exchange Act of 1934. And pursuant to these amendments, the SEC issued proposed regulations that would force many traditional banking activities out of the bank and into SEC, basically making them registered brokers.

In March 2005, as I am sure you all know, 13 Senators from this Committee, including myself and Senator Carper, and frankly, Senator Enzi and Senator Hagel, who have been here today, sent a letter to Chairman Donaldson objecting, and in that letter restated that because we wanted to allow banks to continue to perform certain traditional banking activities involving the purchase and sale of securities, we replaced the exclusion with a series of statutory exceptions to the "broker" and "dealer" definitions.

In doing so it was our intention, clearly expressed in the legislative history of GLBA, that these bank products and services continue to be available to bank customers, and that banks continue to engage in these activities without having to seek additional authorization from the Commission. Indeed, that was the very purpose of adopting the statutory exceptions.

And I realize the SEC is not sitting at the table today but we know that the SEC has not proceeded on the Regulation B, but I guess the question I have is what is the status of this proposal and what efforts have any of the financial regulators made to work together to reach an accommodation on this issue? Where are we?

Mr. KOHN. My understanding, Senator, is that there are ongoing conversations between the financial regulators and the SEC on this issue. As you know, the regulators shared the Senator's concerns about how GLB was being implemented by the SEC. There have been some changes at the SEC. Conversations are taking place. I think from the Board's perspective, it would be good to let this process work itself out, at least for now.

Ms. WILLIAMS. We agree completely with that.

Senator CRAPO. Mr. Jones.

Mr. JONES. We do as well. We are hopeful that by working together with SEC, we can come to a resolution that works for everybody.

Senator CRAPO. So we do not need legislation yet?

Mr. KOHN. That is correct.

Senator CRAPO. All right. I appreciate that. And I just have one more kind of general question that—I have a lot of questions, but in the interest of time, I am not going to go into them all. I just wanted to toss one question out that is a softball, maybe that would let people say whatever else you might not have gotten to say yet. Basically the context of this question is that, as I said in my opening statement, for smaller institutions, one out of every four dollars that they spend in operating expenses goes into the cost of Government regulation, and it is clear that we have a lot of unnecessary and outdated provisions that need to be fixed.

I guess I am just going to toss it out there. Anybody have something that you did not get to say that you really want to toss in right now before we move on then and I go to Senator Carper for his last round of questions?

Mr. REICH. I would like to take you up on your offer, Senator, to say a few more words.

Senator CRAPO. Sure.

Mr. REICH. When we kicked off this EGRPRA effort 3 years ago, roughly, in June 2003, it was kicked off by regulators actually talking about reducing regulatory burden. That was a novel idea to the banking industry, that regulators might be pushing this notion. We were pushing it, however, in response to the Congressional Act which mandated that we review all regulations.

Our effort initially was greeted by the industry, when we began our outreach meetings, with a fair degree of skepticism, cynicism, and certainly, apathy. But as time went by, and we continued our outreach meetings, and I continued speaking about how I felt that community banks were threatened because of regulation, the industry began to get into the notion that maybe this is a serious effort that will, in fact, result in a serious product to reduce regulatory burden on the industry and began to be more participative and hopeful, less skeptical and more optimistic, and that maybe now something can in fact be done.

I truly hope that this year something significant will be done, because if it is not, it will only feed the skepticism and cynicism that existed initially, and the next time that an EGRPRA effort begins, presumably 7 years from now, bankers will remember that we have been through this before, and there is no point in it.

Senator CRAPO. Good comments.

Ms. Jekel.

Ms. JEKEL. Yes. I would like to just say that as regulatory relief looks at small institutions, whether they are credit unions or banks, the regulatory burden that they have can create some problems for them and they may have to merge. For example, in the State of Washington, 60 percent of my credit unions are under $100 million. They have less than 50 employees. An extreme example is Latvian Credit Union, which has one employee that still is in a house, in which the ethnic community——

Senator CRAPO. I have been in that kind of a credit union before, so I know what you mean.

Ms. JEKEL. So it is difficult. Oftentimes when credit unions are getting ready to merge, we ask them for the reasons why, and it is oftentimes the regulatory compliance burden.

Senator CRAPO. All right. Thank you very much.

Mr. Gee.

Mr. GEE. If I could just add a footnote to that, Senator. I really appreciate all that you are doing on this project and have for so long. From my perspective, we come from a small State, as you know, and all we have is smaller community charters, and not only are we seeing consolidation among those, but we also had a record of near record number of credit union mergers, for example, last year.

What we are also seeing is that it is affecting start-ups, that just the regulatory cost and the burden is affecting the number of start-ups, at least in a small State like mine. We have hardly any credit unions, even very few banks that are willing to start up, and I think a large part because of the regulatory burden. Certainly, the consolidation in the industry is driven by regulatory burden and the lack of the ability to compete.

Though I would echo everything that Director Reich has said, I think there is a real urgency. We would certainly support your Committee's markup on this effort as soon as possible because every day we delay it costs consumers money, it costs financial services industry in a very significant way, and it hinders economic development in our communities, in our States, and in our Nation.

Senator CRAPO. Thank you very much.

Anybody else?

Mr. KOHN. Senator, we agree that the burden of regulation falls disproportionately on smaller institutions who need to gear up to some regulatory reporting and regulatory compliance, and as a proportion of their total cost, that can be very high, and discouraging.

We also think that this process that you and Director Reich have led has unearthed a number of changes in which exemptions can be raised, regulations can be simplified, without sacrificing safety and soundness, consumer protections or other important objectives that the Congress has. I would like to identify with Ms. Williams and her discussion of simplifying consumer reporting requirements. I think here is a win-win situation in which both the institution issuing the report and the information to the consumer, and the consumer, can be made better off by taking a hard look at what works and what does not work, and how can we simplify and make things as effective for the consumer as possible, and as cost effective for the institution as possible.

Senator CRAPO. Thank you.

Ms. Johnson.

Ms. JOHNSON. Senator, throughout this process, over half of our credit unions are less than $10 million in assets, and the regulatory burden is great across the line, from the small and to the larger institutions as well. We felt it very important to listen to the institutions because they are the ones that are on the front line serving their members and delivering the products and services. So anytime the regulatory burden takes away from that, being able to actually provide the services, then that is burdensome.

We have not been able to take all of the suggestions that we have heard from the industry, but we certainly have listened to all of those suggestions, and we have—throughout our process, we have used as many of those that we could without undermining safety and soundness, to actually put those in practice for those that actually deliver the services on the front line.

Senator CRAPO. Thank you.

Anybody else?

[No response.]

Before I turn the mic over to Senator Carper, let me just respond to this by saying I very much agree with the comments that have been made, and I appreciate the comments that have been made, and I hope that all the other Members of the Banking Committee hear the message, that we have a window of opportunity here, and we must take it. So, I certainly will be pushing for that.

It is also very true that as we have gone through this process, the field was very fertile. There was a tremendous amount of potential improvement that came up. In fact, 187, the list is growing today while we are having this hearing.

Senator CARPER. Let us stop it soon.

Senator CRAPO. Yes.

[Laughter.]

There is going to be a cutoff point.

Senator CARPER. Maybe we should not go to that second panel, Mr. Chairman.

[Laughter.]

Senator CRAPO. And we are going to have that markup, but I am confident that as soon as we have the markup and get this legislation through, that there will be probably an opportunity to continue working and looking at efforts to improve. So it is really a delight to have the regulating community, the regulators as engaged in this process as you all are, and we deeply appreciate that.

Senator CARPER. Thanks. Before we do stop it, I have three questions I want to ask. Again, I am going to mention the last one first so you all can be thinking about it. We are going to be asked to look at these 187 ideas or more or less, going to be asked to look at them and decide which among them really do enhance the safety and soundness, which of them really do make sure that consumers get a better break, not the short end of the stick. The last question I am going to as you to be thinking about while I ask my first two questions, is just to share your wisdom with us, some things that we may want to keep in mind as we make those, not Solomon-like decisions, but as we try to make those decisions which are worth keeping, which are worth repealing or changing, and which we should keep.

The first question though I want to ask deals with the implementation of bankruptcy reform legislation. We passed it about a year ago. It was implemented roughly 6 months or so ago. I would welcome hearing from you as to how you think it is going, and I presume regulations have been issued. I am not sure just what you all have been doing on this front, but I know there is a real rush for a lot of people to file for bankruptcy last year to beat the deadline, and we are not hearing a whole lot, at least to date, on what effect the new law is having. But I welcome any comments that you could share with us on its implementation.

[Pause.]

And my second question——

[Laughter.]

Dr. Reich, go ahead.

Mr. REICH. I was just going to say that in my outreach meetings with bankers, bankruptcy has not come up as an issue of concern as a result of what was passed last year.

Senator CARPER. Had it ever come up before?

Mr. REICH. Yes, it did.

Senator CARPER. I am sure it did.

Others, please?

Mr. KOHN. I think in some sense, Senator, it is too soon to tell what the continuing effects will be. There were a huge volume of bankruptcies filed in anticipation of the change in the law, so a lot of people who would have done it later, pulled all that forward, and it will take some time to see what a continuing process looks like and how it will affect both lenders and borrowers.

Senator CARPER. Thank you.

Anyone else?

Ms. Johnson.

Ms. JOHNSON. Senator, I would just mention that, of course, we were supportive of the bankruptcy reform, and to a certain degree it was anticipated of the stepped up number of filings there would be. I believe that it is being handled appropriately, and ongoing, the numbers will be reduced. But you have to get to a stage to be able to get by the abuse, and I think that is where we are at.

Senator CARPER. All right, thank you.

Any other comments? Good, thanks.

I have another hearing going on, and I am sure so does the Chairman. Secretary Chertoff from Department of Homeland Security is two flights down, and I am going to go down and rejoin him in just a minute. He has been saying grace over a lot of issues of late, as we know, and one of those is Hurricane Katrina. Several of us on this Committee communicated, I believe, with the regulators of financial institutions on the heels of Katrina, urging of the financial institutions demonstrate some forbearance and willingness to delay payments on a wide variety of things, including home mortgages and car payments, and even credit card bills and that kind of thing.

I do not know that much more of that forbearance is still ongoing, but I would like to know if there is, what you could tell us about it, and do you sense that people are starting to pay their mortgages and their car payments down there a little better, and what, if anything, should our Committee be doing in this regard? Thank you.

Ms. WILLIAMS. Senator, it is a very timely question because at least my principal is headed down to New Orleans maybe even as we speak.

Senator CARPER. For Mardi Gras, wear those beads?

[Laughter.]

Ms. WILLIAMS. No. There is a very important interagency meeting, and I think that some people here may be headed in that direction, to continue the process of getting input from the citizens, banks, and community organizations down there on the conditions, what they need, the things that banks can do, and what messages would be helpful to come from the regulators.

We all have continued to urge the institutions that we supervise to work with their customers and to try to take a reasonable approach in terms of the repayment issues. There still are lingering issues of institutions having trouble locating their customers, and we have collaborated on public service announcements to get the word out that you need to get in touch with your lender so that your lender can work with you. There are issues that pop up that we try to resolve. We have Q&A's on an interagency Katrina website. So there is a lot going on, and we are continuing to urge the institutions that we supervise to work with their customers, and we are continuing to try to identify other things that the banks can do to try to help in the remediation of the situation.

Senator CARPER. Thank you.

Anyone else?

Yes, sir. Director Reich.

Mr. REICH. Senator Carper, I had an outreach meeting with CEO's of all of our thrifts in the New Orleans area 2 weeks ago. And there continues to be a surprising disconnect between the apparent health of the institutions and the health of the New Orleans metropolitan area. Examinations are just beginning. A number of our agencies had deferred scheduled examinations until the institutions got back on their feet, and are more fully staffed, although staffing continues to be a problem in the institutions, as many of the evacuated population were employees and have not returned.

But we do have an interagency forum taking place beginning tomorrow that Ms. Williams referred to, that several principals will be attending, and we hope to get more information about what the needs are, what the conditions are, and I think that as examinations begin to take place, that within the next 6 months we will have a pretty good idea, a much better idea than we do today about how the institutions really are faring.

Senator CARPER. Thanks.

Let me go to my last question now, the one you all had several minutes to think about. And I wanted to ask you just to share your wisdom and counsel with us as we try to decide what to keep and what not in this package.

Ms. JEKEL. One of the areas that I would encourage you to continue to look at is capital reform for credit unions. I know that it will not be a simple issue to work through, but it is necessary that we do something for our credit unions to help them stay viable and competitive in this very dynamic and competitive environment.

Senator CARPER. Thanks, Ms. Jekel.

Ms. JOHNSON. I would echo that. PCA reform, I think, is probably our primary priority. I would like to make it number 188 on the matrix.

Senator CARPER. All right. Thank you.

Ms. Williams.

Ms. WILLIAMS. Senator, there are proposals and suggestions at all levels. Some have more impact than others. I think there are literally dozens and dozens that we have indicated that we are supportive of. I would say, do them all.

[Laughter.]

There are also important provisions that are not so much targeted at relieving a particular regulatory burden, but have safety and soundness enhancement goals, and I would urge you not to leave those behind. There is a good package of safety and soundness enhancement provisions included in the matrix.

Senator CARPER. Thank you, ma'am.

Mr. Jones.

Mr. JONES. I agree with Ms. Williams. There is no one item that we would identify as the most important. There are a number of important initiatives. I think it goes back to what Director Reich said. I think the most important thing is that we actually produce something that is enacted, showing that there is regulatory relief out there and that this process has led to a positive result.

Senator CARPER. That is good advice.

Governor.

Mr. KOHN. We have all highlighted our high-priority items——

Senator CARPER. Again, I am not asking for you to rehighlight your high priority items. I am looking for some words of wisdom.

Mr. KOHN. I think in the process of going through this, we have identified some very low-hanging fruit, situations in which the regulations, when implemented first had very worthy goals and maybe accomplished those goals, but technology changes, the size of institutions changes, the pressure and the competitive markets changes. In some cases, the regulations we are talking about, in the case of the Federal Reserve, were instituted in the 1930's, such as interest on demand deposits, and they are no longer relevant today, and they no longer accomplish their goals. You can accomplish a lot of regulatory relief by picking off this low-hanging fruit that really will not impair your ability to achieve your public policy goals at all.

Senator CARPER. Thank you, sir.

Mr. Gee.

Mr. GEE. Yes. Thanks for the question, Senator. I guess if I had any advice, it would be there are a number—as you look at that matrix, there are a number of provisions in there where most groups agree to. Some of them, I would put in the "no brainer" category. They provide immediate relief to financial institutions and I would hope that the Committee could act on those fairly quickly.

Those that are more controversial, that have people on both sides, I would hope that that is not used as an excuse to delay regulatory burden on those that can be agreed upon. If we cannot strike a compromise on those, then I guess my suggestion would be at least move forward on the ones that people can agree on so we can get some form of regulatory relief out there and send the right message to financial institutions and their customers and this industry that we are serious about reducing regulatory burden wherever we can.

Senator CARPER. Mr. Chairman, the thought comes to me that in putting this bill together, that like one section could be like low-hanging fruit.

[Laughter.]

Another section could be no brainers.

[Laughter.]

I am not sure what the other sections would include. The last word, Dr. Reich.

Mr. REICH. Mr. Chairman, I loved Ms. Williams' response, do them all. It is like asking which of my four children do I like the best. I like them all. But I would say that the Bank Secrecy Act is at the top of the list, with modification to the CTR process. Privacy notices would be at the top of my list. And then in connection with my new responsibilities at the Office of Thrift Supervision, in my testimony, there are a number of items that are related to thrift institutions that I would advocate.

Senator CARPER. I do not know that in the end we will do them all, but hopefully we will do a lot of the ones that really need to be done and provide some sense of priority.

Mr. Chairman, this is a good hearing. I apologize to our second panel of witnesses that are going to come forward now. I have to slip out, but Hillary Joplin, who is sitting right behind me, is going to stay and listen to every single word and give me a full report. Thank you very much.

[Laughter.]

Senator CRAPO. Thank you, Senator, and thank you to this panel. I know we got a late start and we have taken a little long with this panel, but it is a very critical issue, and again, I want to thank you for the work that you have put into your testimony. It is going to be very helpful. Thank you very much.

We will excuse this panel and call up our second panel, and while the second panel is coming forward, I will introduce them to you. I would like to encourage everybody to move out quickly so we can let the second panel get up to the front here. Second panel, as you find your way up, please take your seats and let me introduce who our second panel will be.

Mr. Bradley Rock, President and CEO of the Bank of Smithtown; Mr. Edmund Mierzwinski, who is the Consumer Program Director for the U.S. Public Interest Research Group; Mr. F. Weller Meyer, Chairman, President, and CEO of the Acacia Federal Savings Bank; Mr. Greg McClellan, President and CEO of the MAX Federal Credit Union; Mr. Travis Plunkett, Legislative Director for the Consumer Federation of America; Mr. Steve Bartlett, President and CEO of the Financial Services Roundtable; Mr. Joe McGee, President and CEO of the Legacy Community Federal Credit Union; Ms. Margot Saunders, of Counsel for the National Consumer Law Center; and Ms. Terry Jorde, who is President and CEO of CountryBank USA.

Obviously, you can see there are a lot of you. We had to fill up the whole table and some of you are almost falling off the edges there. I apologize for that.

I would like to remind each of you to please watch the time, and again, I apologize to you. It is always hard for us to fit everything in and especially with an issue of this size and magnitude and the number of people we wanted to have testify. It just becomes increasingly important for you to pay attention to the clock, and I think there is only one clock on that table, so try to pay attention up here if you cannot see the one on your table.

Without anything further, we will begin with you, Mr. Rock.

STATEMENT OF BRADLEY E. ROCK
PRESIDENT AND CHIEF EXECUTIVE OFFICER, BANK OF SMITHTOWN
ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. ROCK. Thank you, Mr. Chairman. I am Chairman, President, and CEO of Bank of Smithtown, a $900 million community bank founded in 1910 and located in Smithtown, New York. I am also Vice Chairman of the American Bankers Association.

The cost of unnecessary regulation is a serious, long-term problem that continues to erode the ability of banks to serve our customers and support the economic growth of our communities. I have included a list of recommended actions with my written testimony, any one of which would provide needed regulatory relief to banks. Today, I would like to emphasize two in particular.

First, under the Bank Secrecy Act, banks fill out more than 13 million currency transaction reports, or CTR, every year. It is undisputed that a vast majority of these reports are filed by publicly traded companies that are well-known by the banks and the government and have nothing to do with potentially criminal activity. The time and resource commitment for CTR's is huge. Even at FinCEN's conservative estimate of around 25 minutes per report for filing and recordkeeping, it means that banks devoted 5.5 million staff hours to handling CTR's in 2005.

Based on our recent survey, the industry paid around $187 million in wages for staff time to comply with this single regulatory requirement.

With three-quarters of the filings for business customers who have been with the bank for over a year, our industry spent around four million staff hours and over $140 million last year filing notices on well-established customers. While the CTR costs have risen, the usefulness of these 35-year-old rules has substantially diminished due to several subsequent laws, including suspicious activity reporting requirements adopted during the 1990's, rigorous customer identification obligations, mandates to match government lists to bank accounts, and the 314(a) inquiry process implemented 3 years ago as part of the USA PATRIOT Act.

The best approach today would be to establish a seasoned customer exemption for business entities, as endorsed by FinCEN in testimony before Congress last year and supported by all the bank regulators.

It is important to remember that cash transaction data will not be lost, but will still reside in the normal bank account data for each seasoned customer and will be available to law enforcement through a variety of the previously mentioned means. Moreover, seasoned customers would continue to be subject to suspicious activity monitoring and reporting. The seasoned customer exemption would help channel resources toward the true public interest, which is stopping the activities of the real crooks and terrorists.

My second point is this. The 500 shareholder threshold to register securities with the SEC should be updated to more accurately reflect the current size and conditions of the investment market. The periodic reporting required imposes considerable costs on smaller public companies, costs that are borne by the company shareholders. Importantly, even with updated limits, shareholders would continue to have ready access to large amounts of information about the company, much of which is required under Federal banking law and regulation. Annual reports and quarterly call reports are two examples.

The cost to small businesses have been staggering. Average auditing fees for smaller public companies, those with less than $1 billion in revenue, rose by 96 percent and exceeded over $1 million per company in 2004, which is the most recent year for which we have data.

Therefore, the 500 shareholder threshold should be updated. Such action is not without precedent, as the asset size parameter has been increased tenfold, from $1 million initially set in 1964 to $10 million. In contrast, the shareholder threshold has never been updated since it was initially adopted in 1964.

We thank you, Mr. Chairman, and the Committee for seeking ways to reduce the regulatory burden on banks.

Senator CRAPO. Thank you very much, Mr. Rock.

Before I go to you, Mr. Mierzwinski, let me discuss with the panel a little problem that is starting to brew up here. In about 10 minutes, there are going to be four stacked votes called on the floor of the Senate, and that is going to take about an hour of time without really much opportunity to conduct much business in between because the votes are stacked. So, I am going to make a suggestion, although it might be an inconvenience to some of you, and I do not want to do that.

We could get as far as we can before they call the votes in taking testimony and then take a break for an hour and you could all grab a bite to eat. I know that some of you probably have schedules, though, that you were planning to meet this afternoon, flights or whatever else that may be, and doing so may be a significant interrupt to you, and so that could be a problem.

The other thing we could do is go directly to questions and just start getting into some questions and answers with the panel for probably 10 or 20 minutes here, and then I would be willing to come back at that point after the votes for any of you who wanted to stick around and present your oral testimony at that time.

I guess the question I have for the members of the panel is, are there any of you who could not come back at, say, one o'clock and spend an hour here, whose schedules would prohibit you from doing that? And please, do not be hesitant to say that you have some kind of another conflict. Everybody could come at one?

Well, then what I propose we do is we will proceed now. Once the vote is called, I can probably go for another 10 minutes before I have to run to the vote, and then I am going to be gone for what will probably be about an hour. At that time, we will adjourn, and I will say until one o'clock, and I will try to be back here at one. If it is not at one, we will have somebody here who can tell you how soon after one it will be. I can probably be back maybe even a little bit before one, so we will do that at this point, then, and we will proceed.

Mr. Mierzwinski.

STATEMENT OF EDMUND MIERZWINSKI CONSUMER PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. MIERZWINSKI. Thank you, Senator Crapo. I am Ed Mierzwinski, for the record, of the U.S. Public Interest Research Group. Along with my colleagues Travis Plunkett of the Consumer Federation of America and Margot Saunders of the National Consumer Law Center, we are delivering joint shared written testimony also on behalf of some of the other leading consumer and community groups, including ACORN, the Center for Responsible Lending, Consumers Union, publishers of *Consumer Reports* magazine, and the National Community Reinvestment Coalition. Each of us will talk about some of the highlighted issues that we have great concerns about in the testimony and our written testimony goes into greater detail on some of these measures.

There are many measures that the Congress has proposed for changes to the laws governing financial services. We do support some of them. We have no positions on others. And we have grave concerns regarding some others. In the testimony, we only focus on some of the provisions that we believe are under significant or serious consideration by the Committee, although we certainly oppose others and we are happy to comment on any of the others that we think may be moving later on.

As the Committee evaluates which of these proposals to include in any bill labeled regulatory relief, we believe that it is critical that the consumer interests be the focal point of the process. A fair bill cannot be limited to provisions supported, introduced, or proposed by either the financial regulators or the financial interests who have 181 or 182 of the 187. I believe four or five come from previous testimony by any of the consumer groups.

We believe that a fair bill must also exclude any measures that are unfair to consumers and that would harm consumers. So in our testimony, we go into details of how the Committee should measure the various provisions.

I want to talk about two of the provisions that are in the bill that we believe are a high priority, unfortunately, and then I want to talk about one that should be in the bill.

First, the rent-to-own industry continues to push something called S. 603. There is nothing that could possibly be construed as regulatory relief or eliminating regulatory burden in this proposal. The rent-to-own industry promises consumers dreams of ownership—furniture, televisions, and the like—and then takes those dreams away, snatches those dreams away with harsh, cruel, unconscionable contracts at 200 to 300 percent interest and other unfair terms. Yet the industry has succeeded in about 45 States in obtaining relief from strong consumer protection regulation. It is the other five States that continue to protect consumers that is the focus of the bill S. 603. The bill would preempt or override the strong consumer lending protections in New Jersey and other States. That is the reason we strongly oppose it. We see no reason that it could possibly be construed as a mere regulatory relief provision.

The rent-to-own industry is part of a whole ecology of predatory lenders that includes the payday lenders, that includes predatory mortgage lenders, that includes auto title pawn shops. We believe this industry is in need of stricter, not lesser, regulation. It is preying on not only the 12 million unbanked Americans, but also on other Americans, as well. So we would urge, keep that out of the proposed bill.

Second, on privacy notices, we oppose any proposal to exempt any privacy notices or change Gramm-Leach-Bliley's Title V in this legislation. We believe that the regulators have two open dockets on privacy notices currently before them. There is the one that Deputy Comptroller Williams mentioned, where they are trying to come up with a layered or improved privacy notice. There is also the new privacy notice that is required by the FACT Act for certain sharing of information between and among the affiliates of companies for marketing purposes. We believe it is inappropriate to consider weakening our privacy laws while there are two open dockets that are considering these very same matters.

Finally, I said that the consumer groups have a number of proconsumer items that we believe could be characterized as regulatory relief. I will mention one very briefly. When I use my credit card, I have the strong protections of the Truth in Lending Act, $50 liability limit and also the right to ask the bank to step into my shoes and protect me if a merchant rips me off. I do not have those same protections when I use my debit card, even though it may be branded with a Visa or a MasterCard logo. I do have some protections with some payroll cards under the law that protects those with debit cards, but not with all plastic cards. So we go in detail in our testimony into ways that you should harmonize upward, so whether you are using a stored value card, a debit card, or a credit card, you always have the same rights.

Thank you.

Senator CRAPO. Thank you very much, Mr. Mierzwinski.

Mr. Meyer.

STATEMENT OF F. WELLER MEYER
CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, ACACIA FEDERAL SAVINGS BANK, FALLS CHURCH, VA AND CHAIRMAN, BOARD OF DIRECTORS, AMERICA'S COMMUNITY BANKERS

Mr. MEYER. Senator Crapo, first, let me begin by thanking you for your efforts. I am Weller Meyer. I am Chairman, President, and CEO of Acacia Federal Savings Bank in Falls Church, Virginia. Acacia Federal is a $1.25 billion community bank with a Federal Savings Bank charter. I am also the Chairman of the Board of Directors of America's Community Bankers. I am pleased to represent ACB at today's hearings.

A strong and vibrant community banking system is good for our country and our communities. The required complexity of the regulations and the precision required to deliver products and services according to the rules has grown to the point where our employees and our customers are drowning in minutia. We believe that the cumulative impact of the regulatory burden has already taken its toll on community banks.

Over the past decade and a half, the assets under the control of the 10 largest banks in the United States has more than doubled and now stands at 53 percent of all U.S. banking assets. Along that pathway, many communities lost their community banks. In the face of the increasingly complex regulatory requirements and the associated costs, many community banks are seeking mergers with larger institutions. Community banks stand at the heart of cities and towns everywhere, and to lose that segment of the industry because of over-regulation would be crippling to those communities.

On the top of every community banker's list of regulatory burden concerns is the implementation of anti-money laundering and corporate governance laws. Community bankers are resolute participants in the fight against crime and terrorism and we fully support the goals of the Sarbanes-Oxley Act and other corporate governance laws. However, we believe that significant changes in both anti-money laundering and corporate governance requirements are urgently needed either through regulation or legislation.

In our written statement, we have detailed several suggestions in two areas. ACB supports many more amendments to current laws that will reduce unnecessary regulation on industry banks. Let me mention a few.

First, a modest increase in the business lending limit for Federal Savings Associations is a high priority for ACB members. Community banks operating under Federal Savings Association charters are experiencing increased demand for small business and agricultural loans. To meet this demand, ACB wants to eliminate the lending limit restrictions on small business loans and to increase the lending limit on other commercial loans to 20 percent. Savings associations could then make more loans to small businesses, farmers, and ranchers.

Second, ACB strongly urges the elimination of the required annual privacy notices for banks that do not share information with nonaffiliated third parties. Community banks should provide customers with an initial notice and be allowed to provide subsequent notices only when the terms are modified. Redundancy under these circumstances does not enhance consumer protection.

Third, ACB vigorously believes that the trust businesses of savings associations should have parity with banks under the Securities Exchange Act and the Investment Advisers Act. There is no substantive reason to subject savings associations to different requirements. Savings associations and banks should operate under the same basic regulatory requirements when engaged in identical trust, brokerage, and other activities.

Fourth, ACB supports giving banking regulators more flexibility in scheduling safety and soundness and compliance examinations for well-capitalized and well-managed depository institutions. We also support raising from $250 million to $1 billion the threshold for the 18-month small institution examination cycle. These proposals will reduce the regulatory burden on low-risk institutions and permit the banking agencies to focus their resources on higher-risk institutions. These proposals would not alter the schedule for CRA examinations.

And fifth, now that the Supreme Court has settled the question of diversity jurisdiction for national banks, Congress needs to give Federal Savings Associations access to Federal courts based on diversity jurisdiction. A written statement includes many other important changes, including easing restrictions on residential development for Federal Savings Associations.

The work you do here is important. Meaningful regulatory relief legislation will reduce costs for community banks and ensure their survival and their continued support for the communities they serve. We look forward to working with you and your staff and I will be happy to answer any questions.

Senator CRAPO. Thank you very much, Mr. Meyer.

We are about four minutes into the first vote, so Mr. McClellan, you will be the last one before we break. Please proceed.

STATEMENT OF H. GREG McCLELLAN PRESIDENT AND CHIEF EXECUTIVE OFFICER, MAX FEDERAL CREDIT UNION ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. MCCLELLAN. Thank you, Senator Crapo. My name is Greg McClellan and I am the President and CEO of MAX Federal Credit Union, located in Montgomery, Alabama. I am here today on behalf of the National Association of Federal Credit Unions to express our views on the need for regulatory relief.

As with all Federal credit unions, MAX Federal Credit Union is a not-for-profit financial cooperative governed by a volunteer board of directors who are elected by our member owners. MAX Federal Credit Union was founded in 1955 and has 106,000 members and just over $650 million in assets.

America's credit unions have always remained true to their original mission of promoting thrift and providing a source of credit for provident or productive purposes, yet credit unions continue to be one of the most highly regulated financial depository institutions.

I am pleased to report to you today that America's credit unions are vibrant and healthy and that membership in credit unions continues to grow, now serving over 87 million members. Yet according to data obtained from the Federal Reserve Board, credit unions have the same market share today as they did in 1980, 1.4 percent of household financial assets, and as a consequence provide little competitive threat to other financial institutions.

As the Committee prepares to move forward and craft a regulatory relief bill, we hope that you will include the credit union provisions outlined in my written testimony and included in the Financial Services Regulatory Relief Act currently pending in the House. We believe those provisions are a positive step for Federal credit unions.

I want to highlight one provision in particular that would address what could become a problem for merging credit unions when FASB changes merger accounting rules from the pooling method to the purchase method. Language to address this issue is included in the House regulatory relief bill and has already passed the House in the form of the Net Worth Amendment for Credit Unions Act. We hope that the language from this bill will also be included in any regulatory relief package introduced in the Senate, as this is a timely issue that needs action before the FASB rule changes go into effect.

To be clear, we are not asking you to legislate accounting rules. Rather, we are asking you to change a definition so that the acquired equity of merging credit unions is properly included in total net worth for PCA purposes. FASB, in testimony before the House last year, recognized that such a change was necessary.

We hope that you will also consider including language from the Credit Union Regulatory Improvement Act, or CURIA, which has been introduced in the House, that would modify the prompt corrective action system for federally insured credit unions to include risk assets as proposed by the NCUA. This would result in a more appropriate measurement to determine the relative risk of a credit union's balance sheet and also ensure the safety and soundness of credit unions and our shared insurance fund. It simply does not make sense that the current capital system treats a 1-year, unsecured $10,000 loan the same as a 30-year mortgage that is on its last year of repayment.

It is important to note that this proposal would not expand the authority for NCUA to authorize secondary capital accounts. Rather, we are moving from a model where one-size-fits-all to a model that considers the specific risk posed by each individual credit union. This proposal revises the standard net worth or leverage ratio requirements for credit unions to a level more comparable to, but still nearly 70 basis points greater than, what is required of FDIC-insured institutions.

In conclusion, the cumulative safety and soundness of credit unions is unquestionable. Nevertheless, there is a need for change in today's financial services marketplace. NACU urges the Committee to consider the provisions outlined in our written testimony for inclusion in any regulatory relief bill. Appropriately designed regulatory relief will ensure continued safety and soundness and allow us to better serve America's 87 million credit union members.

We would like to thank you, Senator Crapo, for your leadership and we are looking forward to working with the Committee on this important matter and welcome any comments or questions.

Senator CRAPO. Thank you very much, Mr. McClellan.

Again, to all the members of the panel, I apologize for this interruption and inconvenience. It is always hard to predict how fast we will be able to go through four votes, but I can pretty well tell you it is not likely to be finished before one o'clock. So what I am going to do is to recess until one o'clock, or as soon thereafter as I can get back here. I would encourage you all to be here at one.

And again, I will say, if there are any of you who had other arrangements made or have a flight to take or whatever it may be that requires that you do that, I will be totally understanding. Just feel free to do that. If that applies to any of you who have not presented your testimony yet, I apologize for that, although the written testimony is incredibly helpful and we already have that from you.

With that, what I will do then is recess this and at least maybe you will have a chance to get a bite to eat, although you probably had other better lunch plans made. This Committee will be recessed until one o'clock.

[Recess.]

Senator CRAPO. This hearing will come to order.

Ladies and gentlemen, things never work out the way you want. We are still voting, and so at some point in the next 10 to 20 minutes, I may get called away again. So what I want to try to do is at least get through the testimony before that happens and then we will just have to make a judgment at that point as to how we proceed.

If I remember correctly, Mr. Plunkett, you were next in line, so please go ahead.

STATEMENT OF TRAVIS PLUNKETT LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA

Mr. PLUNKETT. Thank you, Mr. Chairman. My name is Travis Plunkett. I am the Legislative Director with the Consumer Federation of America. I applaud you and the Committee for ensuring that a diverse array of interests, including consumers, are represented here today.

As the Committee hears one entreaty after another from all sectors of the financial services industry, it is also absolutely essential that it closely examine whether major regulatory gaps exist for consumers, gaps that in some cases have been engineered by these same interests. I would like to mention two of these regulatory gaps to start with and then talk about why it is more important than ever that the Committee reject proposals to allow industrial loan corporations to expand.

First, we were extremely disappointed that final rules issued last year by the Federal Reserve Board covering overdraft extensions of credit left the abusive features of these loans largely in place. These so-called "courtesy overdraft" programs encourage consumers to overdraw their accounts. They do not disclose triple-digit interest rates to these consumers. They take payment in full directly out of consumers' next deposit, and they do not ask for affirmative consent from consumers to borrow from the bank. We urge Congress to step in and require that these loans be treated just like other extensions of credit under the Truth in Lending Act. This would require that creditors inform consumers about the true cost of this credit and receive affirmative consent to loan money.

The second gap involves the growing threat to our Nation's military readiness caused by predatory lenders that target military families. High interest rates, unaffordable repayment terms, and the risk of losing valuable assets characterize lending to the military. We urge the Committee to look at and enact legislation based on Senator Dole's original amendment to the defense authorization bill to cap rates for loans made to military personnel. We also support S. 418 by Senator Enzi and others that would deal with abuses in the sales of periodic payment plans to members of the military.

Finally, I would like to once again urge the Committee to reject legislation that allows industrial loan corporations to expand, either by offering business checking services or by branching into States without their permission. In fact, I strongly urge you to adopt proposals to shut down ILC's completely. One of these proposals is listed on the Senate matrix that has been referred to.

In a report issued last fall, the General Accounting Office became the latest independent authority to raise questions about this expansion and about the impact of the explosive growth of ILC's on the safety and soundness of the deposit insurance system. Since

Congress granted an exception to the Bank Holding Company Act in 1987 for small limited-purpose ILC's in a few States, everything about ILC's has expanded. According to the GAO, ILC assets grew by over 3,500 percent between 1987 and 2004, from $3.8 billion to over $140 billion. In 2004, six ILC's were among the 180 largest financial institutions in the country. Moreover, some of the States allowed to charter ILC's are aggressively encouraging new ILC's to form, especially Utah. These States are promoting the lower level of oversight they offer compared to those pesky regulators at the Federal Reserve.

ILC's now constitute what is essentially a shadow banking system that puts taxpayer-backed deposits at risk and siphons commercial deposits from properly regulated bank holding companies. The key problem with ILC regulation is that while the Federal Reserve has the power to examine the parent of a commercial bank and impose capital standards, in an industrial loan company structure, only the bank can be examined and the FDIC cannot impose capital requirements on the parent companies. Holding company regulation is also essential to ensuring that financial weaknesses, conflicts of interest, malfeasance, or incompetent leadership at the parent company will not endanger taxpayer-insured deposits at the bank.

Commercial firms such as GM, General Electric, Volkswagen, and Volvo own ILC's, as do huge financial firms like Merrill Lynch, American Express, and Morgan Stanley. We have significant concerns with ILC ownership by both types of companies. The involvement of investment banking and commercial firms in recent corporate scandals has provided plenty of evidence of the need for rigorous scrutiny of these companies as they get more involved in the banking industry. These firms were rife with conflicts of interest that caused them to take actions that ultimately harmed their investors. As for ILC ownership by commercial companies, imagine if companies like Sunbeam, Enron, WorldCom, Tyco, and Adelphia had owned ILC's. Not only would employees, investors, and the economy have suffered, but also taxpayers, as well.

Finally, let me finish by mentioning the GAO's major conclusion here. They concluded that proposals to expand ILC's, "may make the ILC charter more attractive and encourage further growth." This is the wrong way to go. We encourage the Committee to examine shutting down the ILC loophole to the Bank Holding Company Act.

Thank you.

Senator CRAPO. Thank you very much, Mr. Plunkett.

Mr. Bartlett.

STATEMENT OF STEVE BARTLETT PRESIDENT AND CHIEF EXECUTIVE OFFICER, FINANCIAL SERVICES ROUNDTABLE

Mr. BARTLETT. Thank you, Mr. Chairman. I am Steve Bartlett, President of the Financial Services Roundtable, which consists of 100 of the large integrated interstate financial services companies in America, which we hold virtually all the charters that are under consideration by the Committee. Like Mr. Plunkett, I also represent the consumers of America, those 200 million-and-some-odd consumers that we call customers. I am here to ask for consumer relief and for relief of those customers from the effects of the regulatory burden that has been placed on them over the course of the last several decades, and I believe it is the role of this Committee and then the Senate and the Congress to relieve that burden.

I would like to add one additional item that I think has not been considered by this Committee in the past and that is a matter of significant regulatory relief that could be enacted and should be enacted by the Congress of the United States, and that is an optional Federal insurance charter. The State-by-State insurance system of regulation is profoundly broken and it is time, indeed, it is past time to modernize that system so that consumers can choose to do their business on an interstate basis if they choose.

Mr. Chairman, in my written testimony, I have cited about 70 provisions of regulatory burden that should be dealt with by this Committee. The ones that I would cite in oral testimony would include interstate branching; the relief of defensive SAR's, the one million SAR's that we think will be filed this year in anti-money laundering; simplified privacy notices; diversity jurisdiction, SEC push-outs, and others.

My point in the oral testimony today is to say, Mr. Chairman, that these items have not unanimous, perhaps, but by and large universal support within the Members of this Committee and by the Senate. Many of these items have been long agreed to. They have been on the table, under discussion, and generally agreed would help the American economy and the American consumer for about 6 years. There are some 70 provisions.

It is my view that to continue these regulatory burdens harms the American consumer, harms small business, and harms the economy. The time to act on these provisions is now; if not now, then next Tuesday; if not next Tuesday, then by June 30, but not 2007 and not 2010 and not 2017. The time to act is now. The American consumer needs relief.

Thank you, Mr. Chairman. I yield back the balance of my time.

Senator CRAPO. Thank you very much, Mr. Bartlett, and I appreciate your yielding back that time.

Mr. McGee.

STATEMENT OF JOE McGEE
PRESIDENT AND CHIEF EXECUTIVE OFFICER,
LEGACY COMMUNITY FEDERAL CREDIT UNION,
BIRMINGHAM, AL
ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION

Mr. MCGEE. Thank you, Senator Crapo, and on behalf of the Credit Union National Association, I appreciate this opportunity to express CUNA's views on legislation to help alleviate the regulatory burden under which all insured financial institutions operate today.

I am Joe McGee, President and CEO of Legacy Community Federal Credit Union in Birmingham, Alabama. I am proud to speak on behalf of America's credit unions today because we are an industry that is good for America. Credit unions are the only financial institutions that are run solely for the benefit of their members, not stockholders. We exist not for charity, not for profit, but for service.

Credit unions are devoted to providing affordable services to all members, especially those of modest means. Now we are asking for the Senate's help in continuing the not-for-profit, people-oriented, cooperative work that we do.

One provision that Senator Sarbanes introduced would better enable us to meet that goal, and I am referring to his legislation S. 31, which seeks to permit credit unions to provide broader check cashing and remittance services.

Perhaps the most critical issue on the horizon for credit unions is the need to reform prompt corrective action. Experience has proven this policy to be unnecessarily inflexible. CUNA strongly supports a rigorous safety and soundness PCA regime for credit unions and agrees that any credit union with a net worth ratio below the adequately capitalized level should be subject to firm corrective action. CUNA has been in constant communication with the Treasury on this very important issue. CUNA believes that the best way to reform PCA would be to transform the system into one that is explicitly based on risk measurement, as outlined by the NCUA proposal and embodied in the House-introduced bill H.R. 2317, the Credit Union Regulatory Improvement Act.

Temporary PCA relief has also been sought after in recent legislation to assist credit unions affected by the hurricanes in 2005. CUNA wholeheartedly supports these efforts so that credit unions temporarily affected by the hurricane do not have to deal with onerous PCA requirements.

Additionally, FASB is expected to adopt rules effective next year that would cause significant problems for healthy credit unions involved in mergers. CUNA believes it is essential that Congress act on this net worth issue immediately. Otherwise, credit unions will be subject to harmful, unintended consequences.

The other issue I wish to address is the correct capital and member business lending. There was really no safety and soundness reason to impose these arbitrary limits on credit unions in 1998. In fact, the Treasury deemed these loans were even safer than other types of credit union loans. CUNA urges the Committee to include an increase in the member business loan cap from 12¼ percent of assets to 20 percent of assets in the regulatory relief measure.

Furthermore, the NCUA should be given the authority to increase the current $50,000 threshold up to $100,000. This would be especially helpful to smaller credit unions as they would then be able to provide the smallest of these loans without the expense of setting up a formal program.

Small business is the backbone of our economy and responsible for the vast majority of new jobs in America, yet the SBA and the Federal Reserve Bank of Atlanta studies reveal that small businesses are having greater difficulty in getting loans in areas where bank consolidation has taken hold. The 1998-passed law severely restricts small business access to credit and impedes economic growth in America. Credit union member business lending is especially important today as we all try to help rebuild the devastated

Gulf Coast, where many have lost their jobs and need even more access to capital.

My written testimony includes an extensive list of amendments to the Federal Credit Union Act, as well as other laws included in your matrix that CUNA urges the Committee to address this Congress.

In conclusion, Mr. Chairman, credit unions and their 87 million members are grateful to the Committee for holding this important hearing. We strongly urge the Committee to act swiftly to provide meaningful regulatory relief this year, and I will be happy to address any questions you may have. Thank you.

Senator CRAPO. Thank you very much.

Ms. Saunders and Ms. Jorde, I am going to have to impose on you again. They have called another vote and there is about 3½ minutes left in the vote, so I am going to recess, run over there and vote, and this is the last vote, and then I will be back. I think it will be about 10 minutes and I will be back and then we can continue with the hearing.

So, I apologize once again, but I will be back. Thank you, and we are recessed.

[Recess.]

Senator CRAPO. The hearing will come to order, and I thank you all for your patience. I do not think we will be voting again for a while, so Ms. Saunders, would you please proceed?

STATEMENT OF MARGOT SAUNDERS
MANAGING ATTORNEY, NATIONAL CONSUMER LAW CENTER

Ms. SAUNDERS. Thank you, Senator Crapo. I appreciate your patience and perseverance in hearing my testimony. I am here today on behalf of the National Consumer Law Center's low-income clients as well as the other groups that my colleagues Ed and Travis have explained.

I would like to emphasize that while you are considering all of these regulatory relief items, you keep in mind that this industry that is suffering from this "terrible regulatory burden" is also experiencing record profits. At the same time consumers are facing increased foreclosures and escalating debts that are more and more difficult for them to bear. The entire discussion here today has been about the impact on institutions. Ed, Travis, and I are here to remind you that on the other side of these regulatory issues lie individuals. Many of the consumer protections that are on the table have significant consumer impacts. Without these consumer protections people would suffer.

It is often the removal of consumer protection regulations that will most likely reduce competitive advantage for responsible financial institutions because those consumer protections are there to ensure that appropriate competition is fostered. Institutions that choose to provide more balanced and consumer-friendly products would find themselves at a competitive disadvantage without adequate regulation.

I want to talk about one affirmative proposal and then explain why a few proposals are particularly dangerous.

As you move forward, please keep in mind there are many consumer protections that needs to be updated. One stands out even more than the rest as a glaring low-hanging fruit for updated consumer protection. The Truth in Lending Act needs to be updated. It was passed in 1968 and it was meant to apply to all consumer transactions. All it does is require uniform disclosures that are made on every consumer transaction in the country. However, at the moment, approximately half the car loans and many other personal loans are not covered by Truth in Lending or most State law. This is because there is a jurisdictional limit of $25,000 for non-home-secured credit under Truth in Lending. The statutory penalties suffer from a similar lack of escalation along with inflation. We really encourage you to consider strongly updating this essential consumer protection as you move forward in this process.

There are many bad provisions that you have on the table and I will try to very briefly address a few of them. First of all, I know that there will be several suggestions or have been suggestions that the Truth in Lending Act's right of rescission be cut back or amended in some way. Let me be very clear. The Truth in Lending Act's right of rescission is one of the most significant consumer protections that lawyers representing low-income consumers and victims of predatory lending use to stop foreclosures. Any cutback on that right of rescission without substantial new protections to stop predatory lending or predatory servicing will substantially hurt consumers and increase the number of foreclosures.

In addition, there are four amendments to the Fair Debt Collection Practices Act that were included in the Manager's Amendment in the House bill and two amendments to the Fair Debt Collection Practices Act that are considered on your matrix. We oppose all of them. The one that was mentioned by Senator Carper would check diversion companies from the Fair Debt Collection Practices Act. These are private, for-profit companies that enter into contracts with district attorneys to collect bounced checks for local merchants. You should please keep in mind that the Fair Debt Collection Practice Act does not prohibit these companies in any way from doing business. All the Fair Debt Collection Practices Act does is require that there be no deception, harassment, or unfairness in the collection of the debt. It prohibits the collection of a debt along with fees that are not authorized. And it requires a right of verification.

In addition, there is a mortgage servicers' amendment that would remove some important protections for consumers who are the subject of collection efforts from mortgage servicers I see I running out of time so I point you to our testimony, where we have explained, I hope forcefully, why that would be a dangerous proposal.

And finally, I know you are considering a proposal that would preempt Arkansas' ability to set usury limits. This provision would place Arkansas in a position unlike that of any other State in the country. Only Arkansas would be unable to pass any usury limits. Only Arkansas would have no control over the interest rates that could be charged to its consumers. It is a very dangerous provision and very unfair to that State.

Thank you.

Senator CRAPO. Thank you very much, Ms. Saunders.

Ms. Jorde.

STATEMENT OF TERRY JORDE
PRESIDENT AND CHIEF EXECUTIVE OFFICER,
COUNTRYBANK USA, CANDO, ND AND
CHAIRMAN-ELECT,
INDEPENDENT COMMUNITY BANKERS OF AMERICA,
WASHINGTON, DC

Ms. JORDE. Thank you, Mr. Chairman. My name is Terry Jorde. I am President and CEO of CountryBank USA. I am also Chairman-Elect of the Independent Community Bankers of America. My bank is located in Cando, North Dakota, a town of 1,300 people where the motto is, "You can do better in Cando." CountryBank has 29 full-time employees and $39 million in assets. We are a small but diversified organization.

Before discussing the topic of today's hearing, I want to thank all of the Members of the Committee for including deposit insurance reform in the recently enacted budget reconciliation bill. I want to extend special thanks to Senators Johnson, Allard, Enzi, and Hagel for their years of hard work, as well as to Chairman Shelby and Ranking Member Sarbanes. This new law is tremendously important in making FDIC insurance a more stable and fair system for community banks and for consumers.

In previous testimony before this Committee and others, we have pointed to a study by two economists at the Federal Reserve Bank of Dallas that concluded that the competitive position and future viability of small banks is questionable, in large part due to the crushing regulatory burden we face. Larger banks have hundreds or thousands of employees to throw into the regulatory breach. If my bank is faced with a new regulation, we must train one or more of our current employees. Complying with a new regulation will take time away from customer service.

My compliance officer not only has responsibility for overseeing our compliance program, but she also originates around 60 real estate loans per year for sale on the secondary market. She sits on our audit and technology committee. She regularly teaches homebuyer education courses at our community college, and she babysits for my son at times like this when I am out here begging for relief. Unlike larger institutions, we cannot just add a person and pass the costs on to our customers.

Senator Brownback's Communities First Act, S. 1568, grew out of that realization. That bill is cosponsored by a Member of this Committee, Senator Hagel, as well as Senators Roberts, Inhofe, and Coburn. It has put into legislative language proposals that ICBA made in our 2004 testimony before this Committee. These proposals are also included in your own comprehensive matrix of regulatory relief proposals. I can tell you from my meetings with community bankers throughout the country that they are very excited about the Communities First Act. A total of 46 State bank trade associations have also endorsed CFA.

We are pleased that six provisions from the Communities First Act are included in the House's broad regulatory relief bill, H.R. 3505. These provisions would streamline call reports, allow banks to file a short form call report in two of every four quarters, reduce the examination burden, simplify reporting for small bank holding companies, eliminate annual privacy notices for banks that do not share information or change their policies, and make it easier for community banks to retain qualified directors.

There is one thing I want to emphasize as strongly as I can. The House bill is a modest slice of the Communities First Act. Many of the regulations that are forcing consolidation of our industry, especially the smaller banks, are those that involve consumer disclosures. Even if you are able to enact the proposals that are on the table now, the benefits will be quite modest. Banks and consumers themselves are drowning in required disclosures that no one reads and that benefit almost no one, except maybe the printing industry. Congress, the agencies, the industry, and consumer groups should begin work today on ways to reduce this burden and actually improve consumers' ability to shop for and understand financial products.

My written statement details provisions in the Communities First Act that would provide substantial benefits while we undertake this review. We strongly urge you to include them in your regulatory relief bill, along with the proposals that are already in the House version.

ICBA very strongly believes that regulatory relief legislation must not become a vehicle to expand new activities for industrial loan companies and credit unions. ILC's and credit unions already have unfair regulatory and tax advantages over community banks. Congress should promptly address these imbalances in the Nation's financial system in the context of regulatory burden relief legislation. We urge you to refrain from making them worse.

In conclusion, ICBA appreciates this Committee's commitment to moving legislation that would reduce the regulatory burden of community banks. I believe the tremendous weight of over-regulation is crushing the banking system and is rapidly driving the consolidation of our industry. Most regulations probably had a well thought out purpose when they were originated, but it has been said that no single raindrop feels it is responsible for the resulting flood. Community banks in particular are awash in regulatory burden and we need substantial relief before we are washed away with the flood waters of regulation.

On behalf of my community bank and the nearly 5,000 members of the Independent Community Bankers of America that I represent today, I ask you to remember this as you consider legislation and regulatory relief for our industry. Thank you.

Senator CRAPO. Thank you very much, Ms. Jorde.

Now, we are going to have about 15 minutes or so because I have to run to something else and close this meeting, so we only have about 15 minutes for questions and answers, and again, I apologize for that, but I want to also say to this panel that the quality of the testimony, the written testimony that has been provided, is outstanding. The points that you all have made in your oral presentations are very well supplemented by it. We will utilize that very well.

I just want to start going into some questions. You do not all have to feel obligated to answer every question, but if you have a point of view on the issue, please feel free to jump in. Because we are limited in time and have so many people, I would appreciate if you could be as succinct as possible so we can get as far as we can into the questions.

The first one I have goes back to something that I brought up in the first panel. In that first panel, Federal Reserve Governor Kohn recommended that we have a rulemaking to determine the appropriate HMDA exemption threshold. I was just curious as to what members of this panel who have an interest in that issue feel about that suggestion. Does anybody want to jump in on that?

Mr. PLUNKETT. I would like to.

Senator CRAPO. Sure. Mr. Plunkett.

Mr. PLUNKETT. Mr. Chairman, consumer and community groups have opposed expanding the exception and here is why. Merely going from approximately $34 million to $250 million may sound like an insignificant exception, but it would cover approximately 25 percent of all depository institutions and 25 percent of institutions that file under HMDA currently. In some States, it would cover even more: Over 70 percent in Alabama, Iowa, Kentucky, Louisiana, and West Virginia. It would significant complicate ongoing regulatory oversight to ensure that fair and nondiscriminatory lending occurs under statutes like the Community Reinvestment Act, the Equal Opportunity Credit Act, and the Fair Housing Act. That is our concern.

Senator CRAPO. All right. Thank you.

Ms. Jorde.

Ms. JORDE. Mr. Chairman, I know those numbers sound big, but when you consider moving the limit to $250 million, that would only cover 6.7 percent of the industry's assets, and so it is really a very small percentage of the banking industry. My bank is not subject to HMDA because we are in a rural area. However, we are very much subject to Fair Lending exams and we go through a rigorous process every time we are examined for Fair Lending. So increasing the exemptions to HMDA will not necessarily take away concerns about Fair Lending.

Mr. MIERZWINSKI. Mr. Chairman, we do not have a specific position on this issue, but I must admit I was struck by the Governor's comment regarding the proposed rulemaking and the idea that perhaps there were other measures that one could look at. I guess just as an individual banker, I was struck by the idea that numbers do tell you a story, and perhaps subjecting institutions that are not making that many mortgage loans from some level of scrutiny would be appropriate.

Senator CRAPO. Any others who want to weigh in on that issue?

Another issue I want to get to very quickly is also one that I raised with the first panel and that is the question about currency transaction reports. It is one of the items on our proposal, or on our matrix, and the seasoned customer currency transaction report exemption proposal. I do not think I need to explain that. I think everybody here probably knows what I mean by that. But I would be interested in the positions of those on the panel on that issue.

Mr. Rock.

Mr. ROCK. Mr. Chairman, in response to the question that you asked Director Reich, you asked him, why don't banks use the existing exemption process more.

Senator CRAPO. Right.

Mr. ROCK. Really, two reasons. First of all, it is more costly, time consuming, and difficult to get the exemption than it is to file the reports, and you heard that the reports themselves took, by a conservative estimate by FinCEN, 5.5 million staff hours of time during 2005. And it is more difficult to get the exemptions, so that is the first reason. More costly, more time consuming.

The second reason is that banks that have sought exemptions have sometimes encountered field examiners who criticize them for seeking exemptions with the notion that those banks that seek exemptions are not willing to do their share in identifying money launderers and terrorists, and no banker really wants to have himself in that position of being criticized, because in fact, bankers want to do their fair share. They just want to spend their time and money and effort in the way that is most productive for identifying the real crooks.

Senator CRAPO. Thank you very much.

Mr. Bartlett.

Mr. BARTLETT. Mr. Chairman, this is one of the major points we made in our testimony. Here is an area that just cries out for Senate action and for Congressional action because it is a real problem for law enforcement. It is a real problem for legitimate customers who are having their accounts closed because of the proliferation of both CTR's and its companion SAR's, and it is a problem that is created by the current statutory framework.

So our proposal is to create an automatic seasoned customer exemption. If the bank designates it and they last a year and they are a seasoned customer, they should be treated like a seasoned customer. Without that, law enforcement continues to be hampered, customers will have their accounts closed, and the costs skyrocket.

The number that we found on the whole CTR and SAR's, by the way, is we believe it costs the industry a total of about $7 billion a year to comply with anti-money laundering, and that is money that is not adding to law enforcement. We think, in fact, it is hampering law enforcement. So make it automatic after a year and then you will start to see seasoned customer exemption used a lot more.

Senator CRAPO. I think the Banking Committee is going to be hearing from law enforcement to get their point of view on this issue, but it does sound like there is potentially some room there for us to help make an improvement.

Does anybody else want to take a stand on this?

Mr. MCCLELLAN. We are on a much smaller scale as a credit union there, but I would echo and support what everybody else has said here. Just on a small scale, we spend a lot of time and effort sending reports back and forth, making sure we get them right before we actually submit those, and it is very time consuming and, as a result, very costly.

Senator CRAPO. All right. Thank you very much.

Another one I wanted to get into is the exam cycle issue, and I know Mr. Mierzwinski, Mr. Plunkett, and Ms. Saunders, I know that you and your organizations are opposed to increasing, if I understand it, increasing the small institution exemption. But others have testified, and I cannot remember if it was this hearing or not, but others have made the argument that that proposed exemption will not actually have an impact on safety and soundness. Are you aware of that counter-argument that has been made to your position, any of you? I just wanted you to discuss that issue with me. One of you might be more briefed in it. Mr. Plunkett, it looks like they are going to give you the ball there.

Mr. PLUNKETT. Yes. Well, Senator, I mean, as you know, there are a number of proposals on the matrix. One would allow banking agencies to forego or delay banking examinations that are currently required for banks with less than $1 million in assets. The concern there is that this will significantly weaken the effectiveness of the Community Reinvestment Act for communities in need of loans and investment.

Senator CRAPO. Now, that is the point I wanted to get at, and I cannot remember where I have seen this argument specifically, but my understanding is that the regulators contend that that proposal would not have an impact on the CRA. Others can jump in.

Mr. ROCK. The proposal was only for safety and soundness exams. It would not change the cycle for compliance exams. It would not change the cycle on compliance exams in CRA, on compliance issues. It is only on the safety and soundness portion of the exam.

Senator CRAPO. So the compliance exam schedule would remain the same?

Mr. ROCK. Yes.

Mr. PLUNKETT. Our concern would mainly be with an effect on the CRA compliance exams.

Senator CRAPO. Okay. So then if we made that distinction and the change was only on the safety and soundness exams, then your concern would be alleviated?

Mr. PLUNKETT. Yes, Mr. Chairman, if we are talking about the CSBS proposal, yes.

Senator CRAPO. Okay. One other comment that I would like to make to everybody on the panel is we have mentioned a dozen times here today that we have got a matrix with 187 proposals, and there are other proposals out there that could work their way into it or that have already been pushed off the matrix. As I would describe it, there are some proposals that it is really clear everybody agrees with. They have been described as the low-hanging fruit. There are some which are extremely controversial, and there are some that we are not quite sure whether they are controversial or whether there is a general consensus about them or not because we have not been able to get everybody to weigh in on every aspect of the proposal, and I am including everybody. It has been like pulling teeth with the regulators and the regulated and the consumer interest groups and others just to find out what everybody's position is on everything.

And the point is that there may be, out of the 187 proposals, there may be a whole bunch that you are just not focused on, any particular group or industry. As we move forward, we are trying to identify that level of support or opposition that is there for different proposals, and like I say, on the main ones, we know. It is really clear.

But I would just encourage you—and you do not have to do it in this hearing—I would encourage you to let us know, and by the way, your testimony, all of your testimony has done a good job of a lot of this, but just to let us know of the areas where you feel there is high concern about a particular proposal or strong support, because we are going to be going through and making the final determinations as to what is going to be included in the bill, and I am not saying that controversial items will be kicked out necessarily, because we will look at them and make a determination as to whether they should be included or not. But we need to know if there is controversy and we need to know what the controversy is.

So, I would just encourage you all, to the extent you have not already done it in your very well-prepared testimony and in your other communications with our offices, to let us know, particularly if there is something that you would strongly oppose being in the bill, if you have not already let us know that.

With that, like I said to the other panel, there are lots of questions and areas that I could go into, but we are down to about five or six minutes left. I think what I am going to do is what Senator Carper and I did toward the end of the last panel, and I may get myself in trouble here because I am going to have to shut us all off in about six minutes, but is there a point that any of you on a particular item have not been able to make yet that you really would like to be sure you get a chance to say? It is your chance to say something.

Mr. Bartlett, very succinctly, please.

Mr. BARTLETT. Mr. Chairman, I have one particular item that I have emphasized and that is the federally regulated—we have a problem with SAR's, with almost—we believe there will be a million SAR's filed this year, up from 76,000 less than 10 years ago—a million—and that is a problem. It is a huge problem for the economy.

We think that part of the solution is take the guidance that the regulatory agencies have already issued, they have issued guidance, and make it into statute. It is informal guidance that our members cannot rely on because of a well-founded fear of prosecution. So if it is made into statute, then we can rely on it.

Now, as you do that, we will have some comments about ways to adjust the guidance and such, but I have to tell you that as long as it is guidance, they may as well not have it at all.

Senator CRAPO. Point well taken.

Mr. Plunkett.

Mr. PLUNKETT. Senator, you asked earlier about SEC Regulation B and proposals to exempt banks there.

Senator CRAPO. Yes.

Mr. PLUNKETT. I would just like to talk about that briefly from the consumer point of view. It is one thing to exempt what I would call traditional banking products. They are fully insured. It is another thing to exempt those products and the sales practices used to sell those products, products such as jumbo CD's that banks are offering that are increasingly looking like traditional securities products.

The golden rule here should be that it should not matter which agency enforces. If the product has certain characteristics and those characteristics resemble a securities product more than a traditional banking product, then it should be regulated in the same manner, no matter who sells it. That means that the sales of the product, as the SEC contemplates in Regulation B, should be regulated in the same manner. Otherwise, we would provide an incentive to some banks to offer riskier products because they can get around regulation of similar products on the security side.

Senator CRAPO. Thank you. Ms. Jorde, were you trying to get in here?

Ms. JORDE. I have a general comment on the matrixes. When I first read through all of them, I do not think it was until I got to about 101 where I really found something that would make a difference in my life in my community bank at home. As you read through the 187 amendments in there, several of them are technical in nature, and I know that the OCC's office put forward a number of those and other regulatory agencies and things that probably needed to be changed over the years because the world has changed since the last time we have taken a look at that. I know that I served on our State banking board for a number of years, and every other year when our legislature met, we would put forward some amendments that needed to be made, and I think a number of these things are just items that need to be changed.

There are also a number of them that the credit union groups referred to them as regulatory reform, and then there are probably a couple dozen of them that I look at as true regulatory burden relief. I would encourage you, as you go through and look at these, that you focus on the items that will really bring regulatory relief to the banking industry and to the community banking industry in particular because they do carry disproportionate burdens for that.

Really, matrixes 101 to 120 are really the ones that, in my bank, would make a difference and might be the difference on whether my bank survives in the future.

Senator CRAPO. All right. That is very helpful to note.

Ms. Saunders.

Ms. SAUNDERS. Senator Crapo, I would ask that you first do no harm and remind you all that until the early 1980's, the practice of lending was a highly regulated industry. It is now not very regulated. All we have to protect consumers are disclosures. I agree with what Julie Williams said of the OCC, that those disclosures are often not as clear as they could be and there are far too many consumers to actually be as helpful as they should be. Nevertheless, it is all the consumers have. We would, if we had our preference, would much prefer substantive regulation. But before you remove disclosures, please recognize that there must be something.

Senator CRAPO. Well taken.

Yes, Mr. McGee.

Mr. MCGEE. Senator, I would just like again to thank you for your efforts and indicate to you, since you asked, that credit unions are not opposed to any of the relief measures that are in the matrix for any financial institutions, but I think that there are some reform issues there that we feel provide regulatory relief that would help us better serve our members. If there were one particular that we would have an interest in, it would probably be the prompt corrective action reporting that is mentioned in my testimony.

Senator CRAPO. All right. Thank you.

Mr. MEYER. Mr. Chairman.

Senator CRAPO. Mr. Meyer.

Mr. MEYER. I think if you asked everybody at this table, do they think community banks are important to the communities they serve, they would all agree that they are. I do not think we can continue with the world as it is today, so I want to underscore what I think is the importance of your efforts and the hearings.

In my statistics which I presented, I noted that over the last 15 years, the assets held by the 10 largest banks in this country have gone from 25 percent of assets to 53 percent. Part of the reason behind that is the regulatory burden that small community banks, which people have commented about today, can no longer keep up with it. Unless something is done, we are going to continue to watch that slow erosion, the slow loss of community banks, and I happen to strongly believe communities do need community banks.

Senator CRAPO. All right. Thank you very much. I do not see anybody else jumping in, but—Mr. Bartlett.

Mr. BARTLETT. Mr. Chairman, 30 seconds for a second one. I just want to remind the Committee that interstate branching is a big deal for the American consumer. I understand that in and of itself, it is not controversial. It is controversial only as it relates to other things. I believe that the Committee can resolve the other things, but interstate branching is a big deal. It is long overdue and it is simply nonsense that we would continue to have this prohibition against companies opening stores where their customers want to do business.

Senator CRAPO. I appreciate that input, and I hope you are right, that we can resolve its relationship to other things, but I think we can, too.

Let me again thank you all for your patience and your understanding, and most importantly, for your outstanding testimony, both what you have said here today as well as what you have provided in writing, and to encourage you to continue to feel very free to give us your input. I cannot tell you exactly when we will have a mark-up, but I believe it will be soon and the bill will be coming out shortly before that. We want to be able to move forward as expeditiously as possible and take advantage of the window of opportunity that we have here. So the time is now and you are all doing this well and I encourage you to keep doing it. Again, I appreciate your patience and long suffering today.

This hearing is adjourned.

[Whereupon, at 2:04 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR MIKE CRAPO

An effective regulatory system appropriately balances the costs and benefits of public laws and regulations. All of us want to protect consumers and ensure the system's safety and soundness; however, excessive regulation increases the costs of producing financial products, stifles productivity and innovation, and misallocates resources. Responding to the steady stream of new regulations while complying with exiting ones has become a challenge for all financial institutions. Rule changes, particularly for smaller institutions with limited staff, can be costly, and these changes are inevitably passed on to consumers. It is also important for us to understand that the resources that are expended working to meet government compliance and paperwork requirements are time and effort that are not available to serve customers and communities.

In Idaho, one of the specific issues that I have been told that results in high costs for community banks and credit unions with little benefit to consumers is the mailing of annual privacy notices when the institution does not share information with third parties or make changes to its privacy policies. One community banker in Idaho told me his community bank spends an estimated $15,000 per year mailing approximately 50,000 privacy notices. In 2004, his bank received one customer call in response to his bank's privacy notice mailing and received no customer responses in 2005. Another community banker in Idaho said that customers do not read the annual privacy notices; most end up in the garbage. This is one of the most obvious provisions in need of reform.

Compliance costs for the financial services industry cost billions of dollars each year. For smaller institutions, $1 out of every $4 in operating expenses goes to pay for the costs of government regulation. While much of this is necessary to assure the safety and soundness of our financial system, it is obvious that there are any unnecessary and outdated provisions that should be eliminated to reduce the costly burdens imposed on financial institutions. If this burden were reduced by even 10 to 20 percent and those funds were made available billions additional lending that would have a direct and positive impact on economic growth and consumers. The bottom line is that too much time and money is spent on outdated and unnecessary compliance and paperwork, leaving less time and resources for actually providing financial services. The House Financial Services Committee recognized this problem and in December 2005, passed its own regulatory relief legislation by a vote of 67 to 0.

In 2004, the Banking Committee held a hearing on proposals regarding regulatory relief for banks, thrifts, and credit unions. The hearing covered all points of view and was made up of three panels of witnesses: Members of Congress, regulators, and trade associations and consumer groups. Office of Thrift Supervision Director John Reich, as the leader of the interagency Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) task force, was asked to review the testimony presented at the hearing and prepare a matrix which listed all the recommendations and positions presented to the Committee. The result brought forward 136 burden reduction proposals. By the second hearing held in June 2005, the list of proposals had grown to 187 items, many of which are in the House-passed bill, H.R. 3505. This was a huge undertaking and I appreciative the hard work and cooperation of so many involved, especially OTS Director Reich for his perseverance in leading this effort.

To ensure transparency in the process, the matrix of 187 items was circulated among the regulators, trade associations, and consumer groups, and all the various viewpoints have been recorded. We have heard witness testimony in two previous hearings, and numerous meetings have also been held with all interested parties throughout this process. Witnesses have thoroughly detailed the ever-increasing number of requirements and outdated restrictions placed on our financial institutions. Each requirement, restriction, report, and examination imposed may individually have been justified when adopted, but as time passes and markets and consumer demand changes, the necessity for imposing some of these requirements and restrictions becomes outdated or subsides. I think that all of us want to try and turn this around, and I know that the witnesses that we are going to hear from today will help us identify where we can trim the regulatory fat without adversely impacting regulatory oversight.

I look forward to working with my colleagues as we quickly proceed to a markup, and I would encourage them to identify which proposals they support or oppose. Some Members have expressed interest in proposals that have both defenders and detractors here today, which I intend to explore with our witnesses.

PREPARED STATEMENT OF SENATOR MICHAEL B. ENZI

Thank you, Mr. Chairman. I would also like to thank Senator Crapo for his hard work on this issue. Providing regulatory relief for our Nation's financial institutions, and the agencies who regulate them, is an important but difficult task. There are many stakeholders and interests to balance. At last count, the list of proposals was reaching 200. I am sure by the end of this process we will have even more. I look forward to reviewing this comprehensive legislative package once it has been introduced.

The reason our Committee is pursuing a regulatory relief proposal is to reduce the paperwork and administrative burden placed on our financial institutions. And we must also ensure that they are operating in a safe and sound manner, with their customers' best interests in mind. However, these terms can have different meanings, depending on the bank, the customer, and the context.

A standard disclosure process used by a large national bank is sometimes not appropriate for a small community bank, but they are forced into a one-size-fits-all approach. There are thousands of examples of this all over the country, including my home State of Wyoming.

Wyoming, like many rural States, has a strong system of community banks and credit unions. These institutions are often an anchor to our towns. They are community centers where Wyoming residents can deposit checks, get a small business loan, or set up a savings account to save for a child's college tuition. And usually, the person sitting across the desk is a friend or neighbor. In Wyoming, banking is done on a personal level, and that is a great way to do business. So when we examine the regulatory burden these banks manage, we need to look at it in a different context.

A large amount of money and resources are spent by banks filing transaction reports and disclosures required by their regulator. This includes currency transaction reports, suspicious activity reports, call reports, and many others. Often they can assist in investigations and prosecutions that put dangerous felons, even terrorists, behind bars.

However, some of these reports contain very little information, but are filed for the sake of compliance. Unnecessary reporting is a drain for law enforcement and financial institutions alike. Banks spend important resources filing these reports, and law enforcement agencies spend more time trying to sort the good information from the bad. This is a classic symptom of the one-size-fits-all approach. And it hits our small banks the hardest. Community banks often cite the time and cost of filing these reports as their largest regulatory expense.

We need to take a more commonsense approach to these processes. We need an approach that allows discretion if the customer is a long-term account holder, or if this particular activity is an everyday transaction for a customer with special needs. This would allow agencies to spend more time focusing on catching the criminals. It would also give banks more time and money to dedicate to their customers.

I have been working on another important issue for an industry familiar to me—accounting. When this Committee considered the bill that became the Gramm-Leach-Bliley Act of 1999, we knew it would drastically change the way our financial industry operated. For example, Title V of the Act enumerated the obligation of financial institutions to protect their customers' private information, something that had never been done on such a large scale before.

But for those in the accounting industry, this was old news. Certified Public Accountants are bound by privacy laws older and stricter than Gramm-Leach-Bliley. However, with the passage of Gramm-Leach-Bliley, CPA's were required to disclose privacy notices like everyone else.

State-licensed CPA's in all States are prohibited from disclosing personal information unless specifically allowed by the customer. Under Gramm-Leach-Bliley, institutions can share information unless prohibited by a customer. There is a significant difference here, and one that makes annual privacy disclosures for CPA's unnecessary.

I have been working closely with Congressman Mark Kennedy from Minnesota on an exemption of this annual disclosure for State-licensed CPA's who follow stricter privacy laws. While the cost of this annual disclosure can be annoying for larger firms, it can be deadly for small firms or sole proprietors. An exemption could save these firms valuable resources.

I look forward to working with my Banking Committee colleagues on this issue and other meaningful reforms for our Nation's small financial institutions.

Thank you Mr. Chairman.

PREPARED STATEMENT OF SENATOR CHUCK HAGEL

Mr. Chairman, I want to thank you for holding today's hearing. I also want to thank Senator Crapo for his leadership in addressing regulatory reform. Since being elected to the Senate, I have advocated and introduced legislation to repeal the ban on banks paying interest on business checking accounts. While this prohibition applies to all banks and businesses, it targets and discriminates against small banks and small businesses. That is why I, along with Senators Snowe and Reed, introduced the Interest On Business Checking Act (S. 1586) last year.

Big banks can currently circumvent the prohibition and offer alternative accounts, called sweep accounts. These sweep accounts allow big banks to effectively provide their customers with interest-bearing checking accounts. These types of accounts are generally too expensive for both small banks and small businesses. While I support business innovation, I do not believe it is fair when any business gains a competitive edge over another due to government interference through over-regulation.

Passage of this bill will remove one of the last vestiges of an obsolete interest rate control system and provide America's small business owners, farmers, and farm cooperatives with a funds management tool that is long overdue. It will ensure America's entrepreneurs can compete effectively with larger businesses. My experience as a businessman has shown me that it is extremely important for anyone trying to maximize profits to be able to invest funds wisely for maximum efficiencies.

Repealing this ban has passed the Senate Banking Committee in previous Congresses. Unfortunately, there has been some disagreement as to how to address this legislation with respect to Industrial Loan Companies or ILC's. Mr. Chairman, the bill which I introduced last year, leaves the decision to be determined by the banking regulators.

This is a straightforward bill that will do away with an unnecessary regulation that burdens American business. It is an important tool to strengthen the Nation's engine of job growth—the small businesses that are important customers for small banks. I urge the Committee to include this proposal in its legislative efforts of regulatory relief. Thank you.

PREPARED STATEMENT OF SENATOR MEL MARTINEZ

Good morning. Thank you, Chairman Shelby for holding this hearing. I also want to commend Senator Crapo and his staff for their excellent and thorough work throughout this regulatory relief legislative process. You have shown strong leadership and command of these issues and I know the Florida Bankers appreciate your efforts—as do I.

I will keep my comments brief since we have fully vetted these issues several times before this Committee, but I want to express for the record how important the provisions related to the Bank Secrecy Act are to the bankers in my State. When the BSA was passed in 1970, terrorism was something very different than it is today. It is crucial to aggressively prevent and investigate terrorist financing and Congress' intention to track terrorists' money trails by requiring financial institutions to submit Currency Transactions Reports and Suspicious Activity Reports was well-intended. However, we may not be obtaining the information Congress originally sought through CTR's—or with the frequency and duplicity that they are filed.

We have heard from previous witnesses in this Committee that CTR's can be a very useful tool to identify and locate criminals and terrorists, but that many of the CTR's filed by financial institutions are of little relevance in investigating financial crime. Because of this and the fact that compliance with the BSA tends to be the most expensive regulatory burden on community banks, I believe changes are needed.

Legislative changes including increasing the threshold for filing a CTR and adjusting it for inflation, allowing banks filing fewer than 50 CTR's a month to file quarterly, and allowing banks to exempt "seasoned customers" would all make a tremendous difference in the daily operations of Florida bankers—and I believe would not take away from our constant effort to deter and intercept terrorist activities.

From the time I hit the campaign trail to the meeting I had with Florida bankers last month, the examples of the burdens of the BSA are alarming. One example that stands out is from Eagle National Bank in Miami which has been around since 1957 and currently holds around $300 million in assets. It files approximately 30 CTR's each month, the majority of which are for its largest cash customer—the Salvation Army. Because the Salvation Army operates on a cash basis, Eagle National Bank provides the necessary banking services it needs to run its Miami locations. The Salvation Army has been one of Eagle National's customers for years, but they still have to file a CTR each time it conducts $10,000 worth of banking transactions on any given day.

There is no doubt that Florida bankers are doing their part to alert law enforcement and regulators of suspicious banking activity that occurs in their banks. If we can help them by relieving some of the excessive regulatory burdens that we are finding are not producing the results Congress was seeking, this is our opportunity and it is our responsibility to do so. Again, I want to thank Senator Crapo for his dedication to this effort and I look forward to hearing from our witnesses.

PREPARED STATEMENT OF SENATOR RICHARD C. SHELBY

The Committee meets today on the "Consideration of Regulatory Reform Proposals." We will be hearing from a number of witnesses including regulators, industry, and consumer groups on regulatory relief proposals for banks, thrifts, and credit unions. Over the past 2 years, we have received input from all the stakeholders and have compiled a matrix of suggestions for regulatory reform.

The financial marketplace is ever evolving because of shifts in consumer demand and changes in technology. These changes occur quickly and can often lead a once useful regulation to become obsolete and overly burdensome.

This Committee is always mindful of the tensions that sometimes exist between the desire to deliver an effective product, ensure safety and soundness, and protect the American consumer. Accordingly, this Committee has attempted to create a transparent and exhaustive process in order to ensure that these concerns are not overlooked. Indeed, a key part of this process was instituted in 1996 when Congress enacted the EGRPRA Act, which directed the agencies to work together to eliminate outdated, unnecessary, and unduly burdensome regulations.

The purpose of this hearing is in furtherance of this process, but our focus lies in addressing any areas where legislative change is required.

Before we begin, I would like particularly to thank Senator Crapo and his staff for their efforts and patience in creating a fair and transparent process to review these proposals.

I would like to welcome all of our witnesses this morning, and I look forward to hearing from each of you.

PREPARED STATEMENT OF SENATOR DEBBIE STABENOW

Mr. Chairman, thank you for scheduling this hearing, it certainly is timely. In the last few months, I have heard from a number of organizations in my State about regulatory relief. The message is always the same—they need our help to ensure that their time and money is spent on what they do best, running their businesses.

Just this morning, I spent some time with CPA's in my State of Michigan. Their most pressing issue over the last few years has been the burdensome regulations that have hindered their ability to focus on their business.

As an example, CPA's have their own strict policies through State licensing and regulations. The State regulations for CPA's are stronger and the penalties are more severe than what is required under the Federal GLB laws. Yet, they are required to abide by GLB regulations even though this does not add any more protection for consumers. In fact, the duplicative requirements weaken both regulations and penalties for CPA's. It just does not make sense.

It is these types of issues that we need to address. We need to make sure that the regulations do what they were intended to do—protect consumers, provide intelligence, and ensure the integrity of financial transactions. Ultimately, we need to make sure that regulations pass the common sense test.

I believe we can accomplish this by working with the panelists today and their organizations in the future to adopt a regulatory structure that is sound and successful in protecting consumers and bringing relief to banks, credit unions, and all other financial institutions who have faced increasing costs of regulation.

I look forward to hearing more about seasoned customers. Specifically, I am very interested in hearing about improvements to our disclosure requirements that allow for better intelligence and consumer protection as well as mitigate any unnecessary information that distorts our ability to analyze transactions.

Thank you again for being here today and working with us to improve current regulations for all stakeholders.

Testimony on Regulatory Burden Relief by

John M. Reich, Director

Office of Thrift Supervision

before the

Senate Committee on Banking, Housing and Urban Affairs

March 1, 2006

I. Introduction

Good morning, Mr. Chairman, Ranking Member Sarbanes, and members of the Committee. Thank you for the opportunity to address the issue of regulatory burden relief.

Mr. Chairman, I wish to commend you, Ranking Senator Sarbanes and the other distinguished Members of this Committee for your efforts to develop legislation to remove unnecessary regulatory burden from the banking industry. I especially want to recognize the tremendous efforts of Senator Crapo and his staff, who have taken the lead in crafting this important legislation.

Since most of our regulations are mandated by statute, I believe it is critical that the agencies work hard not only on the regulatory front, but also on the legislative front, to alert Congress to unnecessary regulatory burden. In fact, the

Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), which I will discuss today, requires us to identify and address unnecessary regulatory burdens that require legislative action.

Removing unnecessary regulatory obstacles that prevent institutions from efficiently and effectively serving their customers, stifle innovation, distort competition in our financial services industry, and impede job creation and economic growth in the general economy, is an important personal goal of mine and a continuing objective of the Office of Thrift Supervision (OTS).

Although we have accomplished much in recent years to streamline and eliminate some of the burdens faced by depository institutions, there remain many other areas for improvement. We are fully committed to work with you, Mr. Chairman, Senator Crapo, Senator Sarbanes, and the Members of the Committee to address these issues.

In my statement, I will discuss the ongoing interagency regulatory burden relief process, pursuant to EGRPRA, which I have led since 2003. I will also highlight the most pressing industry needs for regulatory relief, and provide you with an overview of various legislative proposals important to the banking industry. Finally, I will conclude my remarks with a discussion of the legislative priorities of OTS. The most important of these include the following:

- Removing the duplicative oversight and disparate treatment of savings associations under the federal securities laws by providing the same exemptions available to banks with respect to investment adviser and broker-dealer activities that each conducts on otherwise equal terms and under substantially similar authority.
- Updating commercial lending limits for federal savings associations to enhance their ability to diversify and to provide small and medium-sized businesses greater choice and flexibility in meeting their credit needs.
- Eliminating the existing arbitrary limits on thrift consumer lending activities.
- Clarifying the citizenship status of federal savings associations for federal court diversity jurisdiction.
- Establishing statutory succession authority within the Home Owners' Loan Act (HOLA) for the position of the OTS Director.

I will explain each of these items in more detail at the end of my testimony, and describe several other initiatives that we are recommending for enactment. First, I will summarize our efforts under the EGRPRA Program.

A. The EGRPRA Program

EGRPRA, enacted in 1996, requires the Federal Financial Institutions Examination Council (FFIEC) and each of its member agencies to review their regulations at least once every ten years, in an effort to eliminate any regulatory requirements that are outdated, unnecessary or unduly burdensome. For the past three years, I have been leading the interagency effort and I am pleased to report that we are making progress.

Pursuant to EGRPRA, the agencies are required to categorize their regulations by type (such as "safety and soundness" or "consumer protection" rules) and then publish each category for public comment. The interagency task force divided the agencies' regulations (131 rules in all) into 12 categories and agreed to publish one or more categories for public comment every six months, with 90-day comment periods, for the remainder of the review period (which ends in September, 2006).

The agencies have already jointly published six separate requests for comment in the Federal Register. Those six requests for comments have covered more than 120 regulations. In response to these requests, the agencies received more than 1000 comment letters containing hundreds of recommendations for change from bankers, consumer and community groups, trade associations and other interested parties. Each of the recommendations is being carefully reviewed and analyzed by the agency staffs. Based on these reviews, the appropriate agency or agencies is expected to bring forward, and request public comment on, proposals to change specific regulations.

Industry, consumer and public insight into these issues is critical to the success of our effort. The regulatory agencies have tried to make it as easy as possible for all interested parties to be informed about the EGRPRA project and to let us know what are the most critical regulatory burden issues. The EGRPRA website, which can be found at www.egrpra.gov, provides an overview of the EGRPRA review process, a description of the agencies' action plan, information about our banker and consumer outreach sessions and a summary of the top regulatory burden issues cited by bankers and consumer groups.

The EGRPRA website also provides direct links to the text of each regulation and comments can be sent to the website. Comments submitted through the website are automatically transmitted to all of the financial institution regulatory agencies. Comments are then posted on the website for everyone to review. The website has proven to be a popular source for information about the project, with thousands of hits being reported every month.

While written comments are important to the agencies' efforts to reduce regulatory burden, it is also important to have face-to-face meetings with bankers and consumer group representatives so they have an opportunity to directly communicate their views on the issues. Over the past three years, the agencies sponsored a total of ten banker outreach meetings in different cities around the country to heighten industry awareness of the EGRPRA project. The meetings provided an opportunity for the agencies to listen to bankers' regulatory burden concerns, explore comments and suggestions, and identify possible solutions. Banker outreach meetings were held in Orlando, St. Louis, Denver, San Francisco, New York, Nashville, Seattle, Chicago, Phoenix and New Orleans. More than 500 bankers (mostly CEOs) and representatives from the national and state trade associations participated in these meetings along with representatives from OTS, the Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), the Conference of State Banking Supervisors (CSBS), and the state regulatory agencies. The banker outreach meetings have been extremely useful and productive in identifying regulatory burden concerns. Summaries of the issues raised during the meetings are posted on the EGRPRA website.

We also held three outreach meetings for consumer and community groups. The first meeting was on February 20, 2004, in Arlington, Virginia, the second on

June 24, 2004 in San Francisco and the third on September 23, 2004 in Chicago. Representatives from a number of consumer and community groups participated in the meetings along with representatives from the FDIC, FRB, OCC, OTS, CSBS, and the National Credit Union Administration (NCUA). The meetings provided a useful perspective on the effectiveness of many existing regulations.

At the June 9, 2005 regulatory burden hearing before this Committee, Senator Sarbanes, among others, expressed concern that the banking agencies had not obtained sufficient input from consumer and community groups in connection with the EGRPRA process. The Senator also suggested that we hold several joint meetings with bankers and consumer/community groups. We followed this suggestion and found the opportunity to meet with a number of community and national consumer leaders enormously helpful.

In response to these suggestions, the agencies hosted a meeting on July 20, 2005, in Washington, D.C., with representatives of various national consumer and community organizations to solicit their views on the proposals to reduce regulatory burden. The agencies also sponsored three joint banker and consumer/community group focus group meetings on August 25, 2005 in Washington, D.C., on September 1, 2005 in Los Angeles, and on September 8, 2005 in Kansas City. We subsequently received a document outlining the views of the consumer and community organizations on the items on the EGRPRA Legislative Matrix.

As a result of these efforts, a growing number of legislative items and issues have gained support. It is my sincere hope that all of this effort has not been wasted. I urge you carefully to consider all of the suggestions that you hear today, as well as the various items and proposals set forth by each of the agencies in our written statements.

B. Most Pressing Industry Needs

Before discussing some of the industry's legislative proposals, it is important to note that there are two areas not detailed in this statement that many of our institutions have identified as unduly burdensome—the Bank Secrecy Act (BSA) requirements and the rules under the Sarbanes Oxley (SOX) Act.

Virtually all institutions raise these two issues as regulatory relief priorities; however, the impact of these statutory provisions is often most acute for smaller, community-based institutions that do not have the resources and wherewithal to implement the type of cost-effective, global programs required to address the monitoring of activities under these laws. While these laws are also problematic for larger institutions, smaller institutions are significantly more burdened, by virtue of their size, to develop and implement cost-effective solutions to address

BSA and SOX requirements. This, in turn, imposes greater competitive stresses on smaller institutions relative to their larger competitors.

An item of particular significance is a provision in H.R. 3505, the regulatory relief bill passed by the House last October, to except from filing certain currency transaction reports (CTRs) of so-called "seasoned customers." Eligible customers would include corporations and organizations that have maintained a depository account at an institution for at least 12 months, and have engaged through that account in activities that have triggered multiple CTR filings. It is our understanding that the Financial Crimes Enforcement Network (FinCEN) supports this amendment.

OTS is fully supportive of efforts to provide meaningful BSA relief to the institutions we regulate consistent with the requirements of the BSA and the needs of law enforcement. We will support any burden reduction proposal to streamline existing BSA requirements, provided it is supported by FinCEN, not opposed by law enforcement, and it provides meaningful relief that outweighs any diminished utility to the BSA.

Similarly, we are also open to working with the other federal banking agencies (FBAs), and the Members of this Committee to identify ways to provide relief to all institutions, but particularly to smaller institutions, under the SOX Act.

II. Industry Legislative Proposals

EGRPRA requires input from the industry and other interested parties. As described above, we have made tremendous efforts to get input through the public notice and comment process as well as through outreach meetings held around the country. As a result, we have received many promising ideas for true regulatory burden reduction.

As you will recall, in June of 2004, I testified, along with 17 other witnesses, before this Committee. At the end of the hearing, Senator Crapo asked me, as the leader of the interagency EGRPRA task force, to review the testimony presented at the hearing and extract the various regulatory burden reduction proposals. The result was a matrix with a total of 136 burden reduction proposals.

Thereafter, I convened a meeting of banking industry representatives from the American Bankers Association, America's Community Bankers, the Independent Community Bankers of America, and the Financial Services Roundtable, who together reviewed the matrix of 136 proposals in an effort to determine which of these proposals they could all support as industry consensus items. This process yielded a list of 78 banking industry consensus items.

Subsequently, each federal banking agency reviewed the 136 items, with particular emphasis on the 78 industry consensus items, and provided comment. Review of the agencies positions show that 59 items are supported by at least two agencies, and that 21 items are opposed by at least one agency. This means that there are 115 of 136 items that the agencies either support or do not oppose.

After hearing what the industry viewed as outdated or unnecessary regulatory burdens and numerous interagency discussions analyzing the merits of the industry requests, we next turned to the consumer/community groups for their input. As previously described, the agencies first met with these groups to solicit their input on the matrix items, and then inter-agency meetings were held jointly with the consumer/community groups and bankers in Washington, D.C., Los Angeles and Kansas City. The meetings helped to develop greater consensus and understanding among the parties on the legislative proposals to reduce regulatory burden, and provided an opportunity to work through the matrix to hear the insights and concerns of all parties. The meetings were very thoughtful and interactive and we value the perspective that the consumer and community leaders provided on these issues.

Recently, the agencies and various industry groups identified 50 more items that they believe should be under consideration in any regulatory relief legislation.

The industry and the consumer groups have also provided comment on these items, and I believe that the agencies are nearing final review of these items as well.

For your convenience, we have grouped the 186 matrix items into the following categories of significant regulatory relief priorities promoted by the industry that meet the objectives of the EGRPRA project. These priorities are grouped as follows:

- Bank Secrecy Act amendments (Matrix items 106, 176 and 180)
- Privacy Notices (Matrix items 63, 108, 134, 174 and 177)
- Small Institution Examination Flexibility (Matrix items 42, 68, 112 and 169)
- Interest on Business Checking Accounts (Matrix item 3)
- Federal Court Diversity Jurisdiction (Matrix items 28, 58 and 184)
- Cross Marketing Provision (Matrix items 139, 171 and 187)
- Anti-Tying amendment (Matrix items 136 and 185)
- Streamline Call Reports (Matrix item 109)
- Parity for Savings Associations under the Securities Acts (Matrix item 52)

- Removal of Limitations of Consumer Loans and Small Business Loans (Matrix items 82 and 53)
- Streamline Depository Institution Merger Applications (Matrix items 5, 6, 61 and 69)
- Increase Limits for Thrifts on Commercial Real Estate Loans (Matrix item 87)
- Insider Lending/Regulation O (Matrix items 4, 93 and 111)
- Eliminate Prior Written Consent to Establish Branches by Well-Managed, Well-Capitalized, Highly-Rated Institutions (Matrix items 62 and 118)

Based on the feedback that I have received from the many people who have participated in the EGRPRA process, including various meetings with lawmakers, industry participants, and community leaders, I believe that there is real momentum behind the effort to reduce regulatory burden in our country, and particularly in industries, such as financial services, that directly impact American consumers. I was gratified to see the House Financial Services Committee address some of these burden issues and pass H.R. 3505, the Financial Services Regulatory Relief Act, with unanimous bipartisan support last year. H.R. 3505 includes a number of significant regulatory relief provisions to reduce regulatory burden.

III. OTS Legislative Priorities

All of OTS's top legislative priorities are included in H.R. 3505, although two of the provisions offer only a partial fix. Section 201 of H.R. 3505 provides relief to savings associations under the federal securities laws. Section 212 of H.R. 3505 updates the commercial and small business lending authority of savings associations. In addition, section 622 establishes statutory succession authority for the position of the OTS Director. Sections 213 of H.R. 3505, however, provides only partial relief to savings associations (for auto loans) with respect to the existing consumer lending limits imposed on thrifts. Similarly, section 208 falls short of a complete fix by providing that a federal savings association is a citizen of both its home state and the state of its principal place of business (rather than just its home state) for purposes of federal court diversity jurisdiction.

A. Eliminating Duplicative Regulatory Burdens for Savings Associations under the Federal Securities Laws

OTS's most important regulatory burden reduction legislative priority is revising the federal securities laws so that savings associations are relieved of a duplicative burden imposed on them with respect to their investment adviser and broker-dealer activities. This is easily accomplished by revising the federal securities laws so that savings associations and banks are treated equally. As described more fully below, this involves exempting savings associations from the investment adviser and broker-dealer registration requirements to the same extent that banks are exempt under the Investment Advisers Act (IAA) and the Securities Exchange Act of 1934 (1934 Act).

Although the Securities and Exchange Commission (SEC) has issued several proposals purportedly to address the duplicative burden imposed on savings associations, the application of the federal securities laws in these two areas remains a needless additional burden with no additional supervisory benefit for savings associations. Significant disparities remain under the IAA, with savings associations subject to an entirely duplicative SEC oversight regime. Equally significant, it remains uncertain how the SEC will ultimately treat savings associations for purposes of the broker-dealer exemption. In the SEC's last iteration on this issue, it indicated that it would roll back an interim rule that had extended equal treatment to savings associations vis-à-vis banks for purposes of the broker-dealer exemption.[1] While these issues remain in flux, there has been nothing to indicate that we are heading in the direction of reducing needless duplicative oversight for savings associations under the federal securities laws.

1. SEC Proposed Rule: Regulation B, Release No. 34-49879, approved by the Commission on June 2, 2004, released to the public on June 17, 2004, and published in the Federal Register on June 30, 2004.

Underscoring the case for eliminating these duplicative requirements is the fact that banks and savings associations provide the same investment adviser, trust and custody, third party brokerage, and other related investment and securities services in the same manner and under equivalent statutory authorities. With respect to the oversight and regulation of these activities, OTS examines investment and securities activities of savings associations the same way as the OCC and the other federal banking agencies examine the same bank activities—with savings association and bank customers equally well-protected.

To avoid the regulatory burden and substantial costs of this duplicative regulatory structure, some OTS-regulated savings associations have converted to banks (or to state chartered trust companies) to take advantage of the bank registration exemption. In addition, some institutions have avoided opting for a thrift charter in the first place because of the SEC registration requirements.

The different purposes of the various banking charters make our financial services industry the most flexible and successful in the world. While OTS strongly supports charter choice, that decision should be based solely on the merits of the charter—by choosing a charter that fits a particular business strategy—not on unrelated and extraneous factors such as SEC registration requirements and avoiding duplicative regulation under the federal securities laws. Institutions should be able to expand and diversify their product lines to meet customer demands within the boundaries of their existing charter authorities and without additional, redundant regulatory burdens, such as those imposed by the IAA and 1934 Act registration requirements.

The existing inequity under the federal securities laws undermines our collective efforts to maintain a strong and competitive banking system. Eliminating the unnecessary costs associated with the IAA and 1934 Act registration requirements—as set forth in section 201 of H.R. 3505—would free up significant resources for savings associations in local communities. It would also avoid the regulatory burden and substantial costs associated with a duplicative regulatory structure that has already dictated some institutions' charter choice—an issue recognized by former SEC Chairman Donaldson in the context of the discussion on the SEC's IAA proposal.[2]

1. Investment Adviser Registration

Prior to enactment of the Gramm-Leach-Bliley Act (GLB Act) in 1999, banks—but not savings associations—enjoyed a blanket exemption under the IAA. While the GLB Act slightly narrowed the bank exemption, banks may still provide investment management and advisory services to all types of accounts without

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2. Comment of former SEC Chairman William Donaldson, at the April 28, 2004, SEC meeting discussing SEC Proposed Rule: Certain Thrift Institutions Deemed Not To Be Investment Advisers, Release Nos. 34-49639 (May 3, 2004).

registering as an investment adviser. The one exception is that a bank (or a department of the bank) must register when it advises a registered investment company, such as a mutual fund.

On May 3, 2004, the SEC issued a proposal providing a narrow exemption from IAA registration to savings associations that limit their investment management and advisory services to a limited range of accounts. Under the proposal, savings association fiduciary accounts are segregated into two categories. Savings associations that provide services to accounts that include only traditional trust, estate, and guardianship accounts would be exempt from registration. Savings associations providing services to accounts that include investment management, agency accounts and other accounts that the SEC has defined as not being for a fiduciary purpose would continue to be required to register as an investment adviser.[3]

The practical effect of this approach is that it provides an extremely limited exemption that does not provide meaningful regulatory relief for savings associations. This fact was made clear to the SEC Commissioners at a meeting in May 2004 when the SEC staff advised the Commissioners that none of the savings

3. A more detailed description and comparison of bank and savings association activities, and applicability of the IAA to each, is set forth in an attachment to this statement.

associations currently registered under the IAA—there are 47 savings associations currently registered (and 3 registered operating subsidiaries)—would be able to take advantage of the proposed exemption since all provide investment management and advisory services for both account categories.

While the SEC wants to apply the federal securities laws in two different manners depending on the business operations of a savings association, there is no distinction between these two categories of accounts under the HOLA and OTS regulations applicable to savings associations. The accounts in both categories are fiduciary accounts that receive the same protections under the HOLA and OTS regulations and are subject to similar examination scrutiny. There is no logical basis why savings associations, unlike banks, need duplicative regulatory oversight by the SEC of account activities that OTS already supervises and examines. This is far from functional regulation, but rather over-regulation that accomplishes nothing in the way of a legitimate policy objective.

Savings associations registered as investment advisers have indicated to OTS that registration costs are substantial. IAA costs include registration fees, licensing fees for personnel, and audit requirements, as well as the many hours management must devote to issues raised by duplicative SEC supervision, examinations and oversight. Costs related to legal advice for IAA registration are also a factor. An informal survey last year of most of our largest IAA-registered savings associations indicated aggregate annual institution costs ranging from $75,000 to $518,200.

Limiting the types of accounts for which a savings association may provide investment management and advisory services to avoid IAA registration, as the SEC has proposed, has the likely effect of negating any meaningful exemption. Generally, institutions will not opt to enter the trust and asset management business line and then decide to forego the most profitable aspects of the business activity. In fact, from a safety and soundness standpoint, we would have to question the rationale behind such an approach. Savings associations providing investment management and advisory services should be encouraged to provide competitive products and services to the fullest extent practicable and without concern for arbitrary triggers that could significantly increase their compliance costs and supervision. This is particularly important from a regulatory burden reduction perspective when you consider that a bank competitor will incur none of the regulatory costs and burdens as a savings association for engaging in exactly the same activities.

Ironically, many of these same themes were cited as the basis for the SEC's recent rule exempting certain broker-dealers from the IAA registration requirements.[4] Minimizing duplicative regulation, changes reflecting developments and advances in industry practices, underlying Congressional intent to carve out certain types of entities from IAA registration because of parallel federal oversight, and ensuring and maintaining consistent consumer protections are all reasons supporting the SEC's exemption for broker-dealers under the IAA. These same reasons support an IAA exemption for savings associations.

Duplicative registration and oversight without any additional supervisory or regulatory benefit is, as we all recognize, regulatory burden in its truest form. For the same reasons that SEC registered broker-dealers should not be subject to registration under the IAA, OTS-licensed savings associations should not be subject to IAA registration.

In addressing this issue, it is important to recall that in July 2000 an amendment was offered by Senator Bayh (on regulatory burden reduction legislation then pending before the Senate Banking Committee (SBC)) to extend the IAA exemption to savings associations so that savings associations and banks could compete equally in the provision of investment management and advisory services. During consideration of the amendment, the SEC represented to the SBC

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4. SEC Final Rule: Certain Broker-Dealers Deemed Not To Be Investment Advisers, Release No. 34-51523 (April 12, 2005).

that legislation was not needed to resolve this problem since the SEC would be able to resolve the issue by regulation.[5] More than five years later the issue remains unresolved with virtually no likelihood of this changing given that the SEC's May 2004 proposal offers no relief to existing IAA-registered savings associations. This fact, alone, underscores why nothing short of a legislative solution is adequate to resolve this issue going forward.

While OTS submitted a comment letter to the SEC discussing why the proposed IAA rule is flawed, we are not optimistic that it will change anything given the history of this issue. After much discussion for several years between OTS and the SEC staff and SEC Commissioners, including the three past Chairmen, we have not made any headway toward a mutually satisfactory solution. We have no reason to believe that a comment letter outlining all of the discussions that we have already had with the SEC staff will sway the SEC's position on this issue. This further underscores the need for legislation such as section 201 of H.R. 3505.

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5. During deliberations on the Competitive Markets Supervision Act before the Senate Banking Committee in July 2000, Senator Bayh proposed an amendment to extend the IAA exemption to savings associations. As noted in Senator Bayh's statement and subsequent letter to the SEC (attached), the amendment was withdrawn pending the SEC's offer to resolve the issue by regulation.

2. Broker-Dealer Registration

A similar duplicative burden exists for savings associations under the broker-dealer provisions of the 1934 Act. Extending the current bank broker-dealer exemption to savings associations would eliminate this duplicative burden. Banks—but not savings associations—enjoyed a blanket exemption from broker-dealer registration requirements under the 1934 Act before changes were made by the GLB Act. The GLB Act removed the blanket exemption and permitted banks to engage only in specified activities without having to register as a broker-dealer. All other broker-dealer activities must be "pushed out" to a registered broker-dealer. The SEC issued interim broker-dealer rules on May 11, 2001, to implement the new "push-out" requirements. As part of the broker-dealer "push out" rules, the SEC exercised its authority to include savings associations within the bank exemption. This treated savings associations the same as banks for the first time for purposes of broker-dealer registration. In the interim broker-dealer rule, the SEC recognized it would be wrong to continue disparate, anomalous treatment between savings associations and banks.

The SEC postponed the effective date of the interim rule several times. It released proposed amendments to the interim dealer rule on October 31, 2002, and the final dealer rule on February 14, 2003. The final dealer rule gives savings associations the same exemptions as banks. On June 30, 2004, the SEC published in the Federal Register a new proposed rule (Regulation B) governing when a bank or savings association must register as a broker. Originally scheduled to go into effect on September 30, 2005, the SEC recently extended the effective date for Regulation B until September 30, 2006 in order to afford time to fully consider the comments received from the industry and other interested parties.[6]

Unlike the SEC's Regulation B, savings associations are not treated the same as banks in all respects. Although savings associations would be treated the same as banks for purposes of the 11 statutory activities they may engage in without registering as a broker with the SEC, as provided by the GLB Act, three non-statutory exemptions provided banks would not be extended to savings associations. The SEC describes the three non-statutory exemptions as targeted exemptions that recognize the existing business practices of some banks.

We understand that the SEC staff does not believe savings associations are engaged in the exempted securities activities and will only extend relief for savings associations to the securities activities they are currently performing. A separate analysis conducted by OTS, however, indicates that savings associations currently

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6. Order Extending Temporary Exemption of Banks, Savings Associations, and Savings Banks from the Definition of "Broker" Under Section 3(a)(4) of the Securities Exchange Act of 1934, Release No. 34-52405 (September 9, 2005).

engage in all of the securities activities covered by the three additional exemptions. This information was forwarded to the SEC staff pursuant to their request. Moreover, since the exemptions apply to all banks—whether or not they are currently engaged in one of the exempted activities—this approach is not logical. OTS has strongly urged the SEC to remove this new disparity and the additional duplicative burden it imposes on savings associations.

As was the case in the SEC's investment adviser proposal, in issuing its proposed broker rule, the SEC passed on the opportunity to streamline its overlapping oversight of savings association broker-dealer activities by providing the equivalent treatment to savings associations as banks receive. In both instances, the SEC has proposed to treat savings associations differently than banks in fundamentally important respects. Both of these actions impose duplicative regulatory burdens and demonstrate the continuing, immediate need for legislation to provide relief to savings associations under the federal securities laws.

B. Eliminating Obstacles to Small Business Lending by Federal Savings Associations

Another OTS legislative priority is reducing statutory limitations on the ability of federal savings associations to meet the small business and other commercial lending needs of their communities by providing businesses greater choice and flexibility for their credit needs. HOLA now caps the aggregate amount of loans for commercial purposes at 20 percent of a savings association's assets. Commercial loans in excess of 10 percent of assets must be in small business loans. OTS supports legislative provisions—such as that set forth in section 212 of H.R. 3505—that remove the current limit on small business lending and increase the cap on other commercial lending from 10 percent to 20 percent of assets.

In addition to being good for small business job creation and the economy, there are several reasons these changes make sense for savings associations. First, this will give savings associations greater flexibility to promote safety and soundness through diversification. Additional flexibility, particularly in small business lending, will provide opportunities to counter the undulations of a cyclical mortgage market. This will enable savings association managers to continue to meet their ongoing customers' mortgage and consumer lending needs, while providing additional resources to manage their institutions safely and soundly. In addition, some savings associations are at or near the current statutory limits and must curtail otherwise safe and sound business lending programs. Finally, this proposal will enable savings associations that have a retail lending focus to be able to achieve the economies of scale necessary to engage in this activity safely and profitably.

Small business lending is an integral component of job growth and employment in the United States.[7] This proposal would increase competition for, and the availability of, small business and other commercial loans now and in the future as savings associations develop this line of business. This will be particularly welcome to smaller businesses that have experienced difficulty in obtaining relatively small loans from large commercial banks that set minimum loan amounts as part of their business strategy—a problem that may increase with industry consolidation.[8] Finally, the proposal will also assist businesses that prefer borrowing from entities like savings associations that meet the needs of borrowers with personal service.

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7. There are currently 23 million small businesses in the United States, representing 99.7 percent of U.S. employers. These firms employ more than half of all private sector employees, accounting for 44 percent of the U.S. private sector payroll. Small businesses generate between 60 to 80 percent of all net new jobs annually, and are responsible for over 50 percent of the U.S. private gross domestic product. U.S. Small Business Administration, Frequently Asked Questions (March 2004).

8. See "The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks." Small Business Administration Office of Advocacy (March 2005).

C. Removing Disparate Standards in Savings Association Consumer Lending Authority

Another important regulatory burden legislative proposal for OTS is eliminating an anomaly that exists under HOLA relating to the current consumer lending authority for savings associations. Currently, consumer loans are subject to a 35 percent of assets limitation, while there is no limit on loans a savings association may make through credit card accounts, even though the borrower may use the loan for the same purposes. Ironically, consumer loans subject to the 35 percent cap are typically secured loans, whereas credit card loans—subject to no savings association investment limit—are not secured. Removing the 35 percent cap on consumer lending will permit savings associations to engage in secured lending activities to the same extent that they may make unsecured credit card loans. Our hope is that this will increase savings association secured lending activities relative to unsecured credit card lending, thereby improving the overall safety and soundness of savings association loan portfolios, as well as providing burden relief.

Currently, section 208 of H.R. 3505 removes the 35 percent cap for auto loans made by savings association. For the reasons stated above, we believe eliminating the 35 percent cap for all types of consumer loans, including auto loans, makes good policy sense and we urge that the Committee consider an amendment that accomplishes this objective.

A related amendment would address a similar anomaly that exists with how savings associations compute so-called "qualified thrift investments" (QTI) under the qualified thrift lender (QTL) test. Currently, a savings association may count 100 percent of its credit card loans as QTI, but other consumer loans count as QTI only to the extent that these and other categories of loans do not exceed 20 percent of the savings association's "portfolio assets." This restriction is arbitrary, unduly complex, and unique to the thrift industry. It bears no relationship to the relative risks presented by the loans and, in our experience, the existing limit is irrelevant to the safe and sound operation of an institution. Removing this artificial limit would enable savings associations to perform more effectively as the retail institutions their customers need and expect, without impairing safety and soundness.

D. Clarification of Citizenship of Federal Savings Associations for Federal Diversity Jurisdiction

Pursuant to federal diversity jurisdiction, a federal savings association may sue or be sued in federal court if the claim exceeds $75,000 and the parties are citizens of different states. Section 213 of H.R. 3505 provides that, for purposes of determining diversity jurisdiction, a federal savings association is a citizen of its home state and, if different, the state in which its principal place of business is located. While OTS supports section 213, our preference would be to modify the provision consistent with the Supreme Court's recent decision holding that a national bank is a citizen of only its home state.

Some courts have determined that if a savings association that is organized as a stock corporation conducts a substantial amount of business in more than one state, it is not a citizen of any state and, therefore, it may not sue or be sued in federal court under diversity jurisdiction. A provision similar to section 213 of H.R. 3505 would avoid this result, and also avoid a potential similar problem with respect to mutual savings associations. The general rule for an unincorporated association is that it is a citizen of every state of which any of its members is a citizen. If a court were to apply this general rule to mutual savings associations, those operating regionally or nationally with depositors across the country would find it difficult or impossible to establish diversity jurisdiction. A uniform rule governing federal jurisdiction when a savings association is involved would reduce confusion and uncertainty.

E. Agency Continuity – Creating Statutory Succession Authority and Modernizing Appointment Authority for the OTS Director

OTS urges Congress to authorize the Treasury Secretary to appoint one or more individuals within OTS to serve as OTS Acting Director in order to assure agency continuity. Section 622 of H.R. 3505 would accomplish this by revising the current procedure of relying on the Vacancies Act to fill any vacancy that occurs during or after the term of an OTS Director or Acting Director. This would eliminate potential concerns and time constraints imposed by the Vacancies Act process under which OTS currently operates.

We believe that this revision is important given our continuing focus on the stability of the financial system and the regulatory oversight agencies in the event of a national emergency. For example, existing uncertainty about succession authority for an OTS Acting Director could impair the ability of OTS to act effectively and decisively in a crisis if an existing OTS Director or an Acting Director suddenly was incapacitated as a result of an event arising from a national emergency.

The OCC has long-standing authority for appointing Deputy Comptrollers,[9] and both the FDIC and Federal Reserve Board have succession authority built into their operative authorizing statutes. One approach to ensure OTS continuity would be to amend HOLA to permit the Treasury Secretary to make the OTS appointments so each potential OTS Acting Director would qualify as an "inferior officer" under the Appointments Clause of the Constitution.

The safety and soundness of the banking system depends on regular, uninterrupted oversight by the FBAs. The reality of the appointments process is that there can be a delay of many months before a sub-cabinet level position is filled, and these delays have grown significantly over the last 20 years. An event resulting in numerous vacancies in the Executive Branch would, of course, exacerbate this problem. In light of these growing, and potentially greater, delays, it is important to promote stability and continuity within OTS by establishing a statutory chain of command within OTS. Implementing these suggested changes will avoid the possibility of gaps in authority to regulate and supervise savings associations, eliminate uncertainty for the savings associations OTS regulates, and avoid potential litigation over whether the acts of OTS staff are valid.

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9. 12 U.S.C. § 4.

The vacancy issue is of particular concern to OTS because we are the only financial services sector regulator that could be readily exposed to a vacancy problem. During a vacancy, OTS succession now occurs through the process of the Vacancies Act, which has inherent uncertainty regarding immediate succession when the OTS Director departs and limits the period an Acting Director may serve. The organic statutes of the other financial regulators minimize or avoid vacancy problems by providing for automatic and immediate succession or by vesting authority in the remaining members of a board or commission.

VI. Other Regulatory Burden Reduction Proposals

OTS also recommends enactment of other important regulatory burden relief initiatives. We appreciate the opportunity to work with the Committee on these and other provisions that will benefit the thrift industry. Before addressing these items, however, we want to draw the Committee's attention to a proposal that has been circulated among some Members of the Committee regarding legislation to amend the law applicable to mutual holding companies (MHCs).

A. Proposed Mutual Holding Company Amendments

Within the last several months, we have been asked to opine on several occasions regarding a proposal to amend the statutory and regulatory requirements applicable to mutual holding companies (MHCs). In particular, a request has been made to alter the corporate governance rules for these types of entities in order to permit the minority shareholders of a savings association to override the interests of a controlling, majority MHC shareholder (all MHCs are structured in this manner).

By way of background, a MHC structure is a statutory creation that permits a mutual savings association to remain community-based by avoiding a full-scale mutual-to-stock conversion. As we described in a recent letter to Senator Crapo, "part of the rationale supporting the MHC structure is that it allows for an infusion of capital into the institution without subjecting the institution to the types of shareholder pressures that may compromise and/or eventually eliminate the institution as a separate community banking organization." We believe that this is an important objective that should be preserved.

As part of the process, the MHC is initially the sole shareholder at the outset of a MHC reorganization (owning 100 percent of the outstanding shares of the underlying institution); pursuant to statute and OTS regulations, the MHC is required to remain the majority and controlling shareholder throughout its existence. When an MHC subsequently decides to sell a minority interest to members of the public (including to the existing depositors of the institution), it does so under strict rules and procedures set forth by both the Securities Exchange Commission and OTS. This ensures that minority investors in a depository institution controlled by a MHC acquire their minority interest with full notice and disclosure that the MHC is, and will continue to be, the controlling shareholder of the underlying depository institution.

The proposal that we have been asked to review would provide the minority shareholders in a MHC structure greater control over the underlying depository institution than a majority and controlling MHC. In our view, this is inconsistent with U.S. corporate governance standards, and would undermine the interests of the underlying institution's depositors. Again, as stated in the letter to Senator Crapo, "[t]he interests of a former [mutual savings bank's] mutual depositors, as represented by the MHC in an MHC structure, are paramount in connection with a MHC reorganization. The minority shareholders of an institution in an MHC structure are aware of this at the outset of the transaction, and they purchase shares of the converted institution with this knowledge. Any attempt to provide minority shareholders with greater rights and interests than the majority MHC undermines the basic principles of sound corporate governance and corporate ownership rights, as well as the objective of the mutual-to-stock conversion rules."

It is our view that any proposal that overrides the controlling interest of a majority MHC shareholder in favor of the institution's minority shareholders is inconsistent with good corporate governance and prevailing U.S. rules related to the rights of minority shareholders vis-à-vis majority shareholders in public companies. More fundamentally, we are concerned that the proposal poses significant safety and soundness risks in the operation of MHCs, and also risks the retention and future use of the MHC structure.

B. Eliminating Duplicative Oversight of Savings Association Subsidiaries by OTS and the FDIC

Under current law, savings associations are required to provide notice to both the FDIC and the OTS before acquiring a subsidiary or conducting any new activity through a subsidiary. This duplicative notification is burdensome and unnecessary. OTS supports streamlining the subsidiary notification process by eliminating the FDIC notification requirement for savings associations that wish to acquire a subsidiary or engage in any new activity through a subsidiary. The FDIC would still be able to determine by regulation or order that any specific activity poses a serious threat the Deposit Insurance Fund; and savings associations would still be required to provide notice to OTS when engaging in a new activity or acquiring a new subsidiary.

This proposal would place discretion within OTS, the primary federal regulator of savings associations, to determine permissible activities conducted by savings association subsidiaries. There appears to be no sound policy rationale for having a duplicative oversight procedure for determining what activities are permissible for a savings association subsidiary. In this regard, we note that no similar procedure exists for determining the activities permissible for a national bank subsidiary.

The proposal is set forth in Matrix Item # 95, which it is my understanding is supported by the industry, and not opposed by any consumer groups. We urge inclusion of this provision in any regulatory relief bill considered by the Committee.

C. Authorizing Federal Savings Associations to Merge and Consolidate with Non-Depository Affiliates

OTS favors an amendment, such as that set forth at section 203 of H.R. 3505, providing federal savings associations the authority to merge with one or more of their non-depository institution affiliates, equivalent to authority enacted for national banks at the end of 2000.[10] The Bank Merger Act would still apply, and the new authority does not give savings associations the power to engage in new activities.

Under current law, a federal savings association may only merge with another depository institution. This proposal reduces regulatory burden on savings

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10. Section 6 of the National Bank Consolidation and Merger Act (12 U.S.C. § 215a-3).

associations by permitting mergers with non-depository affiliates where appropriate for sound business reasons and if otherwise permitted by law. Today, if a savings association wants to acquire the business of an affiliate, it must engage in a series of transactions, such as merging the affiliate into a subsidiary and liquidating the subsidiary into the savings association. Structuring a transaction in this way can be costly and unduly burdensome. We support permitting savings associations to merge with affiliates, along with the existing authority to merge with other depository institutions.

D. Amending the International Lending Supervision Act (ILSA) to Support Consistency and Equal Representation

Two amendments to ILSA that we previously proposed would promote greater consistency among U.S. regulators in supervising the foreign activities of insured depository institutions and should be added to any regulatory relief legislation considered by the Committee.

1. Applying ILSA to Savings Associations

OTS recommends making federal and state savings associations (and their subsidiaries and affiliates) subject to ILSA on the same basis as other banking institutions. This will eliminate regulatory burden by promoting the uniform supervision of insured depository institutions. OTS is already covered by ILSA along with the other FBAs, but savings associations are not. In enacting ILSA, Congress sought to assure that the economic health and stability of the United States and other nations would not be adversely affected by imprudent lending practices or inadequate supervision. A depository institution subject to ILSA must, among other things:

- Establish special reserves necessary to reflect risks of foreign activities; and
- Submit to the appropriate FBA quarterly reports on its foreign country exposure.

The legislative history of ILSA is silent on the international lending activities of savings associations because these institutions were not active in international finance in 1983. While savings associations maintain a domestic focus—providing credit for housing and other consumer needs within the United States—some savings associations have significant foreign activities. These include investing in foreign currency-denominated CDs, offering foreign currency exchange services, and making loans on the security of foreign real estate or loans to foreign borrowers. In addition, numerous savings and loan holding companies (SLHCs) have international operations (including several foreign-based holding companies) that provide opportunities for expanded international operations by the subsidiary savings association.

While OTS has broad supervisory powers under HOLA to oversee all activities of savings associations, their subsidiaries, and their affiliates, making savings associations subject to ILSA will enhance OTS's ability to carry out its responsibilities under ILSA and promote consistency among the federal regulators in supervising the foreign activities of insured depository institutions.

2. OTS Representation on the Basel Committee on Bank Supervision

Amending ILSA to support equal representation for OTS on the Basel Committee will enable OTS to share its expertise with respect to consolidated supervision of diverse, internationally active holding companies, one-to-four family and multifamily residential lending, consumer lending, and interest rate risk management. SLHCs operate in more than 130 countries, control over $6 trillion in assets, and their savings association subsidiaries originate almost one in every four residential mortgage loans in the United States. At $2.6 trillion in one-to-four family residential mortgage loan originations in 2004, this market stands as the largest credit market in the world, currently with over $9 trillion in outstanding loans.[11]

11. See Mortgage Bankers Association Mortgage Finance Forecast (June 6, 2005).

OTS currently participates in numerous Basel Committee working groups and subcommittees. Giving OTS a recognized voice on Basel will help assure that international bank supervision policies do not inadvertently harm savings associations or the numerous internationally active SLHCs.

E. Enhancing Examination Flexibility

Current law requires the FBAs to conduct a full-scale, on-site examination for the depository institutions under their jurisdiction at least every 12 months. There is an exception for small institutions that have total assets of less than $250 million and are well-capitalized and well-managed and meet other criteria. Examinations of these small institutions are required at least every 18 months.

When originally enacted in 1991, the small institution examination exception was available to institutions with assets less than $100 million (assuming the other statutory criteria were satisfied). This statutory threshold was raised to $250 million in 1994 for institutions in outstanding condition and meeting the other statutory criteria. In 1996, the FBAs were authorized to extend the $250 million threshold to institutions in good condition. Given the fact that the current threshold has been in place for more than eight years, OTS recommends considering whether the $250 million cap should once again be raised. If so, we support an amendment, such as that set forth in section 607 of H.R. 3505 to increase the small institution threshold to $1 billion for well-capitalized, well-managed institutions.

This provision would reduce regulatory burden on low-risk, small institutions and permit the FBAs to more effectively focus their resources on the highest risk institutions.

F. Removal of Qualified Thrift Lender Requirements with Respect to Out-of-State Branches of Federal Savings Associations

OTS also supports an amendment, such as that at section 211 of H.R. 3505, removing the requirement that federal savings associations meet the QTL test on a state-by-state basis. This requirement is a superfluous regulatory burden because interstate savings associations may currently structure their activities to assure compliance with the state-by-state requirement. Thus, there is no meaningful purpose for maintaining this requirement. The QTL test should, of course, continue to apply to the institution as a whole.

G. Authority for a Savings and Loan Holding Company to Own a Separate Credit Card Savings Association

Another unnecessary and burdensome statutory provision is a limitation imposed on existing SLHCs that limits their activities (to those permissible for a multiple SLHC) for the acquisition or chartering of a limited purpose credit card savings association, but permits acquiring or chartering (without any activities limitations) of a substantially similar limited purpose credit card bank. This restriction arises out of the fact that a SLHC generally cannot own more than one savings association (unless acquired in a supervisory transaction), without being subject to the activities restrictions imposed on SLHCs owning multiple savings associations. Under the HOLA, a SLHC cannot charter or acquire a limited purpose credit card savings association, but can charter or acquire a limited purpose credit card bank without triggering the multiple SLHC restrictions or being treated as a BHC under BHC Act.

From a regulatory burden perspective, it makes no sense to subject a SLHC structure to an additional bank regulator, i.e., supervising the limited purpose credit card bank, simply because of a statutory activities limitation that provides the SLHC cannot own an otherwise permissible limited purpose credit card savings association that it can own if the entity is a bank. This result is illogical and excessive regulatory burden with no additional supervisory or regulatory benefit attached. We support an amendment, such as section 216 of H.R. 3505, providing that a limited purpose credit card savings association is not deemed a savings association, or is excluded from consideration, in applying the activities restrictions imposed on multiple SLHCs under the HOLA.

H. Modernizing the Community Development Investment Authority of Savings Associations

OTS supports updating HOLA to give savings associations the same authority as national banks and state member banks to make investments to promote the public welfare. A provision, such as section 202 of H.R. 3505, would enhance the ability of savings associations to contribute to the growth and stability of their communities.

Due to changes made to HUD's Community Development Block Grant (CDBG) program more than 20 years ago, investment opportunities that meet the technical requirements of savings associations' current statutory community development authority are rare. As a result, OTS has found it cumbersome to promote the spirit and intent of Congress's determination to allow savings associations to make such community development investments. Currently, using its administrative authority, OTS may issue a "no action" letter when a savings association seeks to make a community development investment that satisfies the intent of the existing provision, but does not clearly fall within the wording of the statute or the "safe harbor" criteria issued by OTS for these investments. The no-action process, however, takes time, lacks certainty, and is clearly burdensome.

We favor a provision such as section 202 of H.R. 3505 because it closely tracks the existing authority for banks. Under this provision, savings associations may make investments primarily designed to promote the public welfare, directly or indirectly, by investing in an entity primarily engaged in making public welfare investments. There is an aggregate limit on investments of 5 percent of a savings association's capital and surplus, or up to 15 percent on an exception basis.

I. Eliminating Geographic and Ownership Limits on Thrift Service Companies

OTS supports legislation authorizing federal savings associations to invest in service companies without regard to the current geographic and ownership restrictions. Current law permits a federal savings association to invest in a service company only if (i) the service company is chartered in the savings association's home state, and (ii) the service company's stock is available for purchase only by savings associations chartered by that state and other federal savings associations having their home offices in that states.

HOLA imposed these restrictions before interstate branching and before technological advances such as Internet and telephone banking, and they no longer serve a useful purpose. This restriction needlessly complicates the ability of savings associations, which often operate in more than one state, to join with savings associations and banks to obtain services at lower costs due to economies of scale or to engage in other approved activities.

Today, a savings association seeking to make investments through service companies must create an additional corporate layer—known as a second-tier service company—to invest in enterprises located outside the savings association's home state or with a bank. Requiring second-tier service companies serves no rational business purpose, results in unnecessary expense and red tape for federal savings associations and banks, and discourages otherwise worthwhile investments. While this proposal simplifies the ability of banks and savings associations to invest together in service companies, it does not expand the powers of savings associations or banks. The activities of the service company must be permissible investments under the rules applicable to the savings association or bank.

Currently, section 406 of H.R. 3505 would provide authority for savings associations to invest in bank service companies, and section 503 would eliminate geographic limits on thrift service companies. We support these provisions and urge the Committee to include these in any bill considered by the Committee in order to provide for a streamlined and efficient regulatory framework.

J. Streamlining Agency Action under the Bank Merger Act

OTS supports streamlining the Bank Merger Act application requirements by eliminating the requirement that each FBA request a competitive factors report from the other three banking agencies and the Attorney General. An amendment such as that set forth at section 610 of H.R. 3505 would eliminate the need for five agencies to consider the competitive effects of every proposed bank or savings association merger. The vast majority of proposed mergers do not raise anti-competitive issues, and these multiple reports, even for those few that do raise issues, are not necessary. The proposal decreases the number to two, with the Attorney General continuing to be required to consider the competitive factors involved in each merger transaction and the FDIC, as the insurer, receiving notice even where it is not the lead banking agency for the particular merger. This will streamline the review of merger applications while assuring appropriate consideration of all anti-competitive issues.

VIII. Conclusion

OTS is committed to reducing regulatory burden wherever it has the ability to do so, consistent with safety and soundness and compliance with law, and without undue impact on existing consumer protections. We support proposed legislation that advances this objective and urge action by this Committee to reduce regulatory burden on the industry at the earliest possible date. I want to thank you, Mr. Chairman, Senator Sarbanes, Senator Crapo, and the other Members of the Committee who have shown leadership on this issue. We look forward to working with the Committee to shape the best possible regulatory burden relief legislation.

SEC Proposed Relief

Investment Advisor Registration

Type of Account or Service Provided	National or State Charter Banks and Trust Companies	SEC Proposal for Savings Associations
Accounts without Investment Management or Advice Responsibilities ▪ Trust Accounts ▪ Court Accounts ▪ Agency/Custodial Accounts	These accounts do not trigger investment advisor registration	These accounts do not trigger investment advisor registration
Trust Accounts (with investment management or advice responsibilities) ▪ Personal Trust ▪ Employee Benefit Trust ▪ Charitable Trust	Do not have to register because of existing exemption	**NO CHANGE** **These accounts will still trigger investment advisor registration**
Court Accounts (with investment management or advice responsibilities) ▪ Executor ▪ Administrator ▪ Guardian ▪ Conservator	Do not have to register because of existing exemption	**NO CHANGE** **These accounts will still trigger investment advisor registration**
Agency Accounts (with investment management or advice responsibilities) ▪ Individuals ▪ Personal Trusts ▪ Employee Benefit Plans and Trusts ▪ Corporate Entities ▪ Charities ▪ Mutual Funds ▪ Hedge Funds ▪ Common Trust Funds ▪ Collective Investment Funds	Do not have to register because of existing exemption (unless providing investment advice to a mutual fund, in which case the department or division of the bank or trust company providing the advice must register as an investment adviser)	**NO CHANGE** **These accounts will still trigger investment advisor registration**

Evan Bayh

STATEMENT OF SENATOR EVAN BAYH
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
COMPETITIVE MARKET SUPERVISION ACT
SAVINGS ASSOCIATION EXEMPTION FROM THE INVESTMENT ADVISORS ACT
July 13, 2000

One of the bills that is before us today is the Competitive Market Supervision Act. This bill, which I have co-sponsored, does two important things for the people of the United States. First, the bill reduces securities fees for a large number of Americans. These fees, while relatively small, put an unnecessary burden on all investors, including those with retirement funds or pension funds. Second, the bill would provide for pay parity for Securities and Exchange Commission professional employees, by permitting the SEC to bring their pay in line with that of employees of other financial regulatory agencies. The SEC is charged with ensuring that investors receive the highest level consumer protections. This bill would help the SEC to attract – and retain – the best minds to fulfill its obligations to the American people.

On a separate issue, I have become aware of disparate treatment between savings associations and banks under the Investment Advisors Act. This Act exempts banks from its scope but does not exempt savings associations. This differing treatment puts savings associations at a competitive disadvantage, without reason. A similar disparity used to exist under a related law, the Investment Company Act of 1940; however, last year the Gramm-Leach-Bliley Act corrected the discordant treatment.

In the past few months, my staff has had discussions with the Securities and Exchange Commission and industry representatives. The SEC has determined that it has the statutory authority to exempt individual institutions and groups of institutions – including savings associations – from the scope of the Investment Advisors Act. Since the SEC has concluded that this parity issue may be resolved through rulemaking and has agreed to work with the industry to reach such resolution, I withhold legislative involvement. I appreciate their commitment and look forward to their resolution.

August 18, 2000

The Honorable Arthur Levitt
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Levitt:

As you are aware, on July 13, 2000, the Senate Banking Committee held a markup on S. 2107, The Competitive Market Supervision Act, among other legislation. Although I was unable to attend the markup, I submitted a written statement for the record. I thought you might be interested in seeing a copy of the statement, which I attached for you.

In my written statement, as a co-sponsor of S. 2107, I reiterated my belief of the appropriateness of the legislation and its benefits to Americans. Separately, I commented on the Securities and Exchange Committee's rulemaking initiative to exempt savings associations from the Investment Advisors Act. Savings associations should be provided a level playing field with banks, which historically have been exempt from the Act. Because SEC staff determined that this parity issue may be resolved through rulemaking and agreed to move forward with the rulemaking process, I withheld legislative action at the July 13 markup. I look forward to the SEC's timely resolution of this issue.

If I or my staff may be of assistance in this rulemaking effort or other matters, please do not hesitate to call.

Sincerely,

Evan Bayh

Evan Bayh

Office of Thrift Supervision
Department of the Treasury

John E. Bowman
Chief Counsel

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6372

January 9, 2006

The Honorable Mike Crapo
239 Dirksen Building
Washington, DC 20510

Dear Senator Crapo:

This letter is in response to language on "Mutual Savings Bank Conversions" that your office has asked us to review (copy enclosed). I understand that our staff has already provided informal comments to you on this. The purpose of this letter is to formalize the previous comments, as well as to highlight the concerns of the Office of Thrift Supervision (OTS) with respect to the proposal we have reviewed.

Generally, the language we reviewed raises a number of significant issues. The description also appears confused about the relative rights and ownership interests of mutual members of a mutual holding company (MHC) and minority shareholders of a mutual savings bank (MSB) that has converted to stock form in an MHC structure. As detailed below, OTS believes the proposal would significantly disadvantage the rights and interests of the depositors of an MSB that reorganizes into an MHC structure.

First, the discussion indicates that OTS currently regulates MSBs. Please note that the OTS and FDIC both regulate MSBs and have similar rules with respect to the substantive issue raised in the proposal, i.e., enabling minority shareholders to control a savings association subsidiary of an MHC. These rules are intended to provide for the MHC structure as an alternative to an outright mutual-to-stock conversion by a mutual depository institution.

Second, part of the rationale supporting the MHC structure is that it allows for an infusion of capital into the institution without subjecting the institution to the types of shareholder pressures that may compromise and/or eventually eliminate the institution as a separate community banking organization.

Third, when minority shareholders invest in a depository institution owned in an MHC structure, they understand that they are purchasing a minority ownership interest, which OTS (and FDIC) rules clearly state and contemplate. Specifically, they understand that the MHC controls the institution and makes the business decisions regarding it.

Fourth, while many depositors of an MSB may execute "running proxies" that will continue at the MHC level, depositors always have the ability to rescind these and vote on any matter pending at an annual meeting. Regarding the notification rules for an annual meeting by an institution in an MHC structure, the minority shareholders of the MHC's savings association subsidiary receive the same notice as required for any stock institution.

Finally, with respect to the reference that the non-public MHC would prevail in a situation where 100 percent of the public shareholders voted against a management slate that is approved by the nonpublic MHC, please note that the largest and controlling shareholder of a converted institution in an MHC structure remains the MHC. The premise of the MHC structure is that depositors (who are members of the MHC) retain control of the institution. Moreover, to the extent that such control would pass from the MHC to the minority shareholders, a mutual-to-stock conversion would effectively occur, without compliance with existing mutual-to-stock conversion regulations.

The interests of a former MSB's mutual depositors, as represented by the MHC in an MHC structure, are paramount in connection with an MHC reorganization. The minority shareholders of an institution in an MHC structure are aware of this at the outset of the transaction and purchase shares of the converted institution with this knowledge. Any attempt to provide minority shareholders with greater rights and interests than the majority MHC undermines the basic principles of sound corporate governance and corporate ownership rights, as well as the objectives of the mutual-to-stock conversion rules.

If you have any further questions, please feel free to contact me or Kevin Petrasic, Managing Director for External Affairs, at (202) 906-6452. Thank you.

Sincerely,

John E. Bowman

John E. Bowman
Chief Counsel

Enclosure

PREPARED STATEMENT OF GAVIN GEE

DIRECTOR OF FINANCE, IDAHO DEPARTMENT OF FINANCE
ON BEHALF OF THE
CONFERENCE OF STATE BANK SUPERVISORS
MARCH 1, 2006

Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. I am Gavin Gee, Director of Finance for the Idaho Department of Finance, and I am pleased to be here today on behalf of the Conference of State Bank Supervisors (CSBS). Thank you for inviting CSBS to be here today to discuss strategies for reducing unnecessary regulatory burden on our Nation's financial institutions.

CSBS is the professional association of State officials who charter, regulate, and supervise the Nation's approximately 6,240 State-chartered commercial banks and savings institutions, and nearly 400 State-licensed foreign banking offices nationwide.

As past Chairman of CSBS, I am pleased to represent my colleagues in all 50 States and the U.S. territories.

CSBS gives State bank supervisors a national forum to coordinate, communicate, advocate and educate on behalf of the State banking system. We especially appreciate this opportunity to discuss our views in our capacity as the chartering authorities and primary regulators of the vast majority of our Nation's community banks.

Chairman Shelby and Senator Crapo, we applaud your longstanding commitment to ensuring that regulation serves the public interest without imposing unnecessary or duplicative regulatory burdens on financial institutions. At the State level, we are constantly balancing the need for oversight and consumer protections with the need to encourage competition and entrepreneurship. We believe that a diverse, healthy financial services system serves the public best.

CSBS and the State banking departments have been working closely with the Federal banking agencies, through the Federal Financial Institutions Examination Council, to implement the Economic Growth and Regulatory Paperwork Reduction Act of 1996. While this legislation made necessary and beneficial changes, we see continuing opportunities for Congress to streamline and rationalize regulatory burden, especially for community banks.

Principles for Regulatory Burden Relief

The Conference of State Bank Supervisors has developed a set of principles to guide a comprehensive approach to regulatory burden relief. We ask Congress to consider each proposal carefully against these principles.

First, a bank's most important tool against regulatory burden is its ability to make meaningful choices about its regulatory and operating structures. The State charter has been and continues to be the charter of choice for community-based institutions because the State-level supervisory environment—locally oriented, relevant, responsive, meaningful, and flexible—matches the way these banks do business.

A bank's ability to choose its charter encourages regulators to operate more efficiently, more effectively, and in a more measured fashion. A monolithic regulatory regime would have no incentive for efficiency. The emergence of a nationwide financial market made it necessary to create a Federal regulatory structure, but the State system remains as a balance to curb potentially excessive Federal regulatory measures, and as a means of promoting a wide diversity of financial institutions.

Second, while our current regulatory structure and statutory framework recognize some differences between financial institutions, too often it demands a "one size fits all" approach. Overarching Federal requirements designed to cover all institutions are often unduly burdensome on smaller or community-based banks.

Regulatory burden always falls hardest on smaller institutions. Although 48 of the Nation's 100 largest banks hold State charters, State charters make up the vast majority of the 6,100 smaller institutions. We see this impact on earnings every day among the institutions we supervise. Community banks represent a shrinking percentage of the assets of our Nation's banking system, and we cannot doubt that compliance costs are in part driving mergers. These mergers do not always serve the best interests of our citizens. Even where laws officially exempt small, privately held banks, as in the case of Sarbanes-Oxley, the principles behind these laws hold all institutions to increasingly more expensive compliance standards.

Congress has an urgent responsibility to review the impact that these Federal statutes have had on our Nation's economy. My colleagues and I see a financial service industry that is bifurcated, and becoming more so. We see the emergence of a line that divides our country's banking industry into larger and smaller institutions. This process has wide-ranging implications for the economic health of our entire country.

The Nation's community banking industry is the fuel for the economic engine of small business in the United States. Although I speak as a State bank supervisor, I recognize that federally chartered community banks are equally important to small business.

The Small Business Administration tells us that small business in the United States accounts for 99 percent of all employers, produces 13 times more patents per employee than large firms, generates 60 to 80 percent of new jobs, and employs 50 percent of the private sector. Small businesses must be served, and community banks are the primary source of that service. They are often better-positioned to offer customized products that meet small businesses' unique needs.

Unnecessary regulatory burden shifts community banks' financial and human resources away from these activities to activities whose benefits may not justify their costs. Reducing this burden will allow banks to focus on their core businesses, providing the services that fuel our economy.

We suggest that Congress and the regulatory agencies seek creative ways to tailor regulatory requirements for institutions that focus not only on size, but also on a wider range of factors that affect consumer needs and business practices. These factors might include geographic location, structure, management performance, and lines of business. The largest banks are pushing, understandably, for a comprehensive, national set of rules for their evolving multistate operations. We ask you to remember, however, that new universal Federal requirements will also cover State-chartered banks operating in States that do not already have similar rules in place, because these States have made individual determinations that they are unnecessary regulatory burdens.

Third, while technology continues to be an invaluable tool of regulatory burden relief, it is not a panacea.

Technology has reduced regulatory burden in countless ways. State banking departments, like their Federal counterparts, now collect information from their financial institutions electronically as well as through on-site examinations. Most State banking departments now accept a wide range of forms on-line, and allow institutions to pay their supervisory fees on-line. Many State banking departments allow institutions online access to maintain their own structural information, such as addresses, branch locations, and key officer changes.

At least 25 State banking agencies allow banks to file data and/or applications electronically, through secure areas of the agencies' websites. Nearly all of the States have adopted or are in the process of accepting an interagency Federal application that allows would-be bankers to apply simultaneously for a State charter and for Federal deposit insurance.

Shared technology allows the State and Federal banking agencies to work together to improve the examination process, while making the process less intrusive for financial institutions. Technology helps examiners target their examinations through better analysis, makes their time in financial institutions more effective, and expedites the creation of examination reports.

The fact that technology makes it so much easier to gather information, however, should not keep us from asking whether we *should* be gathering all of this information.

Our Bankers Advisory Board members have expressed particular concern about Bank Secrecy Act (BSA) requirements, Currency Transaction Reports and Suspicious Activity Reports. These collection requirements have become far more extensive in the past 3 years, representing the new importance of financial information to our national security. Financial institutions recognize that they are in a unique position to gather this type of financial data, and that this information can prove to be invaluable. However, as both State and Federal regulators and law enforcement officials become more sophisticated about the types of financial information that is useful, we hope that Congress can review requirements to assure that banks collect only essential information. In particular, we urge Congress, FinCEN and the Federal banking regulators to simplify the BSA reporting forms and look carefully at potential changes to threshold levels.

Likewise, CSBS has worked diligently with FinCEN and the Federal banking agencies to develop clear, risk-based BSA examination procedures. We hope these procedures will alleviate some of the financial industry's concerns in this area.

Recommendations for Regulatory Burden Relief

Specifically, my colleagues and I recommend that Congress include the following reforms in any regulatory burden relief legislation.

Federal Financial Institutions Examination Council

Improving coordination and communication among regulators is one of the most important regulatory burden relief initiatives. To that end, we recommend that Congress change the State position on the Federal Financial Institutions Examination Council (FFIEC) from one of observer to that of full voting member.

The FFIEC's State Liaison Committee includes State bank, credit union, and savings bank regulators. The chairman of this Committee participates in FFIEC meetings, but is not able to vote on policy or examination procedures that affect the institutions we charter and supervise. State bank supervisors are the primary regulators of approximately 74 percent of the Nation's banks, and thus are vitally concerned with changes in Federal regulatory policy and procedures. (Matrix number 72)

Regulatory Flexibility for the Federal Reserve

CSBS also believes that the Federal Reserve should have the flexibility it needs to allow State-chartered member banks to exercise the powers granted by their charters, as long as these activities pose no significant risk to the deposit insurance fund.

Current law limits the activities of State-chartered, Fed member banks to those activities allowed for national banks. This restriction stifles innovation within the industry, and eliminates a key dynamic of the dual banking system. We endorse an amendment to remove this unnecessary limitation on State member banks, which has no basis in promoting safety and soundness.

A major benefit of our dual banking system has always been the ability of each State to authorize new products, services and activities for its State-chartered banks. Congress has consistently reaffirmed this authority; the Federal Deposit Insurance Corporation Improvement Act (FDICIA), in 1991, allowed States to continue to authorize powers beyond those of national banks. Removing unnecessary restrictions on State member banks would be a welcome relief. (Matrix number 70)

Coordination of State Examination Authority

CSBS and the State banking departments have developed comprehensive protocols to coordinate the supervision of State-chartered banks that operate branches in more than one State. Through the CSBS Nationwide State Federal Cooperative Agreements, in place since 1996, a bank's chartering State (the home State) works closely with either the FDIC or Federal Reserve and bank commissioners in the States where the bank operates branches (the host State) to provide quality, risk-focused supervision. To bolster these efforts, we strongly recommend that the Senate include language that reinforces these principles and protocols in any regulatory burden relief bill.

CSBS believes that Congress should codify the procedures for examining State-chartered institutions with branches in more than one State. The House included a provision to make this change in H.R. 1375, the regulatory burden relief bill it passed in the 108th Congress.

This provision, as slightly modified, would recognize the primary authority of the chartering or home State, while requiring all home and host State bank supervisors to abide by any written cooperative agreement relating to coordination of exams and joint participation in exams.

The language adopted by the House also provides that, unless otherwise permitted by a cooperative agreement, only the home State supervisor may charge State supervisory fees on multistate banks.

The host State supervisor could still examine the branch for compliance with host State consumer protection laws, with written notification to the home State supervisor. If the cooperative agreement allows it or if the bank is troubled, the host State supervisor could also participate in the home State's examination of the out-of-State bank, to ascertain that the bank is conducting its branch activities in a safe and sound manner.

If the host State supervisor determines that a branch is violating host State consumer protection laws, the supervisor may undertake enforcement actions, with written notice to the home State supervisor. This provision would not limit the authority of Federal banking regulators in anyway, nor would it affect State taxation authority. (Matrix number 60)

Limited Liability Corporations

States have been the traditional source of innovations and new structures within our banking system, and CSBS promotes initiatives that offer new opportunities for banks and their customers without jeopardizing safety and soundness.

In this tradition, CSBS strongly supports an FDIC proposal to make Federal deposit insurance available to State-chartered banks that organize as limited liability corporations (LLC's). An LLC is a business entity that combines the limited liability of a corporation with the pass-through tax treatment of a partnership.

The FDIC has determined that State banks organized as LLC's are eligible for Federal deposit insurance if they meet established criteria designed to insure safety and soundness and limit risk to the deposit insurance fund.

Only a handful of States now allow banks to organize as LLC's, including Maine, Nevada, Texas, Vermont, and, most recently, Utah. More States may consider this option, however, because the structure offers the same tax advantages as Subchapter S corporations but with greater flexibility. Unlike Subchapter S corporations, LLC's are not subject to limits on the number and type of shareholders.

It is not clear, however, that Federal law allows pass-through taxation status for State banks organized as LLC's. An Internal Revenue Service regulation currently blocks pass-through tax treatment for State-chartered banks. We ask the Committee to encourage the IRS to reconsider its interpretation of the tax treatment of State-chartered LLC's. (Matrix number 71)

De Novo Interstate Branching

CSBS seeks changes to Federal law that would allow all banks to cross State lines by opening new branches. While the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 intended to leave this decision in the hands of the States, inconsistencies in Federal law have created a patchwork of contradictory rules about how financial institutions can branch across State lines.

These contradictions affect State-chartered banks disproportionately. Federally chartered savings institutions are not subject to *de novo* interstate branching restrictions. Creative interpretations from the Comptroller of the Currency have exempted most national banks, as well.

Therefore, we ask Congress to restore competitive equity by allowing *de novo* interstate branching for all federally insured depository institutions. (Matrix number 26)

Additionally, the Conference of State Bank Supervisors endorses approaches, such as the Communities First Act (S. 1568, introduced by Senator Brownback of Kansas and cosponsored by Senator Hagel of Nebraska), that recognize and encourage the benefits of diversity within our banking system. CSBS supports the great majority of regulatory burden reductions proposed in the Communities First Act, believing that they will alleviate the burden on community banks without sacrificing either safety and soundness or community responsiveness and responsibility. Our dual banking system exists because one size is not appropriate for every customer, and one system is not appropriate for every institution. We ask that Congress include some type of targeted relief for community banks in any regulatory relief legislation.

The Communities First Act (CFA) includes several of the changes CSBS recommends to help reduce regulatory burden without undue risk to safety and soundness. My colleagues and I have developed these recommendations through extensive discussions among ourselves and with State-chartered banks, and we ask that the Committee include these provisions in any legislation it approves.

Extended Examination Cycles for Well-Managed Banks under $1 Billion

We believe that advances in off-site monitoring techniques and technology, combined with the health of the banking industry, make annual on-site examinations unnecessary for the vast majority of healthy financial institutions. Section 107 of the CFA would extend the mandatory Federal examination cycle from 12 months to 18 months for healthy, well-managed banks with assets of up to $1 billion, and CSBS endorses this change.

Raising the threshold for eligibility for the 18-month examination cycle from $250 million in assets to $1 billion in assets will allow for more effective allocation of examiner resources, as well as relieving unnecessary burden on well-managed institutions.

Changing the safety-and-soundness examination cycle for these banks would have no effect on the cycles for Community Reinvestment Act (CRA) and compliance examinations, which are scheduled separately. (Matrix number 169)

Privacy Notices

We recommend that, in certain circumstances, banks be exempted from the provisions of the Gramm-Leach-Bliley Act (GLBA) that require annual privacy notices be sent to all customers. Section 203 of the CFA would create this exemption for banks that do not share customer information except as permitted by GLBA exceptions, do not share information with affiliates under the Fair Credit Reporting Act, and have not changed their privacy policy since they last mailed privacy notices to their customers. (Matrix number 63)

Call Reports

We support CFA's provisions, in Sections 102 and 204, to allow well-capitalized and well-rated banks with assets of $1 billion or less to file a short form Call Report every other quarter. This would reduce the reporting obligations of smaller institutions while still providing the banking agencies with the information we need. In conjunction with this, we believe that streamlining the information currently by Call Reports would reduce burden without endangering safety and soundness. Much of the perceived burden associated with Call Reports is the ever-increasing demand for more information, not all of which seems essential for regulators to do their jobs.

More broadly, we believe that banks would benefit from the type of sunset provisions on Federal legislations that many States include in their own banking statutes. Although regulators constantly review regulations for their continued relevance and usefulness, many regulations and supervisory procedures still endure past the time that anyone remembers their original purpose. (Matrix number 109)

Sunset provisions require legislators and regulators to review their laws at regular intervals to determine whether they are still necessary or meaningful. The passage of the Fair Credit Reporting Act amendments showed how valuable this review process can be.

Understanding that we cannot impose a sunset date on the entire Federal banking code, we urge Congress to apply this approach to as wide a range of banking statutes as possible.

Challenges to Regulatory Burden Relief

The current trend toward greater, more sweeping Federal preemption of State banking laws threatens all of the regulatory burden relief issues described above.

Federal preemption can be appropriate, even necessary, when genuinely required for consumer protection and competitive opportunity. The extension of the Fair Credit Reporting Act amendments met this high standard.

We appreciate that the largest financial services providers, creating a nationwide financial marketplace, want more coordinated regulation. We share these goals, but not at the expense of distorting our marketplace, denying our citizens the protection of State law and the opportunity to seek redress close to home, or eliminating the diversity that makes our financial system great.

The Comptroller's regulations may reduce burden for our largest, federally chartered institutions and their minority-owned operating subsidiaries, but they do so at the cost of laying a disproportionate burden on State-chartered institutions and even on smaller national banks.

We ask the Committee and Congress to review the disparity in the application of State laws to State and nationally chartered banks and their subsidiaries. Because expansive interpretations of Federal law created this issue, a Federal solution is necessary in order to preserve the viability of the State banking system.

Conclusion

Mr. Chairman, Members of the Committee, the regulatory environment for our Nation's banks has improved significantly over the past 10 years, in large part because of your diligence.

As you consider additional measures to reduce burden on our financial institutions, we urge you to remember that the strength of our banking system is its diversity. The American banking system has a sufficient number of financial institutions, of different sizes and with different specialties, to meet the needs of the world's most diverse economy and society. While some Federal intervention may be necessary to reduce burden, relief measures should allow for further innovation and coordination at both the State and Federal levels, and among community-based institutions as well as among the largest providers.

Diversity in our financial system is not inevitable. Community banking is not inevitable. This diversity is the product of a consciously developed State-Federal system. Any initiative to relieve regulatory burden must recognize this system's value. Vibrant, diverse local economies require a responsive and innovative State banking system that encourages community banking.

History shows that State bank examiners are often the first to identify and address economic problems, including cases of consumer abuse. We are the first responders to almost any problem in the financial system, from downturns in local industry or real estate markets to the emergence of scams that prey on senior citizens and other consumers. We can and do respond to these problems much more quickly than the Federal Government, often bringing these issues to the attention of our Federal counterparts and acting in concert with them.

State supervisors are sensitive to regulatory burden, and constantly look for ways to simplify and streamline compliance. We believe in, and strive for, smart, focused, and reasonable regulation. Your own efforts in this area, Chairman Shelby, have greatly reduced unnecessary regulatory burden on financial institutions regardless of their charter.

The industry's continued high earnings levels suggest that whatever regulatory burdens remain, they are not interfering with larger institutions' ability to do business profitably. The growing gap between large and small institutions, however, suggests a trend that is not healthy for the industry or for the economy.

The ongoing effort to streamline our regulatory process while preserving the safety and soundness of our Nation's financial system is critical to our economic well-being, as well as to the health of our financial institutions. State bank supervisors continue to work with each other, with our legislators and with our Federal counterparts to balance the public benefits of regulatory actions against their direct and indirect costs.

We commend you, Mr. Chairman, Senator Crapo, and the Members of this Committee for your efforts in this area. We thank you for this opportunity to testify, and look forward to any questions that you and the Members of the Committee might have.

PREPARED STATEMENT OF DONALD L. KOHN

MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MARCH 1, 2006

Chairman Shelby, Senator Sarbanes, and Members of the Committee, thank you for the opportunity to discuss the Federal Reserve's views on regulatory relief. The Board commends the Committee for its continued focus and work on this important issue. In particular, I would like to recognize and thank Senator Crapo and his staff for their ongoing efforts to coordinate the many regulatory relief proposals that have been advanced to date by the Federal banking agencies, financial trade associations, and others.

The regulatory requirements imposed on our Nation's banking organizations have grown over time. Often the impact of these requirements falls hardest on our Nation's community banks, which have fewer resources than larger organizations to meet the challenges posed by new or additional regulations. Although the individual requirements and restrictions imposed by Federal law may well have been justified at the time of adoption, changes in the marketplace, technology, and, indeed, in the Federal banking laws themselves may well have altered the balance of the cost-benefit analysis that should underlie each requirement and restriction. Unnecessary regulatory burdens hinder the ability of large and small banking organizations to meet the needs of their customers, operate profitably, innovate, and compete with other financial services providers. That is why the Board periodically reviews its own regulations and why it is so important for Congress to periodically review the Federal banking laws to determine whether there are any provisions that may be streamlined or eliminated without compromising the safety and soundness of banking organizations, consumer protections, or other important objectives that Congress has established for the financial system.

The Board, working with the other banking agencies, has been, and will continue to be, a strong and active supporter of Congress' regulatory relief efforts. In 2003, the Board provided this Committee with a number of legislative proposals for inclusion in a regulatory relief bill. Since then, in response to requests from Senator Crapo, the Board has reviewed numerous other regulatory relief proposals included in the Matrix of Financial Services Regulatory Relief Proposals (Matrix) compiled by Senator Crapo's staff that may affect the Federal Reserve or the organizations we supervise. As a result of that process, I am pleased to report that the Board now supports more than 35 legislative proposals. These proposals would meaningfully reduce regulatory burden, improve the supervision of banking organizations, or otherwise enhance the Federal banking laws without compromising the fundamental goals of bank regulation and supervision. A complete listing and summary of the proposals supported by the Board is included in the appendix to my testimony. We believe these proposals provide an excellent starting point for any regulatory relief legislation, and we look forward to working with the Committee as you develop and perfect such legislation.

In my remarks, I will highlight the three items that are the Board's highest regulatory relief priorities. These proposals would allow the Federal Reserve to pay interest on balances held by depository institutions at Reserve Banks, provide the Board greater flexibility in setting reserve requirements, and permit depository institutions to pay interest on demand deposits. These proposals may well sound familiar to you and they should. The Board has supported these amendments for many years because we believe each of them would improve the operation of our financial system. I should note that these three amendments form the core of S. 1586, the Interest on Business Checking Act of 2005, which was introduced last year by Senators Hagel, Reed and Snowe. The Board strongly supports passage of S. 1586, either independently or as part of a broader regulatory relief bill.

In addition to these priority items, I will highlight a few other legislative proposals that we believe would provide meaningful regulatory relief to banking organizations as well as some steps that the Board has taken on its own to reduce regulatory burden. Finally, I will discuss several matters related to industrial loan companies (ILC's). This topic has been raised by some regulatory relief proposals, but it has much broader policy implications for the structure and supervision of the banking industry.

Interest on Reserves and Reserve Requirement Flexibility (Matrix Nos. 1 and 2)

The first two of the Board's priority items relate to reserve requirements, which exist to assist the Federal Reserve conduct monetary policy. Federal law currently obliges the Board to establish reserve requirements on certain deposits held at depository institutions and mandates that the Board set the ratio of required reserves on transaction deposits above a certain threshold at between 8 and 14 percent. Because the Federal Reserve does not pay interest on the balances held at Reserve Banks to meet reserve requirements, depositories have an incentive to reduce their required reserve balances to a minimum. To do so, they engage in a variety of reserve avoidance activities, including sweep arrangements that move funds from deposits that are subject to reserve requirements to deposits and money market investments that are not. These sweep programs and similar activities absorb real resources and therefore diminish the efficiency of our banking system.

Besides required reserve balances, depository institutions also voluntarily hold two other types of balances in their Reserve Bank accounts—contractual clearing balances and excess reserve balances. A depository institution holds contractual clearing balances when it needs a higher level of balances than its required reserve balances in order to pay checks or make wire transfers out of its account at the Federal Reserve without incurring overnight overdrafts. Currently, such clearing balances do not earn explicit interest, but they do earn implicit interest in the form of credits that may be used to pay for Federal Reserve services, such as check clearing. Excess reserve balances are funds held by depository institutions in their accounts at Reserve Banks in excess of their required reserve and contractual clearing balances. Excess reserve balances currently do not earn explicit or implicit interest.

The Board has long supported legislation that would authorize the Federal Reserve to pay depository institutions interest on the balances they hold at Reserve Banks. As we previously have testified, paying interest on required reserve balances would remove a substantial portion of the incentive for depositories to engage in reserve avoidance measures, and the resulting improvements in efficiency should eventually be passed through to bank borrowers and depositors. Having the authority also to pay interest on contractual clearing and excess reserve balances as well as required reserves would enhance the Federal Reserve's ability to efficiently conduct monetary policy. In addition, it would complement another of the Board's proposed amendments, which would give the Board greater flexibility in setting reserve requirements for depository institutions.

In order for the Federal Open Market Committee (FOMC) to conduct monetary policy effectively, it is important that a sufficient and predictable demand for balances at the Reserve Banks exist so that the Federal Reserve knows the volume of reserves to supply (or remove) through open market operations to achieve the FOMC's target Federal funds rate. Authorizing the Federal Reserve to pay explicit interest on contractual clearing balances could potentially provide a demand for voluntary balances that would be stable enough for monetary policy to be implemented effectively through existing procedures without the need for required reserve balances. In these circumstances, the Board, if authorized, could consider reducing—or even eliminating—reserve requirements, thereby reducing a regulatory burden for all depository institutions, without adversely affecting the Federal Reserve's ability to conduct monetary policy.

Having the authority to pay interest on excess reserves also could help mitigate potential volatility in overnight interest rates. If the Federal Reserve was authorized to pay interest on excess reserves, and did so, the rate paid would act as a minimum for overnight interest rates, because banks generally would not lend to other banks at a lower rate than they could earn by keeping their excess funds at a Reserve Bank. Although the Board sees no need to pay interest on excess reserves in the near future, the ability to do so would be a potentially useful addition to the monetary policy toolkit of the Federal Reserve.

Interest on Demand Deposits (Matrix No. 3)

Another priority item for the Board would repeal the statutory restrictions that currently prohibit depository institutions from paying interest on demand deposits. Repealing these restrictions would improve the overall efficiency of our financial sector, assist small banks in attracting and retaining business deposits, and allow small businesses to earn direct interest on their checking account balances. As a practical matter, these restrictions currently do not impede the payment of interest on consumer deposits because depository institutions generally are permitted to offer individuals interest-bearing negotiable order of withdrawal (NOW) accounts, which are checkable transaction accounts similar to demand deposits.

To compete for the liquid assets of businesses, however, banks have been compelled to set up complicated procedures to pay implicit interest on compensating balance accounts and they spend resources—and charge fees—for sweeping the excess demand deposits of businesses into money market investments on a nightly basis. Small banks often do not have the resources to develop the sweep or other programs that are needed to compete for the deposits of business customers. Moreover, from the standpoint of the overall economy, the expenses incurred by institutions of all sizes to implement these programs are a waste of resources and would be unnecessary if institutions were permitted to pay interest on demand deposits directly. The costs incurred by banks in operating these programs are passed on to their large and small business customers and many small businesses do not benefit from these programs.

For these reasons, the Board's proposed amendment would allow all depository institutions that have the legal authority to offer demand deposits to pay interest on those deposits. The amendment would eliminate the need for banks to operate, and business customers to pay for, sweep and compensating balance arrangements to pay or earn interest on demand deposits. As I will explain a little later, however, the Board opposes amendments that would separately authorize ILC's that operate outside the supervisory and regulatory framework established for other insured banks to offer, for the first time, transaction accounts to business customers.

The Board believes that, once enacted, the authorization for depository institutions to pay interest on demand deposits should become effective promptly. S. 1586 would achieve this goal by requiring that the authority to pay interest on demand deposits become effective no later than 90 days after enactment. The Board, however, does not advocate the provisions of S. 1586 or other bills that would allow banks to offer a reservable money market deposit account (MMDA) from which twenty-four transfers a month could be made to other accounts of the same depositor. These provisions would permit banks to sweep balances from demand deposits into MMDA's each night, pay interest on them, and then sweep them back into demand deposits the next day. This type of twenty-four-transfer MMDA likely would be useful only during the transition period before direct interest payments were allowed. Moreover, as the Board has explained in previous testimonies, this type of account would represent an inefficient, more costly and less readily available alternative to interest-bearing demand deposits.

De Novo Interstate Branching

The Board also strongly supports an amendment that would remove outdated barriers to de novo interstate branching by banks. Since enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal Act), all fifty States have permitted banks to expand on an interstate basis through the acquisition of an existing bank in their State. Interstate banking is good for consumers and the economy as well as banks. The creation of new branches helps maintain the competitiveness and dynamism of the American banking industry and improve access to banking services in otherwise underserved markets. It results in better banking services for households and small businesses, lower interest rates on loans, and higher interest rates on deposits. Interstate branching also increases convenience for customers who live, work, and operate across State borders.

However, the Riegle-Neal Act permitted banks to open a branch in a new State without acquiring another bank only if the host State enacted legislation that expressly permits entry by de novo branching (an opt-in requirement). To date, twenty-two States and the District of Columbia have enacted some form of opt-in legislation, while twenty-eight States continue to require interstate entry through the acquisition of an existing bank.

This limitation on de novo branching is an obstacle to interstate entry for all banks and also creates special problems for small banks seeking to operate across State lines. Moreover, it creates an unlevel playing field between banks and Federal savings associations, which have long been allowed to establish de novo branches on an interstate basis.

The Board's proposed amendment would remove this last obstacle to full interstate branching for banks and level the playing field between banks and thrifts by allowing banks to establish interstate branches on a de novo basis. The amendment also would remove the parallel provision that allows States to impose a minimum requirement on the age of banks that are acquired by an out-of-State banking organization. While the Board supports expanding the de novo branching authority of banks, the Board continues to believe that Congress should not grant this new branching authority to ILC's unless the corporate owners of these institutions are subject to the same type of consolidated supervision and activities restrictions as the corporate owners of other full-service insured banks.

Small Bank Examination Flexibility (Matrix No. 68)

The Board also supports expanding the number of small institutions that may qualify for an extended examination cycle. Federal law currently requires that the appropriate Federal banking agency conduct an on-site examination of each insured depository institution at least once every 12 months. The statute, however, permits institutions that have less than $250 million in assets and that meet certain capital, managerial, and other criteria to be examined on an 18-month cycle. As the primary Federal supervisors for State-chartered banks, the Board and Federal Deposit Insurance Corporation (FDIC) may alternate responsibility for conducting these examinations with the appropriate State supervisory authority if the Board or FDIC determines that the State examination carries out the purposes of the statute.

The $250 million asset cutoff for an 18-month examination cycle has not been raised since 1994. The Board's proposed amendment would raise this asset cap from $250 million to $500 million. Importantly, this change would not exempt any insured depository institution from routine safety and soundness examinations, and would not lengthen the examination cycle for institutions experiencing financial or managerial difficulties. This change is unanimously supported by the Federal banking agencies and potentially would allow approximately an additional 1,200 insured depository institutions to qualify for an 18-month examination cycle. The Board believes this change would provide meaningful relief to small, financially strong institutions without compromising safety and soundness.

The Board's supervisory experience, however, indicates that institutions with assets approaching $1 billion tend to have more complex risk profiles and are more likely to operate business lines on a regional or national basis than institutions with assets of less than $500 million. For these reasons, the Board is not comfortable raising the asset threshold for an 18-month examination cycle to $1 billion, as items No. 112 and No. 169 in the Matrix would do. The Board also does not support proposals, such as item No. 42 in the Matrix, that would allow a Federal banking agency to extend the examination cycle for a potentially indefinite period of time for institutions of any size. Despite advances in off-site monitoring, the Board continues to believe that regular on-site examinations play a critical role in helping bank supervisors detect and correct asset, risk-management, or internal control problems at an institution before these problems result in claims on the deposit insurance funds. If an agency is experiencing shortages in its examination resources, we believe it would be better to address these constraints through the supplementation of the agency's resources, rather than by extending the mandated frequency of safety and soundness examinations.

Other Board Legislative Proposals and Actions to Reduce Regulatory Burden

In addition to these proposals, the Board supports a variety of other regulatory relief amendments included in the Matrix. These amendments, which are discussed more fully in the Appendix, would among other things:

- Restore the Board's ability to determine that nonbanking activities are "closely related to banking" for purposes of Section 4(c)(8) of the Bank Holding Company Act (BHC Act) and, thus, permissible for all bank holding companies to conduct directly or through a nonbank subsidiary (Matrix No. 137(a));
- Streamline the process for insured banks to acquire savings associations and trust companies in interstate merger transactions (Matrix No. 138);
- Modify the cross-marketing restrictions that apply to the merchant banking and insurance company investments of financial holding companies (Matrix No. 139);

- Eliminate certain reporting requirements imposed on banks and their executive officers and principal shareholders that do not contribute significantly to the monitoring of insider lending or the safety and soundness of insured depository institutions (Matrix No. 4);
- Streamline the interagency consultation process for transactions under the Bank Merger Act (Matrix No. 5);
- Shorten the post-approval waiting period for bank acquisitions and mergers where the Attorney General and the relevant Federal banking agency agree the transaction will not have a significant adverse effect on competition (Matrix No. 6);
- Simplify the restrictions governing dividend payments by national and State member banks in a way that would not adversely affect the safety and soundness of member banks (Matrix No. 31); and
- Facilitate the flow of information during the supervisory process by clarifying that depository institutions and others do not waive any privilege they may have with respect to information when they provide the information to a Federal, State, or foreign banking authority as part of the supervisory process (Matrix No. 100).

In our discussions with banking organizations about regulatory relief, one topic that frequently comes up is the Bank Secrecy Act (BSA). We recognize that provisions of the BSA require considerable effort by the banking industry to obtain, document and provide information to law enforcement. To further promote the uniform application of BSA and anti-money laundering (AML) requirements, the Federal banking agencies, working with the Financial Crimes Enforcement Network of the Treasury Department, recently issued a joint BSA/AML Examination Manual that is designed to promote the effective and consistent examination of BSA/AML compliance. The Board will continue to work with our fellow banking agencies and FinCEN to address key issues related to BSA/anti-money laundering compliance. With respect to currency transaction reports (CTR's), we support the efforts of the Treasury Department and others to develop ways of reducing the burdens imposed on banks in a manner that would not adversely affect the ability of banks to manage their risk or unintentionally impede the investigative tools available to law enforcement.

Before moving on, I would like to mention some recent changes that the Board itself has made to its Small Bank Holding Company Policy Statement (Policy Statement) and capital guidelines that we believe should provide significant relief to community banking organizations. The Board adopted the Policy Statement in 1980 to help facilitate the transfer of ownership of small, community-based banks. Currently, the Policy Statement applies to bank holding companies that have consolidated assets of less than $150 million and that meet certain qualitative criteria. These qualitative criteria are designed to ensure that a small bank holding company does not qualify for the Policy Statement if it engages in significant activities outside its supervised bank subsidiaries. Small bank holding companies that qualify for, and operate under, the Policy Statement also are subject to several additional restrictions and conditions that are designed to ensure that they do not present an undue risk to the safety and soundness of their subsidiary banks.

Last week, the Board approved an amendment that increases to $500 million the asset size threshold for determining whether a bank holding company may qualify for the Policy Statement and the related exemption from the Board's capital guidelines for bank holding companies. The Board also has proposed to make conforming revisions to its regulatory reporting framework, which should further lower reporting and compliance costs for small bank holding companies. The Board believes these actions properly balance the goals of facilitating the transfer of ownership of small banks, on the one hand, and ensuring capital adequacy and access to necessary supervisory information on the other hand. The Board, however, does not support amendments, like item No. 116 in the Matrix, that potentially would require the Board to raise the asset size threshold in the Policy Statement to $1 billion.

Industrial Loan Companies

As I noted earlier, the Board strongly supports amendments that would allow depository institutions to pay interest on demand deposits and allow banks to open de novo branches on an interstate basis. The Board, however, believes that, because the corporate owners of ILC's operate outside the prudential and legislative framework applicable to the corporate owners of other types of insured banks, ILC's should *not* be authorized to offer transaction accounts to business customers or branch de novo across State lines. Our position on these matters is long-standing and based on the broad policy issues presented by the special exemption in current law for ILC's chartered in certain States.

ILC's are banks; specifically, they are State-chartered FDIC-insured banks. However, due to a special exemption in the Federal BHC Act, any type of company, including a commercial or retail firm, may acquire an ILC in a handful of States—principally Utah, California, and Nevada—and avoid the activity restrictions and consolidated supervisory requirements that apply to bank holding companies.

ILC's were first established early in the 20th century to make small loans to industrial workers. When the special exemption for ILC's initially was granted in 1987, ILC's were still mostly small, local institutions that had only limited deposit-taking and lending powers. For example, in 1987, most ILC's had less than $50 million in assets and the largest ILC had assets of less than $400 million. Moreover, in 1987, the relevant States were not actively chartering new ILC's. Utah, for example, had a moratorium on the chartering of new ILC's at the time the exemption was enacted.

However, as the Government Accountability Office (GAO) recently documented, the ILC exemption has been actively exploited in recent years, resulting in a significant change in the character, powers, and ownership of ILC's. For example, one ILC operating under the exception now has more than $60 *billion* in assets and more than $52 *billion* in deposits, and an additional nine exempt ILC's each have more than $1 billion in deposits. The aggregate amount of estimated insured deposits held by all ILC's has grown by more than 500 percent since 1999, and the total assets of all ILC's has grown from $3.8 billion in 1987 to $140 billion in 2004. Several large, internationally active commercial companies now own ILC's under this exception and use these banks to support various aspects of their global commercial operations.

While only a handful of States have the ability to charter exempt ILC's, there is no limit on the number of exempt ILC's these grandfathered States may charter in the future. In addition, due to the limited restrictions that apply under Federal law to the ILC's operating under this exemption, an exempt ILC legally may engage in the full range of commercial, mortgage, credit card, and consumer lending activities; offer payment-related services, including Fedwire, automated clearing house (ACH) and check clearing services, to affiliated and unaffiliated persons; and accept time and savings deposits, including certificates of deposit (CD's), from any type of customer.

Why does this growth and potential further expansion of ILC's matter? Simply stated, it has the potential to undermine several important policies that Congress has established for the banking system. Let me explain.

Congress has established a prudential framework for banking organizations in the United States that is based both on the supervision of insured banks *and* the supervision of their corporate owners on a group-wide or consolidated basis. Consolidated supervision refers to the legal framework that provides a supervisor the tools it needs—such as reporting, examination, capital and enforcement authority—to understand, monitor and, when appropriate, restrain the risks associated with an organization's consolidated or group-wide activities. Consolidated supervision of the organizations that control banks not only helps prevent bank failures, it also provides important tools for managing and resolving bank failures if and when they do occur. In fact, following the collapse of Bank of Commerce and Credit International (BCCI), which lacked a single supervisor capable of monitoring its diverse and global activities, Congress amended the BHC Act in 1991 to require that foreign banks demonstrate that they are subject to comprehensive supervision on a consolidated basis prior to acquiring a bank in the United States.

For a variety of reasons, Congress also has long sought to maintain the general separation of banking and commerce in the United States. This position was reaffirmed by Congress in the Competitive Equality Banking Act of 1987 and again in the GLB Act of 1999. In fact, in each of these acts the Congress took affirmative action to close the main loophole then being used by commercial firms to acquire FDIC-insured depository institutions—the so-called "nonbank bank" loophole in 1987 and the unitary thrift loophole in 1999.

ILC's have developed and expanded in recent years outside this framework that governs banking organizations generally. Because of their special exemption in Federal law, any type of company may acquire an FDIC-insured ILC that is chartered in certain States without regard to the activity restrictions that Congress has established to maintain the general separation of banking and commerce. The exemption also allows a company to acquire an FDIC-insured bank and avoid the consolidated supervisory framework—including consolidated capital, examination and reporting requirements—that applies to the corporate owners of other full-service insured banks under the BHC Act. In addition, the exemption allows a foreign bank to acquire a U.S. bank engaged in retail banking activities without meeting the requirement under the BHC Act that the foreign bank be subject to comprehensive supervision on a consolidated basis in its home country.

As insured banks, each ILC is supervised by the FDIC as well as by its chartering State. The Board has never questioned either the need for, or the adequacy of, this supervision of an ILC. However, experience has led Congress to determine that supervision of a full-service insured bank is not sufficient, by itself, to protect the taxpayer and the financial system when the bank operates as part of a larger corporate organization. The FDIC does not have the authority to supervise the corporate owners of ILC's and their affiliates in the same manner that bank holding companies and their nonbank affiliates are supervised under the BHC Act. The GAO recently concluded that, due to these differences in authority, exempt ILC's may pose more risk to the deposit insurance funds than banks operating in a bank holding company structure.

The exemption for ILC's in the BHC Act also permits a diversified securities, insurance or financial firm to acquire an FDIC-insured bank without complying with the enhanced capital, managerial and Community Reinvestment Act (CRA) requirements established by Congress in the GLB Act for financial holding companies. In addition, although the USA PATRIOT Act requires the Board to consider the effectiveness of a company's policies in combating money laundering prior to approving the company's application to acquire a bank, this requirement does not apply to companies that seek to acquire an exempt ILC.

Affirmatively granting ILC's the ability to offer transaction accounts to business customers or open de novo branches nationwide would significantly expand the powers of exempt ILC's, increase the attractiveness of the current loophole, and eliminate any vestige of a distinction between ILC's and full-service insured banks. This result would be inconsistent with both the historical functions of ILC's and the terms of their special exemption in current law. These proposals individually and collectively also would exacerbate the competitive advantage that the corporate owners of ILC's have over other banking organizations that operate within the supervisory framework established by Congress.

The Board believes that the important principles governing the structure of the Nation's banking system—such as the separation of banking and commerce, consolidated supervision, and the supervisory criteria applicable to companies that seek to own or control a bank—should be decided by Congress and, once established, should apply to all organizations that own a bank in a competitively equitable manner. We are concerned that the expansion and exploitation of the ILC exemption is undermining the prudential framework that Congress has carefully crafted and developed for the corporate owners of insured banks. Importantly, these changes also threaten to remove from Congress' hands the ability to determine the direction of our Nation's financial system with regard to the mixing of banking and commerce.

Congress should not permit the Nation's policy on these important issues to be decided for it on a de facto basis through the expansion of a loophole that is available to only one type of institution chartered in a handful of States. Rather than expanding the powers of ILC's that operate under this special exemption in a regulatory relief bill, we believe it is important for Congress separately to conduct a thorough review of the special exemption for ILC's and its potential to change the landscape of our financial system and create an unlevel competitive playing field.

Conclusion

I appreciate the opportunity to discuss the Board's legislative suggestions and priorities concerning regulatory relief. The Board looks forward to working with the Committee and your staffs in developing and advancing meaningful regulatory relief legislation that is consistent with the Nation's public policy objectives.

PREPARED STATEMENT OF DOUGLAS H. JONES

ACTING GENERAL COUNSEL, FEDERAL DEPOSIT INSURANCE CORPORATION

MARCH 1, 2006

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I appreciate the opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on proposed legislative initiatives to provide regulatory burden relief to the financial services industry while insuring appropriate safety and soundness and consumer protections are retained. The FDIC shares the Committee's continuing commitment to eliminate unnecessary burden and to streamline and modernize laws and regulations as the financial industry evolves. Also, we would like to thank Senator Crapo and his staff as well as the Committee staff who have worked with us to review the proposals. In addition, the inclusion of consumer groups in reviewing and commenting on the many burden relief proposals has provided a wider range of perspectives and beneficial analysis.

The Federal financial institution regulatory agencies (regulatory agencies) have been working together over the last few years to identify regulatory requirements that are outdated, unnecessary, or unduly burdensome, in accordance with the requirements of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). The agencies have identified numerous proposals to reduce regulatory burden. We continue to work with the other agencies in an effort to achieve greater consensus and, as required by law, we will submit a final report to Congress with legislative recommendations later this year.

In my testimony today, I will briefly describe a few examples of burden reduction and operational efficiencies undertaken by the FDIC, or implemented as interagency initiatives, which are expected to relieve regulatory burden, clarify regulatory requirements or assist financial institutions to improve their operations. Next, I will identify a number of legislative burden relief proposals that are supported by all of the Federal regulatory agencies. Finally, I will address specific legislative provisions that the FDIC has proposed to improve our performance.

Recent Interagency and FDIC Actions

The FDIC and the other regulatory agencies are committed to improving the quality and efficiency of financial institution regulation and to reducing administratively unnecessary regulatory burden where it is identified and where changes to current practices do not diminish public protections. We are also examining and revising our regulations, procedures, and industry guidance to improve how we relate to the industry and its customers. Included among the changes we have made recently are the following items.

HURRICANE RECOVERY

The regulatory agencies worked cooperatively with State regulatory agencies and other organizations to determine the status of financial institutions located in the areas affected by Hurricanes Katrina, Rita, and Wilma. The agencies established a taskforce to address policy issues that arose due to the severity of these natural disasters. The agencies quickly released regulatory relief guidance to help rebuild areas affected by the hurricane and encouraged bankers to work with consumers and business owners experiencing difficulties due to the storms. Exercising their authority under Section 2 of the Depository Institutions Disaster Relief Act of 1992 (DIDRA), the agencies made exceptions to statutory and regulatory requirements when the exceptions would facilitate recovery from the disaster and would be consistent with safety and soundness.

CALL REPORT MODERNIZATION

The FDIC, Federal Reserve Board and Office of the Comptroller of the Currency implemented the Central Data Repository (CDR) designed to modernize and streamline how the agencies collect, process, and distribute bank financial data. The CDR system took effect beginning with the third quarter 2005 Call Report Data. Under this new system, institutions file their Call Report data via the internet using software that contains edits by the Federal Financial Institutions Examination Council (FFIEC) for validating Call Report data before submission.

CALL REPORT REVISIONS

In September, the FDIC, Office of the Comptroller of the Currency and Federal Reserve Board requested comments on proposed revisions to the Call Report, representing the first set of revisions to the content since March 2002. The proposed changes would affect banks of all sizes and would take effect as the March 31, 2006 report date. The proposed revisions would enhance the agencies' on- and off-site supervision activities, which should alleviate some overall regulatory burden on banks.

FDICCONNECT

FDIC*connect* is a secure website that allows FDIC-insured institutions to conduct business and exchange information with the FDIC. FDIC*connect* supports examination file exchange and electronic distribution of Special Alerts. FDIC*connect* reduces regulatory burden by providing a more efficient means for insured institutions to interact with the FDIC and various States. This is accomplished by improving processes to enable more efficient and effective communication and customer support. For example, institutions may obtain quarterly certified statement invoices for deposit insurance assessments online, thus reducing burden on institutions by eliminating the requirement that institutions sign and return corrected invoices. In 2005, the number of electronic bank applications that can be filed was expanded from three to six. There are now 20 business transactions available through FDIC*connect*.

RELATIONSHIP MANAGER PROGRAM

On September 30, 2005, the Corporation implemented the Relationship Manager Program for all FDIC-supervised institutions. The Program, which was piloted in 390 institutions during 2004, is designed to strengthen communication between bankers and the FDIC, as well as improve the coordination, continuity, and effectiveness of regulatory supervision. Each FDIC-supervised institution is assigned a relationship manager who will serve as a local point of contact over an extended period, and will often participate in or lead examinations for their assigned institution.

EGRPRA Interagency Consensus Items

Through the interagency EGRPRA effort led by former FDIC Vice Chairman John Reich, now Director of the Office of Thrift Supervision, consensus among all of the Federal regulatory agencies was reached on twelve regulatory burden relief proposals. One of these proposals addressing possible reforms to the flood insurance program has been overtaken by the devastation and aftermath of Hurricane Katrina. Clearly, the need for comprehensive flood insurance reform is apparent and is being addressed through separate legislative efforts. We withdraw our earlier proposal regarding flood insurance and stand ready to assist the Committee in their review of the program.

The FDIC joins with the other Federal regulatory agencies in supporting inclusion of the remaining eleven interagency consensus proposals for regulatory burden relief:

Repeal Certain Reporting Requirements Relating to Insider Lending

These amendments repeal certain reporting requirements related to insider lending imposed on banks and savings associations, their executive officers, and their principal shareholders. The reports recommended for elimination are: (1) reports by executive officers to the board of directors whenever an executive officer obtains a loan from another bank in an amount more than he or she could obtain from his or her own bank; (2) quarterly reports from banks regarding any loans the bank has made to its executive officers; and (3) annual reports from bank executive officers and principal shareholders to the bank's board of directors regarding their outstanding loans from a correspondent bank.

The Federal regulatory agencies have found that these particular reports do not contribute significantly to the monitoring of insider lending or the prevention of insider abuse. Identifying insider lending is part of the normal examination and supervision process. The proposed amendments would not alter the restrictions on insider loans or limit the authority of the Federal regulatory agencies to take enforcement action against a bank or its insiders for violations of those restrictions.

Streamline Depository Institution Merger Application Requirements

This proposal streamlines merger application requirements by eliminating the requirement that each Federal regulatory agency must request a competitive factors report from the other three Federal regulatory agencies, in addition to requesting a report from the Attorney General. Instead, the agency reviewing the application would be required to request a report only from the Attorney General and give notice to the FDIC as insurer.

Improve Information Sharing with Foreign Supervisors

This proposal amends Section 15 of the International Banking Act of 1978 to add a provision to ensure that the Federal Reserve, OCC, FDIC, and OTS cannot be compelled to disclose information obtained from a foreign supervisor in certain circumstances. Disclosure could not be compelled if public disclosure of the information would be a violation of the applicable foreign law and the U.S. regulatory agency obtained the information under an information sharing arrangement or other procedure established to administer and enforce the financial institution laws. This amendment would reassure foreign supervisors that may otherwise be reluctant to enter into information sharing agreements with U.S. regulatory agencies because of concerns that those agencies could not keep the information confidential and public disclosure could subject the foreign supervisor to a violation of its home country law. It also would facilitate information sharing necessary to supervise institutions operating internationally, lessening duplicative data collection by individual national regulators. The regulatory agency, however, cannot use this provision as a basis to withhold information from Congress or to refuse to comply with a valid court order in an action brought by the United States or the agency.

Provide an Inflation Adjustment for the Small Depository Institution Exception under the Depository Institution Management Interlocks Act

This proposal increases the threshold for the small depository institution exception under the Depository Institution Management Interlocks Act. Under current law, a management official generally may not serve as a management official for another nonaffiliated depository institution or depository institution holding company if their offices are located, or they have an affiliate located, in the same metropolitan statistical area (MSA). For institutions with less than $20 million in assets, this MSA restriction does not apply. The proposal would increase the MSA threshold, which dates back to 1978, to $100 million.

Call Report Streamlining

This proposal requires the Federal regulatory agencies to review information and schedules required to be filed in Reports of Condition (Call Reports) every 5 years to determine if some of the required information and schedules can be eliminated. Currently, banks must report substantial amounts of financial and statistical information with their Call Report schedules that appear to many bankers to be unnecessary to assessing the financial health of the institution and determining the amount of insured deposits it holds. This amendment would require the agencies to review their real need for information routinely so as to reduce that burden.

Enhance Examination Flexibility

Currently, the FDI Act requires the regulatory agencies to conduct a full-scale, on-site examination of the insured depository institutions under their jurisdiction at least once every twelve months. The FDI Act provides an exception for small institutions—that is institutions with total assets of less than $250 million—that are well-capitalized and well-managed, and meet other criteria. Examinations of these qualifying smaller institutions are required at least once every 18 months. This interagency proposal raises the total assets ceiling for small institutions to qualify for an 18-month examination cycle from $250 million to $500 million, thus potentially permitting more institutions to qualify for less frequent examinations. This would reduce regulatory burden on low-risk, smaller institutions and permit the regulatory agencies to focus their resources where the great majority of the industry's assets and deposits are.

Shorten Post-Approval Waiting Period on Bank Mergers and Acquisitions Where There Are No Adverse Effects on Competition

This proposal would amend the Bank Holding Company Act and the FDI Act to shorten the current 15-day minimum post-approval waiting period for certain bank acquisitions and mergers when the appropriate Federal regulatory agency and the Attorney General agree that the transaction would not have significant adverse effects on competition. Under those circumstances, the waiting period could be shortened to 5 days. However, these amendments would not shorten the time period for private parties to comment on the transaction prior to approval under the public notice requirements.

Exempt Merger Transactions Between an Insured Depository Institution and One or More of its Affiliates from Competitive Factors Review and Post-Approval Waiting Periods

This proposal amends the Bank Merger Act (12 U.S.C. 1828(c)) to exempt certain merger transactions from both the competitive factors review and post-approval waiting periods. It applies only to merger transactions between an insured depository institution and one or more of its affiliates, as this type of merger is generally considered to have no affect on competition.

Authorize the Federal Reserve to Pay Interest on Reserves

This proposal would give the Federal Reserve Board express authority to pay interest on balances that depository institutions are required to maintain at the Federal Reserve Banks. By law, depository institutions are required to hold funds against transaction accounts held by customers of those institutions. These funds must be held in cash or on reserve at Federal Reserve Banks. Over the years, institutions have tried to minimize their reserve requirements. Allowing the Federal Reserve Banks to pay interest on those reserves should put an end to economically wasteful efforts by banks to circumvent the reserve requirements. Moreover, it could be helpful in ensuring that the Federal Reserve will be able to continue to implement monetary policy with its existing procedures.

Increase Flexibility for the Federal Reserve Board to Establish Reserve Requirements

This proposal gives the Federal Reserve Board greater discretion in setting reserve requirements for transaction accounts below the ranges established in the Monetary Control Act of 1980. The provision would eliminate current statutory minimum reserve requirements for transaction accounts, thereby allowing the Board to set lower reserve requirements, to the extent such action is consistent with the effective implementation of monetary policy.

Authorize Member Banks to Use Pass-Through Reserve Accounts

This proposal allows banks that are members of the Federal Reserve System to count as reserves their deposits in affiliated or correspondent banks that are in turn "passed through" by those banks to the Federal Reserve Banks as required reserve balances. It extends to these member banks a privilege that was granted to nonmember institutions at the time of the Depository Institutions Deregulation and Monetary Control Act of 1980.

Provisions to Increase FDIC Efficiency

The FDIC has also developed several proposals that will help the FDIC become more efficient and effective in its regulation of insured institutions as described below.

JUDICIAL REVIEW OF CONSERVATORSHIP AND RECEIVERSHIP APPOINTMENTS

This proposal specifies the time period during which the appointment, in certain circumstances, of the FDIC as conservator or receiver of a failed insured depository institution could be challenged. Moreover, this provision provides greater certainty to the receiver's activities and to those doing business with the receiver.

Currently, some provisions of Federal law specify a 30-day period for challenges after appointment of a receiver. In contrast, other provisions of the FDI Act that govern appointment of a conservator or receiver by the appropriate Federal regulatory agencies for a State-chartered institution under prompt corrective action provisions and the FDIC's appointment of itself as conservator or receiver for an insured depository institution are silent on the limitations period for challenges to those appointments. At least one court has previously held that the Administrative Procedure Act applied because the National Bank Receivership Act was silent regarding the time period for challenging such an appointment. The court held that the national bank had 6 years from the date of appointment to challenge the action. The proposed legislation remedies the silence in the National Bank Receivership Act and in the FDI Act consistent with the parallel provisions in Section 5 of the Home Owners' Loan Act and another appointments provision of the FDI Act.

ENFORCEMENT OF AGREEMENTS AND CONDITIONS

This proposal enhances the safety and soundness of insured depository institutions and protects the deposit insurance funds from unnecessary losses. The proposed amendment provides that the Federal regulatory agencies may enforce (i) conditions imposed in writing, and (ii) written agreements in which an institution-affiliated party agreed to provide capital to the institution. The proposal similarly would clarify existing authority of the FDIC as receiver or conservator to enforce written conditions or agreements entered into between insured depository institutions and institution-affiliated parties and controlling shareholders.

In addition, the proposal eliminates the requirement that an insured depository institution be undercapitalized at the time of a transfer of assets from an affiliate or controlling shareholder to the insured institution in order to prevent a claim against a Federal regulatory agency for the return of assets under bankruptcy law. Under Section 18(u) of the FDI Act, protection against a claim for the return of assets would still require that, at the time of transfer, the institution must have been subject to written direction from a Federal regulatory agency to increase its capital and, for that portion of the transfer made by a broker, dealer, or insurance firm, the Federal regulatory agency must have followed applicable procedures for those functionally regulated entities.

AMENDMENT CLARIFYING FDIC'S CROSS GUARANTEE AUTHORITY

This proposal will correct a gap in current law regarding cross guarantee liability. As part of the Federal Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Congress established a system that permits the FDIC to assess liability for FDIC losses caused by the default of an insured depository institution. Cross guarantee liability, however, is currently limited to commonly controlled insured depository institutions as defined in the statute. Because the statutory definition does not include certain types of financial institutions such as credit card banks that are controlled by nonbank holding companies, liability may not attach to insured institutions that are owned by the same nonbank holding company.

Over the years, a growing number of companies have acquired, either directly or through an affiliate, one or more credit card banks, trust companies, industrial loan companies, or some combination of those types of institutions. Because these companies do not fall within the scope of depository institution holding companies for common control purposes, in the event of default, the FDIC may not be able to assess cross guarantee liability as envisioned in the statute. The proposal corrects language to strengthen the FDIC's efforts to protect the deposit insurance funds when it is determining whether and to what extent to exercise its discretionary authority to assess cross guarantee liability. The assessment of liability would continue to be only against the insured depository institution under common control with the defaulting institution.

AMENDMENT CLARIFYING THE FDIC'S GOLDEN PARACHUTE AUTHORITY

This proposal amends Section 18(k) of the FDIC Act to clarify that the FDIC could prohibit or limit a nonbank holding company's golden parachute payment or indemnification payment. In 1990, Congress added this section to the FDI Act and authorized the FDIC to prohibit or limit prepayment of salaries or any liabilities or legal expenses of an institution-affiliated party by an insured depository institution or depository institution holding company. Such payments are prohibited if they are made in contemplation of the insolvency of such institution or holding company or if they prevent the proper application of assets to creditors or create a preference for creditors of the institution. Due to the statutory definition of depository institution holding company, it is not clear that the FDIC is authorized to prohibit these types of payments made by nonbank holding companies. Some examples are companies that own only credit card banks, trust companies, or industrial loan companies.

The lack of clear authority for the FDIC to prohibit payments made by nonbank holding companies to institution-affiliated parties frustrates the purpose of the legislation by allowing nonbank holding companies to make golden parachute payments when an institution is insolvent or is in imminent danger of becoming insolvent to the detriment of the institution, the insurance funds, and the institution's creditors. The proposed amendment strengthens the FDIC's efforts to protect the insurance funds and ensure that an insured institution does not make these payments to the detriment of the institution.

CHANGE IN BANK CONTROL ACT AMENDMENTS

This proposal amends the Change in Bank Control Act to address an issue that arises when a "stripped charter" institution is the subject of a change-in-control notice. A stripped charter is essentially a bank charter with insurance, but without any significant ongoing business operations. Such "stripped charters" can result after a purchase and assumption transaction where the assets and liabilities of an institution are transferred to an acquiring institution, but the charter remains and may have value attached to it.

The Change in Bank Control Act provides the appropriate Federal regulatory agency with authority to disapprove a change-in-control notice within a set period of time. The availability of stripped charters for purchase in the establishment of new financial institution operations is sometimes used as an alternative to de novo charter and deposit insurance applications. Change-in-control notices are subject to strict time periods for disapproval and extensions of time beyond the 45 days for review. These time frames place significant pressures on the agencies when they are required to analyze novel or significant issues or complex or controversial business proposals. For example, issues presented by change-in-control notices proposing control by nonresident foreign nationals, or issues presented where third parties are proposed to have significant participation in the financial institution's operations, generally require additional scrutiny to satisfy safety and soundness concerns. This proposal clarifies the bases for which such notices may be disapproved and expand the bases for extensions of time for consideration of certain notices raising novel or significant issues. The provision is a safety and soundness measure that would greatly increase the agencies' ability to adequately consider the risks inherent in a proposed business plan and to use that information in determining whether to disapprove a notice of change-in-control.

RECORDKEEPING AMENDMENT

This proposal modifies the requirement for retention of old records of a failed insured depository institution at the time a receiver is appointed. Currently, the statute requires the FDIC to preserve all records of a failed institution for 6 years from the date of its appointment as receiver, regardless of the age of the records at the time of the failure. After the end of 6 years, the FDIC can destroy any records that it determines to be unnecessary, unless directed not to do so by a court or a government agency or prohibited by law. Consequently, the FDIC must preserve for 6 years very old records that have no value to the FDIC, the public interest, or to any pending litigation.

The proposed provision allows the FDIC to destroy records that are 10 or more years old at the time of its appointment as receiver that are not relevant to any pending or reasonably probable future litigation, unless directed not to do so by a court or a government agency or prohibited by law. This change benefits the FDIC and/or acquirers of failed institutions by reducing the storage costs for these outdated records.

PRESERVATION OF RECORDS BY OPTICAL IMAGING AND OTHER MEANS

This proposal permits the FDIC to rely on records preserved electronically, such as optically imaged or computer scanned images, as well as the "preservation of records by photography" currently provided by the statute.

Under present law, the FDIC is permitted to use "permanent photographic records" in place of original records for all purposes, including introduction of documents into evidence in State and Federal court. The substance of the statute has been unchanged since 1950. Because of the advent of electronic information systems and imaging technologies that do not have any photographic basis, this amendment would significantly aid the FDIC in preservation of documents by newer methods. In addition, it can be expected that the technology in this area will continue to develop. This amendment is intended to provide the FDIC with the flexibility to rely on appropriate new technology, while retaining the requirement that our Board of Directors prescribe the manner of the preservation of records to ensure their reliability, regardless of the technology used.

CLARIFICATION OF SECTION 8(g) PROHIBITION AUTHORITY

Section 8(g) of the FDI Act provides the appropriate Federal regulatory agency with the authority to suspend or prohibit individuals charged with certain crimes from participation in the affairs of the depository institution with which they are affiliated. This proposal clarifies that the agency may suspend or prohibit those individuals from participation in the affairs of *any* depository institution and not solely the insured depository institution with which the institution affiliated party is or was associated. The provision will make clear that a Federal regulatory agency may use the Section 8(g) remedy even where the institution that the individuals were associated with ceases to exist.

AUTHORITY TO ENFORCE CONDITIONS ON THE APPROVAL OF DEPOSIT INSURANCE

This proposal amends Section 8 of the FDI Act to provide each of the other three appropriate Federal regulatory agencies with express statutory authority to take enforcement action against the financial institutions they supervise based upon a violation of a condition imposed by the FDIC in writing in connection with the approval of an institution's application for deposit insurance.

The FDIC frequently imposes written conditions when approving deposit insurance to a de novo bank or thrift pursuant to Section 5 of the FDI Act (application for deposit insurance). Because of a drafting anomaly under current law, the other three appropriate Federal regulatory agencies cannot enforce violations of deposit insurance conditions by their supervised institutions. Currently, our only recourse—for institutions that we do not serve as primary regulator—is to commence deposit insurance termination proceedings. This provision would provide express enforcement authority for the involved institution's appropriate Federal regulatory agency.

CLARIFICATION OF SECTION 8 ENFORCEMENT AUTHORITY THAT CHANGE-IN-CONTROL CONDITIONS ARE ENFORCEABLE

The FDIC recommends language that clarifies the appropriate Federal regulatory agencies' authority to take enforcement action against the banks they supervise based on a violation of a condition imposed in writing in connection with any action by the agency on an application, notice, or other request by an insured depository institution or institution-affiliated party. The agencies frequently provide conditions on applications, notices, or other requests, and the proposed change to Section 8 of the FDI Act would expressly provide that this enforcement authority applies equally to conditions imposed in connection with notices and to applications, notices, or other requests by an institution-affiliated party.

DEPOSIT INSURANCE RELATED TO THE OPTIONAL CONVERSION OF FEDERAL SAVINGS ASSOCIATIONS

Under a provision adopted in the Gramm-Leach-Bliley Act (Section 739), Section 5(i)(5) of the Home Owners' Loan Act permits Federal savings associations with branches in one or more States to undergo a conversion into one or more national or State banks. Such conversions require the approval of the OCC and/or the appropriate State authorities. However, Section 739 does not specifically mention either deposit insurance or the FDIC.

The FDIC supports an amendment to Section 739 clarifying that conversions under that section, which result in more than one bank, would continue to require deposit insurance applications from the resulting institutions, as well as review and approval by the appropriate Federal regulatory agency. A one-to-one conversion does not change the risk to the deposit insurance funds because it involves one institution simply changing charters. However, a "breakup conversion" presents a potential increase in risk to the insurance funds because two or more institutions are created with risk profiles that are likely to differ from the original institution.

BANK MERGER ACT AND BANK HOLDING COMPANY ACT—CONSIDERATION OF POTENTIAL EFFECTS ON DEPOSIT INSURANCE FUND

The FDIC supports amendments to the Bank Merger Act and Bank Holding Company Act to require consideration of the potentially adverse effects on the deposit insurance fund of any proposed bank merger transaction or holding company formation/acquisition. As presently written, these laws do not require that any specific consideration be given to a transaction's possible impact on the deposit insurance fund. The omission is noteworthy and potentially damaging to the financial viability of the fund.

Language specifying consideration of risks to the deposit insurance fund already exists for consideration of other transactions. For example, regarding change in control of insured financial institutions, the FDI Act provides authority to the appropriate Federal regulatory agency to disapprove any proposed acquisition if the agency determines that the proposed transaction would result in an adverse effect on the deposit insurance fund.

In addition, Section 207 of FIRREA amended Section 6 of the FDI Act to include a new factor—"the risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund"—that must be considered in granting deposit insurance. Additional parallels can also be found in Sections 24 and 28 of the FDI Act.

Given the potential insurance risks inherent in transactions involving large diversified financial services organizations, the addition of an "adverse effect on the deposit insurance fund" assessment factor as a requirement under the Bank Merger Act and Bank Holding Company Act would seem warranted. As with the other factors, each of the agencies would be required to make a separate "adverse effect on the deposit insurance fund" evaluation during its review of the proposed transaction. The intent would be to ensure that the financial integrity of the deposit insurance fund is a prime consideration in any proposed combination. As indicated, there is precedent in other financial institution application reviews and we believe a compelling case can be made for its inclusion in both the Bank Merger Act and the Bank Holding Company Act.

RECEIVER'S OR CONSERVATOR'S CONSENT REQUIREMENT

This proposal would require the consent of the receiver or conservator before a party to a contract to which the depository institution is a party could exercise any right or power to terminate, accelerate, or declare a default under any contract, or to obtain possession of or exercise control over any property of the institution or affect any contractual rights of the institution. Currently a conservator or receiver has the power to seek a 45- or 90-day stay of legal actions following appointment of the receiver, which must be granted, by any court with jurisdiction of such action or proceeding. However, parties to contracts with the depository institution are able to take unilateral action based on contractual rights without the foreknowledge of the receiver or conservator. The proposal would require the consent of the receiver or conservator before a party could exercise such contract provisions.

The FDIC also suggests including language that will:

- Provide for the FDIC in its role as receiver of failing institutions to gain access to individual FICO scores to improve the FDIC's ability to evaluate assets and recommend transaction structures for failing banks;
- Clarify the provision of the FDI Act relating to the resolution of deposit insurance disputes in the case of failed insured depository institutions;
- Clarify that the FDIC is a "covered agency" for purposes of sharing confidential information among the Federal regulatory agencies and other "covered agencies" without losing the work-product, attorney-client, or other privileges recognized under Federal or State law.

Conclusion

Thank you for the opportunity to present the FDIC's views on these issues. The FDIC supports the Committee's continued efforts to reduce unnecessary burden on insured depository institutions without compromising safety and soundness or consumer protection. We continually strive for more efficiency in the regulatory process and are pleased to work with the Committee in accomplishing this goal.

PREPARED STATEMENT OF JULIE L. WILLIAMS

FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL
OFFICE OF THE COMPTROLLER OF THE CURRENCY

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Introduction

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I appreciate this opportunity to appear before you today on behalf of the Office of the Comptroller of the Currency (OCC) to further the goal of reducing unnecessary regulatory burden on America's banks. I also want to take this opportunity to again express our appreciation to Senator Crapo for his continuing dedication to this issue.

The OCC welcomes the opportunity to offer suggestions for reforms that would affect all depository institutions, and to discuss particular proposals affecting national banks and the national banking system. We appreciate your holding this hearing today and we welcome this initiative to pursue regulatory burden relief legislation.

The impact of unnecessary burdens is not one-dimensional—it is not simply a matter of bank costs. When unnecessary regulatory burdens drive up the cost of doing business for banks, bank customers feel the impact in the form of higher prices and, in some cases, diminished product choice. Unnecessary regulatory burden also can become an issue of competitive viability, particularly for our Nation's community banks. Over-regulation neither encourages greater competition nor improved allocation of resources; to the contrary, it can shackle competition and lead to inefficient use of resources.

The regulatory burdens imposed on our banks arise from several sources. One source is regulations promulgated by the Federal banking agencies. Thus, as regulators we need to recognize that we have a responsibility to ensure that our regulations effectively protect safety and soundness, foster the integrity of bank operations, and safeguard the interests of consumers, *and* do not impose regulatory burdens that exceed what is necessary to achieve those goals. We should be guided by these principles when we adopt new rules, and when we review and revise existing ones.

We also need to recognize that not all the regulatory burdens imposed on banks today come from regulations. Another source of regulatory burden is mandates of Federal legislation. Relief from some manifestations of unnecessary regulatory burden requires action by Congress. My testimony contains a number of recommendations for legislative changes to reduce unnecessary regulatory burden by adding provisions to law to provide new flexibilities, modify requirements to be less burdensome, and in some cases, eliminate certain requirements currently in the law.

My testimony will:

- Summarize how the Federal banking agencies are working together under the able leadership of Director Reich of the Office of Thrift Supervision (OTS) through the process required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) to identify unnecessary regulatory burdens, highlight several regulatory initiatives that the OCC is pursuing with the other Federal banking agencies to reduce burden, and summarize important regulatory burden implications of actions of other agencies; and
- Summarize several of the OCC's priority legislative items for regulatory burden relief, provide an overview of some other legislative items that the OCC supports, and note additional comments about other legislative proposals.

Regulatory Initiatives to Address Regulatory Burden

EGRPRA Process

The OCC has been and continues to be an active participant in and supporter of the regulatory burden reduction initiative being led by OTS Director Reich. Under Director Reich's capable and dedicated leadership, the Federal banking agencies have been working together since 2003 to complete the regulatory review required under Section 2222 of EGRPRA. On a 10-year cycle, Section 2222 requires the Federal Financial Institutions Examination Council and each Federal banking agency to identify outdated, unnecessary regulatory requirements and, in a report to Congress, to address whether such regulatory burdens can be changed through regulation or require legislative action. The agencies are required to complete the publication and review cycle by September 2006 and then will submit the report to Congress shortly thereafter.

The Federal banking agencies—the OCC, the Board of Governors of the Federal Reserve System (Fed), the Federal Deposit Insurance Corporation (FDIC), and OTS—divided their regulations into thirteen categories for purposes of publishing those regulations for review as part of the EGRPRA process. In six public notices published between mid-2003 and the beginning of 2006, the agencies have requested public comment in all categories of their rules. The comment period for the last notice published in early January 2006 requesting public comment on rules pertaining to Prompt Corrective Action and the Disclosure and Reporting of CRA-Related Agreements does not close until April 4. To date, we have received over 800 comments on our notices. Every comment received will be considered in formulating the agencies' recommendations for specific regulatory changes as well as legislative recommendations.

Moreover, in addition to soliciting written comments, the Federal banking agencies, in conjunction with the Conference of State Bank Supervisors and State regulatory agencies, have held 10 banker outreach meetings in different cities and regions throughout the country to hear first-hand the bankers' concerns and suggestions to reduce burden. In addition, the agencies have held four outreach meetings with consumer and community groups in different parts of the country and three joint outreach meetings with both bankers and consumer/community groups. Through the public comment process and these meetings, the agencies have made every effort to ensure that there is ample opportunity for consumers and the industry to participate in this process.

Other Burden Reduction Regulatory Initiatives

The OCC constantly reviews its regulations to identify opportunities to streamline regulations or regulatory processes, while ensuring that the goals of protecting safety and soundness, maintaining the integrity of bank operations, and safeguarding the interests of consumers are met. In the mid-1990's, pursuant to our comprehensive "Regulation Review" project, we went through every regulation in our rulebook with that goal in mind. We have since conducted several supplemental reviews focused on particular areas where we thought further improvements could be made. The following are several significant regulatory projects we are pursuing to identify and reduce unnecessary regulatory burdens.

Improving the Value and Reducing the Burden of Privacy Notices. The OCC, together with the other Federal banking agencies, the Federal Trade Commission, the SEC, and the Commodity Futures Trading Commission, has undertaken an unprecedented initiative to improve and streamline the privacy notices required under GLBA, consistent with current law. In an Advance Notice of Proposed Rulemaking in December 2003, the agencies asked for comments on whether to consider amending their respective privacy regulations to allow, or require, financial institutions to provide alternative types of privacy notices, such as a short-form privacy notice, that would be more understandable and useful for consumers and less burdensome for banks to provide. The agencies also asked commenters to provide sample privacy notices that they believe work well for consumers. Most significantly, the agencies pledged to engage in consumer testing before proposing changes to the privacy regulations.

The OCC and a number of the other agencies then engaged experts in plain language disclosures and consumer testing to assist in conducting focus groups and comprehensive, in-depth consumer interviews to find out what information consumers need to understand and compare privacy practices, and the most effective way to disclose that information to them. The object of the testing is to assess weaknesses with current notices, suggest alternatives that correct these weaknesses, and test these alternatives with consumers. This project has the potential to be a win-win for consumers and financial institutions. Shorter, more focused notices will lessen the burden on banks. And such notices will enable consumers to make more informed decisions about their personal information. The agencies expect to make public the results of this testing soon, as well as their decision about the need for additional testing. The results of this testing will provide the basis for the agencies' next steps in advancing the use of simplified notices.

Reducing CRA Burden on Small Banks. Another important burden-reduction initiative recently undertaken by the OCC, Fed, and the FDIC was amendments to our Community Reinvestment Act (CRA) regulations. The joint final rule became effective on September 1, 2005. The joint final rule made significant changes to the agencies' regulations that will benefit community banks. Prior regulation defined a "small bank" for purposes of CRA as a bank with assets of up to $250 million. Banks above that asset threshold were categorized as "large" banks for CRA purposes and were subject to a three-part test that separately assesses their lending, services, and investments in their assessment areas.

For purposes of CRA, the new joint final rule creates a new class of "intermediate" small banks, namely those with assets between $250 million and $1 billion. "Intermediate" small banks are subject to the streamlined small bank lending test and a flexible new community development test that considers a mix of community development lending, investment, and services that a bank provides, particularly in light of the bank's resources and capacities, and the needs of the communities it serves. "Intermediate" small banks also are no longer subject to certain data collection and reporting requirements.

The new rule also provides additional flexibility with respect to qualifying "community development" activities. The new rule revises the "revitalize or stabilize" category of "community development" to provide that activities that revitalize or stabilize designated disaster areas or areas designated by the agencies as "distressed or underserved nonmetropolitan middle-income geographies" qualify as community development activities. Notably, banks' qualifying revitalization and stabilization activities to provide assistance to communities in the Hurricanes Katrina and Rita designated disaster areas are eligible for CRA credit under the rule. This change benefits banks of all sizes and the communities in the disaster areas that they serve.

The agencies' joint rule carefully balances the goals of reducing unnecessary regulatory reporting burdens with achieving the goals of the CRA. The agencies expect to issue final questions and answers that provide additional guidance on these new provisions within the next several days.

Other Burden Reduction Areas of Concern

We also appreciate the Committee's interest in examining all sources of regulatory burdens imposed on banks today, including those that do not arise from regulations promulgated by bank regulators. We welcome the continued interest of the Committee in issues such as regulatory implementation of the Bank Secrecy Act and anti-money laundering standards. This area presents particular challenges for burden reduction initiatives because the interests of law enforcement must be carefully weighed, and may outweigh, in some cases, the burden reduction benefits of particular proposals.

We also welcome the Committee's interest in ensuring that any broker rules promulgated by the Securities and Exchange Commission (SEC) to implement the so-called "push-out" provisions of the Gramm-Leach-Bliley Act (GLBA) are faithful to the law's intent and not so burdensome as to drive well-established banking functions out of banks.

In addition, we note that the Committee may consider ways to reduce the disproportionate burden that is being imposed on smaller banks and bank holding companies that are subject to the reporting requirements of Section 404 of the Sarbanes-Oxley Act of 2002. As you know, Section 404 directed the SEC to adopt rules requiring all registered companies to include information in their annual reports on management's responsibility for internal controls over financial reporting and also required independent auditors to attest to, and report on, management's assessment.

Recently, the SEC's Advisory Committee on Smaller Public Companies released a draft of its final report on its website that addresses, among other things, Section 404's high compliance costs for small companies. This draft of the report concludes that "relief is urgently needed" for smaller public companies so that they may cope with the unanticipated escalating costs of complying with Section 404 that have disproportionately affected smaller companies.

Legislative Proposals to Address Regulatory Burden

The OCC has supported a package of legislative amendments that we believe will help reduce unnecessary regulatory burden on national banks and other depository institutions. These items generally are included in the matrix that Senator Crapo was instrumental in assembling. My testimony today will highlight some of those items.[1]

[1] Please refer to the appendices attached to my testimony before the Committee on June 21, 2005 for detailed explanations of the OCC supported items.

National Bank Operations

Expanding the Eligibility for the 18-Month Examination Cycle. The OCC supports amending the Federal Deposit Insurance Act (FDIA) to increase the small bank threshold from $250 million to $1 billion so that more small banks may qualify to be examined on an 18-month rather than an annual cycle. Under current law, insured depository institutions with total assets of $250 million or less that are well capitalized, and, as of the most recent examination, are well managed and have a composite condition of "1" or "2" under the banking agencies' uniform rating system may be examined on an 18-month, rather than an annual cycle in a full-scope, on-site examination.[2] The proposal would change *only* the asset threshold and would not change any of the other requirements in the law.

For national banks, increasing this threshold to $1 billion would mean that approximately 340 more national banks may qualify for the 18-month cycle. Today, approximately 58 percent of all national banks are eligible for the 18-month cycle but, if the law were amended to raise the threshold to $1 billion, approximately 76 percent of all national banks could qualify. This change would ease the examination burden and associated costs for a meaningful number of qualifying national banks without raising safety and soundness concerns. Only the top-rated banks would be eligible for the extended cycle, and we would continue our active off-site monitoring oversight of these banks, as well as accelerating the timing of an on-site examination whenever developments warranted.

Repealing State Opt-In Requirements for De Novo Branching. Repeal of the State opt-in requirement that applies to national banks that choose to expand interstate by establishing branches *de novo* would remove a significant unnecessary burden imposed on national banks that seek to establish new interstate branch facilities to enhance service to customers. Under the Riegle-Neal Banking and Branching Efficiency Act of 1994 (Riegle-Neal), interstate expansion through bank mergers generally is subject to a State "opt-out" that had to be in place by June 1, 1997. Interstate bank *mergers* are now permissible in all 50 States. *De novo* branching, however, is permissible only in those approximately 23 States that have affirmatively opted-in to allow the establishment of new branches in the State. Approximately 17 of these 23 States impose a reciprocity requirement.

In many cases, in order to serve customers in multistate metropolitan areas or regional markets, national banks must structure artificial and unnecessarily expensive transactions in order to establish a new branch across a State border. The OCC supports an amendment that would relieve these unnecessary and costly burdens.

Providing Relief for Subchapter S National Banks. Another priority item supported by the OCC is an amendment that would allow directors of national banks that are organized as Subchapter S corporations to purchase subordinated debt instead of capital stock to satisfy the directors' qualifying shares requirements in national banking law. As a result, the directors purchasing such debt would not be counted as shareholders for purposes of the 100-shareholder limit that applies to Subchapter S corporations. This relief would make it possible for more community banks with national bank charters to organize in Subchapter S form while still requiring that such national bank directors retain their personal stake in the financial soundness of these banks.

Simplifying Dividend Calculations for National Banks. Under current law, the formula for calculating the amount that a national bank may pay in dividends is complex, antiquated, and unnecessary for purposes of safety and soundness. The amendment supported by the OCC would make it easier for national banks to perform this calculation, while retaining safeguards in the current law that provide that national banks need the approval of the Comptroller to pay a dividend that exceeds the current year's net income combined with any retained net income for the preceding 2 years.[3] The amendment would ensure that the OCC would continue to have the opportunity to deny any dividend request that may deplete the net income of a national bank that may be moving toward troubled condition. Other safeguards, such as Prompt Corrective Action, which prohibit any insured depository institution from paying any dividend if, after that payment, the institution would be undercapitalized (*see* 12 U.S.C. § 1831o(d)(1)) would remain in place.

Modernizing Corporate Governance. The OCC also supports an amendment that would eliminate a requirement that precludes a national bank from prescribing, in

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[2] In addition, the law requires that an eligible institution cannot currently be the subject of an enforcement action or the target of a change-in-control transaction during approximately the last year. Moreover, the statute does not prohibit a Federal banking agency from conducting an examination more frequently than required if deemed necessary.

[3] The same rules apply to State member banks but, in the case of State member banks, the Federal Reserve has approval authority.

its articles of association, the method for election of directors that best suits its business goals and needs. Unlike most other companies and State banks, national banks cannot choose whether or not to permit cumulative voting in the election of their directors. Instead, current law *requires* a national bank to permit its shareholders to vote their shares cumulatively. Providing a national bank with the authority to decide for itself whether to permit cumulative voting in its articles of association would conform the National Bank Act to modern corporate codes and provide a national bank with the same corporate flexibility available to most corporations and State banks.

Modernizing Corporate Structure Options. Another amendment supported by the OCC is an amendment to national banking law clarifying that the OCC may permit a national bank to organize in any business form, in addition to a "body corporate." An example of an alternative form of organization that may be permissible would be a limited liability national association, comparable to a limited liability company. The provision also would clarify that the OCC by regulation may provide the organizational characteristics of a national bank operating in an alternative form, consistent with safety and soundness. Except as provided by these organizational characteristics, all national banks, notwithstanding their form of organization, would have the same rights and privileges and be subject to the same restrictions, responsibilities, and enforcement authority.

Organization as a limited liability national association may be a particularly attractive option for community banks. Subject to applicable Federal and State tax rules, the bank may be able to take advantage of pass-through tax treatment for entities organized as limited liability companies (LLC's) under certain tax laws and eliminate double taxation under which the same earnings are taxed both at the corporate level as corporate income and at the shareholder level as dividends. Some States currently permit State banks to be organized as unincorporated LLC's, and the FDIC adopted a rule allowing certain State bank LLC's to qualify for Federal deposit insurance. This amendment would clarify that the OCC can permit national banks to organize in an alternative business form, such as an LLC, in the same manner.

Paying Interest on Demand Deposits. The OCC supports amendments to the banking laws to repeal the statutory prohibition that prevents banks from paying interest on demand deposits.[4] The prohibition on paying interest on demand deposits was enacted approximately 70 years ago for the purpose of deterring large banks from attracting deposits away from community banks. The rationale for this provision is no longer applicable today and financial product innovations, such as sweep services, allow banks and their customers to avoid the statutory restrictions. Repealing this prohibition would reduce costs associated with establishing such additional accounts to avoid the restrictions.

Giving National Banks More Flexibility in Main Office Relocations. The OCC supports two amendments to national banking law that will give national banks more flexibility in making main office relocation business decisions. The amendment will reduce unnecessary burdens on a national bank seeking (1) to relocate its main office as part of a merger or consolidation transaction with another bank or banks *in the same State,* or (2) to relocate its main office to a branch location *in the same State.* These amendments are consistent with current law and would not permit a national bank to establish or retain a branch at any location within a State where it could not do so today.

The first such amendment would provide that a national bank that is merging or consolidating with another bank *in the same State* pursuant to national banking law (rather than Riegle-Neal which applies only to interstate mergers and consolidations), has the same opportunity to retain certain offices that it would have if the merger or consolidation were an interstate merger subject to Riegle-Neal. The amendment would allow a national bank, with the Comptroller's approval, to retain and operate as its *main office* any main office or branch of any bank involved in the transaction. This is the same result that Congress authorized for *interstate* mergers in Riegle-Neal, over 10 years ago.

Under the second amendment, national banking law would be amended to give any national bank more flexibility when relocating its main office to an already existing branch location within the same State. However, the amendment would permit the former main office to be operated as a *branch* only if a branch at the same location could be established and operated under 12 U.S.C. § 36(c). Under 12 U.S.C. § 36, a national bank would be able to retain branches or operate a former main office as a branch when engaging in transactions or relocations covered by these

[4] This provision was included in H.R. 1224, the Business Checking Freedom Act of 2005, as passed by the House on May 24, 2005.

amendments only if a State bank could establish and operate a branch at the same location. Thus, the amendments would *not* override State "home office protection" types of laws that restrict branch locations.

Enhancing National Banks' Community Development Investments. The OCC supports an amendment that would increase the maximum amount of a national bank's investments that are designed to promote the public welfare either directly or by purchasing interests in an entity engaged in making these qualifying investments, such as a community development corporation (CDC). We recommend increasing the maximum permissible amount of such investments from 10 percent to 15 percent of the bank's capital and surplus. The maximum limit only applies if the bank is adequately capitalized and only if the OCC determines that this higher limit will not pose a significant risk to the deposit insurance fund.

Today, more than 90 percent of national banks' utilization of this authority is in investments in community development entities engaged in low-income housing development projects. Losses associated with such projects have been very low. Benefits, in terms of provision of affordable housing stock and economic revitalization, have been significant. Allowing certain adequately capitalized national banks to modestly increase their community development investments subject to the requirements of the statute will enable them to expand investments that have been profitable, low-risk, and beneficial to their communities.

The OCC evaluates all investments made under this authority, whether made by the bank directly or indirectly through its CDC, on a case-by-case basis to determine if the investment has a primary public welfare purpose. In practice, we "look through" the CDC to apply the same primary public welfare test as if the bank were making the investment directly. This approach ensures that the increased investment authority is focused on investments that promote the public welfare purpose of the statute.

Repealing the Geographic Limits on Bank Service Companies. The OCC supports removing the geographic restrictions on bank service companies (BSC). In light of the advent of interstate banking and branching under Riegle-Neal, it no longer makes sense to restrict the general operations of BSC's to the State where the BSC's bank shareholders or members are located and to require that all insured bank shareholders or members must be located in the same State. We support amending the statute to permit bank service companies to perform any services at any location where its bank shareholders or members could perform the same services. Our proposal, however, does not change the requirement in current law that a BSC may conduct activities that are not otherwise authorized and that are closely related to banking under the Bank Holding Company Act only with Fed approval.

OCC Operations

Improving Ability to Obtain Information from Regulated Entities. The OCC supports efforts to improve our ability to obtain information from regulated entities. In particular, we would like to call your attention to two specific amendments that we believe would significantly enhance the free flow of information between the OCC and the institutions that we supervise.

First, the OCC strongly supports an amendment that would ensure that no applicable privilege is waived when a person provides information to a Federal, State, or foreign banking regulator as part of the regulator's supervisory process.[5] There are conflicting court decisions on this issue that may impede a regulator's access to important supervisory information about a regulated banking institution. An amendment would be enormously beneficial to resolve the uncertainty so as to ensure that banks may freely provide information to regulators without fear that any applicable privilege may be waived. Amendments such as this one that enhance the dialogue between banks and regulators improve the supervisory process with added safety and soundness benefits.

Second, the OCC supports an amendment that would permit all of the Federal banking agencies—the OCC, FDIC, OTS, and the Fed—to establish and use advisory committees in the same manner. Under current law, only the Fed is exempt from the disclosure requirements under the Federal Advisory Committee Act (FACA). Yet, all types of insured institutions and their regulators have a need to share information and to conduct open and frank discussions that may involve nonpublic information about the impact of supervisory or policy issues. Because of the potentially sensitive nature of this type of information, the public meeting and disclosure requirements under FACA may inhibit the supervised institutions from pro-

[5] Such legislation, however, should specifically provide that the privilege cannot be asserted against the banking regulator to whom the information is provided, in order to allow the regulator to use the information as necessary to carry out its supervisory responsibilities.

viding the agencies their candid views. Importantly, this is information that any one bank could provide to its regulator and discuss on a confidential basis. It is only when several banks simultaneously do so in a collective discussion and offer suggestions to regulators that issues are raised under FACA. An amendment would cure this anomaly.

Safety and Soundness

The OCC also supports a number of amendments that would promote and maintain safety and soundness and facilitate the ability of regulators to address and resolve troubled bank situations.

Enforcing Written Agreements and Commitments. The OCC supports an amendment that would expressly authorize the Federal banking agencies to enforce written agreements and conditions imposed in writing in connection with an application or when the agency imposes conditions as part of its decision not to disapprove a notice, *for example,* a Change in Bank Control Act (CBCA) notice.

This amendment would rectify the results of certain Federal court decisions that conditioned the agencies' authority to enforce such conditions or agreements with respect to a nonbank party to the agreement, such as a controlling company, on a showing that the nonbank party was "unjustly enriched." We believe that this amendment will enhance the safety and soundness of depository institutions and protect the deposit insurance funds from unnecessary losses.

Barring Convicted Felons From Participating in the Affairs of Depository Institutions. The OCC also supports an amendment to the banking laws that would give the Federal banking agencies the authority to prohibit a person convicted of a crime involving dishonesty, breach of trust, or money laundering from participating in the affairs of an *un*insured national or State bank or *un*insured branch or agency of a foreign bank without the consent of the agency. Under current law, the ability to keep these "bad actors" out of depository institutions applies only to *insured* depository institutions. Thus, for example, it would be harder to prevent an individual convicted of such crimes from serving as an official of an uninsured trust bank whose operations are subject to the highest fiduciary standards, than to keep that individual from an administrative position at an insured bank.

Strengthening the Supervision of "Stripped-Charter" Institutions. The OCC supports an amendment to the CBCA to address issues that have arisen when a stripped-charter institution (*that is,* an insured bank that has no ongoing business operations because, for example, all of the business operations have been transferred to another institution) is the subject of a change-in-control notice. The agencies' primary concern with such CBCA notices is that the CBCA is sometimes used as a route to acquire a bank with deposit insurance without submitting an application for a *de novo* charter and an application for deposit insurance, even though the risks presented by the two transactions may be substantively identical. In general, the scope of review of a *de novo* charter application or deposit insurance application is more comprehensive than the current statutory grounds for denial of a notice under the CBCA. There also are significant differences between the application and notice procedures. In the case of an application, the banking agency must affirmatively approve the request before a transaction can be consummated. Under the CBCA, if the Federal banking agency does not act to disapprove a notice within certain time frames, the acquiring person may consummate the transaction. To address these concerns, the OCC supports an amendment that (1) would expand the criteria in the CBCA that allow a Federal banking agency to extend the time period to consider a CBCA notice so that the agency may consider business plan information, and (2) would allow the agency to use that information in determining whether to disapprove the notice.

Federal Branches and Agencies of Foreign Banks

The OCC also licenses and supervises Federal branches and agencies of foreign banks. Federal branches and agencies generally are subject to the same rights and privileges, as well as the same duties, restrictions, penalties, liabilities, conditions, and limitations and laws that apply to national banks. Branches and agencies of foreign banks, however, also are subject to other requirements under the International Banking Act of 1978 (IBA) that are unique to their organizational structure and operations in the United States as an office of a foreign bank. In this regard, the OCC is recommending amendments to reduce certain unnecessary burdens on Federal branches and agencies while preserving national treatment with national banks.

Implementing Risk-Based Requirements for Federal Branches and Agencies. The OCC supports an amendment to the IBA to allow the OCC to set the capital equivalency deposit (CED) for Federal branches and agencies to reflect their risk profile. We prefer an amendment that would allow the OCC, after consultation with the

Federal Financial Institutions Examination Council, to adopt regulations setting the CED on a risk-based institution-by-institution basis. This approach would closely resemble the risk-based capital framework that applies to both national and State banks.

Other Recommendations from the EGRPRA Process

As a result of the dialogue between the Federal banking agencies—the OCC, the Fed, the FDIC, and the OTS—and the banking industry as part of the EGRPRA process and other discussions over the last several years on regulatory burden relief legislation, it has become apparent that we all support amendments that would:

- Authorize the Fed to pay interest on reserve accounts under the Federal Reserve Act (FRA); [6]
- Provide that member banks may satisfy the reserve requirements under the FRA through pass-through deposits;
- Provide the Fed with more flexibility to set reserve requirements under the FRA;
- Repeal certain reporting requirements relating to insider lending under the FRA;
- Streamline depository institutions' requirements under the Bank Merger Act (BMA) to eliminate the requirement that the agency acting on the application must request competitive factor reports from all of the other Federal banking agencies;
- Shorten the post-approval waiting period under the BMA in cases where there is no adverse effect on competition;
- Exempt mergers between depository institutions and affiliates from the competitive factors review and post-approval waiting periods under the BMA;
- Improve information sharing with foreign supervisors under the IBA;
- Provide an inflation adjustment for the small depository institution exception under the Depository Institution Management Interlocks Act; and
- Provide that the Federal banking agencies will review the requirements for banks' reports of condition under the FDIA every 5 years and reduce or eliminate any requirements that are no longer necessary or appropriate.

Other Comments

We would like to take this opportunity to also make you aware of our views on another legislative proposal that may be under consideration.

Maintaining Parity Between Permissible Securities and Stock Investments of National Banks and State Member Banks. One amendment that has been suggested to the Committee would be to repeal 12 U.S.C. § 335.[7] While the amendment has been described as removing limitations on the powers of State member banks, it would, in fact, liberalize the authority of State member banks to invest in stock and other investment securities. Repealing 12 U.S.C. § 335 would result in permitting State member banks to invest in stock and investment securities that are impermissible for national banks.

This change would undo the long-standing parity that similarly limits national banks' and State member banks' permissible investments in stock and investment securities—a parity framework that dates back to the 1933 Glass-Steagall Act and was carefully maintained when GLBA was enacted in 1999. Portions of § 335 were enacted in 1999 as part of the GLBA compromise relating to financial subsidiary activities. Consistent with the parity framework, this key language in § 335 provides that State member banks' financial subsidiaries are subject to the *same* limitations and prudential safeguards that apply to national banks' financial subsidiaries. This sentence was the result of a carefully crafted compromise to ensure that parallel firewalls, safeguards, and rules were applied to financial subsidiaries of national and State member banks.

Conclusion

Mr. Chairman, on behalf of the OCC, I thank you for your leadership in holding these hearings. The OCC strongly supports initiatives that will reduce unnecessary

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[6] Some of the amendments to the FRA discussed above were included in H.R. 1224, the Business Checking Freedom Act of 2005, as passed by the House on May 24, 2005.

[7] 12 U.S.C. § 335 states:

"State member banks shall be subject to the same limitations and conditions with respect to the purchasing, selling, underwriting, and holding of investment securities and stock as are applicable in the case of national banks under paragraph 'Seventh' of Section 5136 of the Revised Statutes, as amended [12 U.S.C. § 24(Seventh)]. This paragraph shall not apply to an interest held by a State member bank in accordance with Section 5136A of the Revised Statutes of the United States [12 U.S.C. § 24a] and subject to the same conditions and limitations provided in such section."

burden on the industry in a responsible, safe and sound manner. We are pleased to continue to work with you and your staff to make that goal a reality.

I would be happy to answer any questions you may have.

PREPARED STATEMENT OF JoANN M. JOHNSON

CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

MARCH 1, 2006

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee on behalf of the National Credit Union Administration (NCUA) I am pleased to be here today to present our agency's views on regulatory relief initiatives being considered by Congress. NCUA's longstanding view on this issue is that enactment will provide a tangible benefit to America's consumers by giving them access to more modern, up to date, and efficient financial institutions. An equally important benefit will be an overall improvement in regulatory efficiency by removing outmoded, duplicative, and unnecessary regulations while maintaining a focus on the primary safety and soundness responsibility that Congress has conferred on the Agency.

Regulatory Relief and Efficiency

In June 2005, I testified before this Committee and presented several legislative proposals NCUA recommended for your consideration. NCUA continues to recommend these provisions as desirable components of regulatory reform:

- Permit Federal credit unions to cash checks and money transfer services for individuals in their field of membership but not yet members. This is particularly important to Federal credit unions in furthering their efforts to serve those of limited income or means in their field of membership. These individuals, in many instances, do not have mainstream financial services available to them and are often forced to pay excessive fees for check cashing, wire transfer and other services. The House of Representatives has taken this up as H.R. 749, amended it to include international remittances and passed the bill. Section 3 of S. 31, introduced by Senator Sarbanes and other Members of the Committee includes a similar provision;
- Increase the allowable maturity on Federal credit union loans from 12 to 15 years. Federal credit unions should be able to make loans for second homes, recreational vehicles and other purposes in accordance with conventional maturities that are commonly accepted in the market today;
- Increase the investment limit in credit union service organizations (CUSO's) from 1 percent to 3 percent. The 1 percent aggregate investment limit is unrealistically low and forces credit unions to either bring services in-house, thus potentially increasing risk to the credit union and the NCUSIF, or turn to outside providers and lose control;
- Safely increase options for credit unions to invest their funds by expanding authority beyond loans, government securities, deposits in other financial institutions and certain other very limited investments. The recommendation is to permit additional investments in corporate debt securities (as opposed to equity) and further establish specific percentage limitations and investment grade standards;
- Alleviate NCUA from the process now required that it consider a spin-off of any group of over 3,000 members in the merging credit union when two credit unions merge voluntarily. A spin-off would most likely undermine financial services to the affected group and may create safety and soundness concerns;
- Provide relief for credit unions from a requirement that they register with the SEC as broker-dealers when engaging in certain de minimums securities activities. The principle established by the present bank exemption, and a similar exemption sought by thrifts, is that securities activities of an incidental nature to the financial institutions do not have to be placed into a separate affiliate;
- Make needed technical corrections to the Federal Credit Union Act.

These NCUA recommendations are more fully described on the following pages.

Additionally, NCUA encourages this Committee to consider changes to the current credit union member business lending regimen that would improve the ability of credit unions to provide a source of needed credit to small businesses.

NCUA has also reviewed the following additional credit union provisions included in the matrix circulated by Senator Crapo in anticipation of this hearing. We have carefully examined each and have determined that these provisions present no safety and soundness concerns for the credit unions we regulate and/or insure: Leases of land on Federal facilities for credit unions; exclusion of member business loans to nonprofit religious organizations; criteria for continued membership of certain member groups in community charter conversions; credit union governance provisions; providing NCUA with greater flexibility to adjust the Federal usury ceiling for Federal credit unions; and an exemption from the premerger notification requirements of the Clayton Act.

Preserving the Net Worth of Credit Unions in Mergers

NCUA is aware that the Financial Accounting Standards Board (FASB) has extended its expected date to publish a final rule requiring the acquisition method of accounting for mergers of credit unions to 2007. This new rule would eliminate the "pooling" method and require the "acquisition" or "purchase" method to be used.[1] When this change to accounting rules is implemented it will require that, in a merger, the net assets on a fair value basis of the merging credit union as a whole be carried over as "acquired equity." The Federal Credit Union Act does not recognize "acquired equity" as part of capital rather defining capital in terms of "retained earnings." Retained earnings does not include acquired equity. This FASB policy has been in place since mid-2001 for most business combinations and the delay by FASB in implementing it for credit unions, as well as other cooperative organizations, has allowed all of us to explore how credit unions could conform to the new financial reporting standards.

Without the changes to the Federal Credit Union Act, only "retained earnings" of the continuing credit union will count as net worth after a merger. This result would seriously reduce the post-merger net worth ratio of a federally insured credit union, because this ratio is the retained earnings of only the continuing credit union stated as a percentage of the combined assets of the two institutions. Not only would this inaccurately depict the actual net worth of the new, merged credit union, a lower net worth ratio also has adverse implications under the statutory "prompt corrective action" (PCA) regulation. This result will discourage voluntary mergers and on occasion make NCUA assisted mergers more difficult and costly to the National Credit Union Share Insurance Fund (NCUSIF). Absent a legislative remedy, an important NCUA tool for reducing costs and efficiently managing the fund will be unavailable. NCUA encourages this Committee to include language in legislation to allow NCUA to redefine "net worth" to include the premerger retained earnings of the merging credit union for purposes of regulatory capital calculation and prompt corrective action. Credit unions would continue to be required to prepare financial reports consistent with generally accepted accounting principles including FAS 141.

A solution was passed unanimously by the House last June, H.R. 1042, the "Net Worth for Credit Unions Act," and I strongly encourage this Committee to include that bill language in any regulatory relief legislation that you introduce.

Reform of Prompt Corrective Action System for Federally Insured Credit Unions

The Credit Union Membership Access Act of 1998 mandated a system of Prompt Corrective Action (PCA) for credit unions designed to ensure problems in federally insured credit unions are resolved at the least long-term cost to the NCUSIF. PCA, and the focus it creates on active management of capital levels, has proven very valuable to NCUA's management of the National Credit Union Share Insurance Fund (NCUSIF) and the overall health of the credit union system. NCUA continues to strongly support a robust, statutorily mandated PCA system that fosters healthy capitalization levels and effective capital management in federally insured credit unions.

However, the current statutory requirements for credit unions are too inflexible and establish a structure based primarily on a "one-size-fits-all" approach, relying largely on a high leverage requirement of net worth to total assets. This creates inequities for credit unions with low-risk balance sheets, limits NCUA's ability to have a risk-based requirement that governs more often, without requiring unduly high capital levels, and fosters accumulation of capital levels well in excess of what is needed for most credit unions' safety and soundness and strategic needs.

[1] Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations, requiring the acquisition method for business combinations and effectively eliminating the pooling method. The pooling method has typically been used by credit unions to account for credit union mergers. The standards became effective for combinations initiated after June 30, 2001. Paragraph 60 of the standard deferred the effective date for mutual enterprises (that is, credit unions) until the FASB could develop purchase method procedures for those combinations. In the interim, credit unions have continued to account for mergers as poolings (simple combination of financial statement components).

Credit unions enjoy very strong capital levels, with 98 percent of credit unions categorized as well-capitalized under PCA. Credit unions' conservative nature and limited ability to manage compliance with capital standards has resulted in their accumulating a cushion of capital well in excess of PCA requirements, with the aggregate level of capital at 11.24 percent of total assets. Though high capital levels afford the insurance fund with additional protection and the institution with various benefits, it does not come without a cost. Consider that 85 percent of credit unions maintain a leverage ratio (net worth to total assets) in excess of 9 percent. As the table below illustrates, this results in net worth in the credit union system of $15.2 billion above this level. If credit unions had more flexibility to manage their compliance with PCA, they could still maintain a good cushion above regulatory requirements while safely returning more earnings to the members and expanding member services and other outreach programs.

Based on December 31, 2005, Data	
Total Federally-Insured Credit Unions (FICUs)	8,965
Number of FICUs with Net Worth Ratio > 9%	7,604
% of FICUs with Net Worth Ratio > 9%	84.8%
Total Net Worth at 11.24% of assets (billions)	$76.3
Amount of Net Worth in Excess of 9% of assets (billions)	$15.2

Further, as the Federal bank and thrift regulators are in the process of implementing changes to the capital standards their regulated institutions operate under, it becomes even more important that capital standards for credit unions are able to be updated to remain comparable and incorporate relevant improvements in approaches to measuring risk and allocating capital. Thus, reform of PCA standards for federally insured credit union remains a vital issue.

NCUA's purposes in seeking PCA reform is to achieve greater comparability with other federally insured financial institutions, provide a good balance between sound protection for the insurance fund and reasonable constraints on insured institutions, and to make our capital requirements more risk-sensitive. We recognize that some credit unions will be provided with greater flexibility in managing capital levels as a result, which is largely a function of their relatively low risk profiles and strong capital levels. On the whole we believe reforms to our system can strike an effective balance between maintaining robust standards while providing additional flexibility where warranted. Also, we very much appreciate that there are inherent limitations in risk-based capital techniques, and thus the leverage ratio plays an important part in a good regulatory capital system given. It is important to have the right interaction between the leverage and risk-based requirements to ensure the risk-based requirement is effective in influencing risk management decisions of institutions and more closely relates required capital levels to institution specific risk profiles.

In March 2005, NCUA published specific PCA reform recommendations designed to achieve these goals. The reform proposal is intended to provide enough details to enable a thoughtful consideration of the impact of any such reform, as well as to establish a basis for specific statutory language that would be needed to accomplish our reform objectives. In order to achieve greater comparability and a more risk-based system, we have proposed some reduction in the standard net worth (that is, leverage) ratio requirement for credit unions. Adjustment of the leverage ratio for credit unions will enable it to effectively complement the risk-based requirement, not overshadow it. Credit unions will have to more actively manage the risk they take in relation to their capital levels. It will reduce any competitive disadvantage that results from being held to a higher capital standard than other federally insured institutions when the higher standard is not warranted.

NCUA recognizes that there are some differences between the types of federally insured financial institutions that need to be taken into account, and we will continue to consult with the Department of the Treasury on comparability issues. For example, credit unions do have limitations on their ability to raise capital. However, they also have a relatively low risk profile given greater restrictions on powers compared to other financial institutions, as evidenced by their low loss history. We recognize the need to account for the 1 percent deposit method of capitalizing the NCUSIF given its effect on the overall capital in the share insurance fund and the credit union system. Thus, our reform proposal incorporates a revised method for calculating the net worth ratio for PCA purposes by adjusting for the deposit credit unions maintain in the share insurance fund. Our proposed treatment of the NCUSIF deposit for purposes of regulatory capital standards in no way alters its treatment as an asset under generally accepted accounting principles, or NCUA's steadfast support of the mutual, deposit-based nature of the NCUSIF.

This reform proposal also outlines improvements we believe are needed to make our risk-based net worth requirement more risk-sensitive and relevant. We intend to have a well designed risk-based system that maintains comparability with FDIC's risk-based capital requirements for non-BASEL II insured institutions. For potential impact analysis purposes, we designed a risk-based model using elements of BASEL I and the standard approach of BASEL II. However, since we issued our proposal, there have been further developments related to risk-based capital standards for other federally insured financial institutions. We continue to closely monitor developments in risk-based capital standards for other insured financial institutions and will modify our risk-based requirement model and impact analysis as needed.

As there are limitations in any regulatory capital scheme, NCUA's reform proposal also includes recommendations to address these other forms of risk under the second pillar of the supervisory framework, a robust supervisory review process. Through our examination and supervision process, NCUA will continue to analyze each credit union's capital position in relation to the overall risk of the institution, which will at times reflect a need for capital levels higher than regulatory minimums.

Enabling NCUA to adopt a PCA system that remains relevant and up-to-date with emerging trends in credit unions and the marketplace provides safety, efficiency, and benefits to the credit union consumer. I believe our reform proposal achieves a much needed balance between enabling credit unions to utilize capital efficiently to better serve their members while maintaining safety and soundness and protecting the share insurance fund. A well-designed risk based system would alleviate regulatory concerns by not penalizing low risk activities and by providing credit union management with the ability to manage their compliance through adjustments to their assets and activities. A PCA system that is more fully risk-based would better achieve the objectives of PCA and is consistent with sound risk management principles.

Reform of Credit Union Member Business Lending

NCUA recommends improvements in the current credit union member business lending regimen that would provide an enhanced ability to make those loans while maintaining a strong focus on safety and soundness.

Specifically, NCUA would support legislative changes that would:

- Remove the limit on assets a credit union can place in member business loans, currently calculated at 1.75 times actual net worth, and substitute a flat rate of 20 percent of the credit union's total assets.
- Eliminate the current $50,000 threshold for defining a loan as a MBL, and grant NCUA authority to exclude member business loans under $100,000.

Given the extensive regulations under which credit union member business lending is done, NCUA believes that both the 12.25 percent cap and the $50,000 limit present an unnecessary barrier to a type of lending that experience has shown to be exceptionally safe and sound.

Explanation of NCUA Recommended Provisions for Consideration by the Committee on Banking, Housing, and Urban Affairs

CHECK CASHING AND MONEY TRANSFER SERVICES OFFERED WITHIN THE FIELD OF MEMBERSHIP OF THE CREDIT UNION

Current Law

Section 107 of the Federal Credit Union Act authorizes Federal credit unions to provide check cashing and money transfer services to members.

Proposed Amendment

This amendment permits Federal credit unions to offer these same services to persons eligible to be members of the credit union, defined as those that fall within the field of membership of the credit union.

Reasons for Change

- Congress and the Administration are asking financial institutions to do more to reach the "unbanked."
- Credit unions are constrained from extending the most basic financial transaction (check cashing) to those who have avoided traditional financial institutions.
- Expanding check cashing, wire transfer, and similar services to nonmembers within a credit union's field of membership would provide an introduction to reliable low-cost financial services which can provide a viable alternative to less savory practices while at the same time increase confidence in traditional financial organizations.
- With more and more credit unions adopting underserved areas, these services become especially important in reaching out to the underserved.

ELIMINATE THE 12-YEAR LIMIT ON TERM OF FEDERAL CREDIT UNION LOANS

Current Law

The Federal Credit Union Act imposes a 12-year loan maturity limit on most credit union loans. Principal residence loans have maturities up to 30 years, and principal mobile home loans have maturities of 15 years.

Proposed Amendment

The proposed amendment permits the NCUA Board to provide for maturity limits up to 15 years, or longer, as the NCUA Board may allow by regulation.

Reasons for Change

- The current restriction placed on Federal credit unions is outdated and unnecessarily restricts a credit union's lending terms to its members.
- Members of Federal credit unions should be able to obtain loans for second homes, recreational vehicles, and other purposes in accordance with conventional maturities that are commonly accepted in the market today.

INCREASE IN 1 PERCENT INVESTMENT LIMIT IN CUSO'S

Current Law

The Federal Credit Union Act permits Federal credit unions to invest in Credit Union Service Organizations (CUSO's)—organizations providing services to credit unions and credit union members. An individual credit union, however, may invest in aggregate no more than 1 percent of its shares and undivided earning in these organizations.

Proposed Amendment

The provision increases the permissible credit union investment in CUSO's from 1 percent to 3 percent of its shares and undivided earnings.

Reasons for Change

- CUSO's are frequently established by several credit unions to provide important services to credit unions, such as check clearing and data processing, which can be done more efficiently for a group.
- When these services are provided through a CUSO, any financial risks are isolated from the credit union while allowing the credit unions to retain quality control over the services offered and the prices paid by the credit unions or their members.
- An increase in the CUSO investment to 3 percent allows the CUSO to continue servicing its credit union members without having to bring services back in-house or engage outside providers. This controls risk and expense to the credit union.
- The 1 percent limit has not been updated since its inception in 1977.

INVESTMENTS IN SECURITIES BY FEDERAL CREDIT UNIONS

Current Law

The Federal Credit Union Act authorizes Federal credit unions to invest in loans, obligations of the United States, or securities fully guaranteed as to principal and interest by the U.S. Government, deposits in other financial institutions, and certain other limited investments, such as obligations of Federal Home Loan Banks, wholly owned government corporations, or in obligations, participations or other instruments issued by, or fully guaranteed by FNMA, GNMA, or FHLMC.

Proposed Amendment

This amendment would provide authority for Federal credit unions to purchase and hold for their own account "investment securities" if they are in one of the four highest investment rating categories—subject to further definition and qualification by NCUA rulemaking.

The amendment limits Federal credit unions' investments in investment securities in two ways. First, a statutory "single obligor" percentage limitation is established, such that the total amount of investment securities of any single obligor or maker held by the Federal credit union for the credit union's own account cannot exceed 10 percent of the net worth of the credit union. Second, the aggregate amount of investments held by the Federal credit union for its own account cannot exceed 10 percent of the assets of the credit union.

Reasons for Change

- A number of private debt instruments such as highly rated commercial paper, corporate notes, and asset-backed securities would be appropriate investments for Federal credit unions.
- Other federally regulated and State regulated financial institutions have a proven track record with these limited investments.
- Allowing such investments would give credit unions more asset liability management options.
- NCUA implementing regulations will further address appropriate investment gradings, possible minimum credit union net worth requirements, and other safety and soundness requirements.
- With a percentage limitation of 10 percent of net worth per single obligor, this modest increase in investment flexibility will not subject credit unions to undue risk.
- The 10 percent limitation language parallels the limitation applicable to national banks when applied to the "net worth" measurement for credit unions.
- The prohibition against investment in equity securities is maintained.

VOLUNTARY MERGER AUTHORITY

Current Law

Section 109 of the Federal Credit Union Act requires NCUA to engage in an analysis of every voluntary merger of healthy Federal credit unions to determine whether a spin-off of any select employee group (SEG) of over 3,000 members in the merging credit union can be effectively accomplished.

Proposed Amendment

The recommendation is to eliminate the requirement that NCUA engage in an analysis of every voluntary merger to determine whether a select employee group over 3,000 can be spun-off into a separate credit union.

Reasons for Change

- Requiring NCUA to engage in an analysis of every voluntary merger of healthy Federal credit unions to consider a spin-off from the merging credit union of any select employee group (SEG) of over 3,000 is cumbersome and provides little practical benefit or purpose. There are about 300 a year.
- When two healthy multiple bond credit unions pursue a merger, it increases their financial strength and member service is enhanced, as well as their long-term safety and soundness.
- Member employee (or other) groups over 3,000 are already included in a multiple group credit union in accordance with statutory standards.

TREATMENT OF CREDIT UNIONS AS DEPOSITORY INSTITUTIONS UNDER SECURITIES LAWS

Current Law

Section 201 and 202 of the Gramm-Leach-Bliley Act, enacted in 1999, created specific exemptions from broker-dealer registration requirements of the Bank Exchange Act of 1934 for certain bank securities activities. Banks are also exempt from the registration and other requirements of the Investment Advisers Act of 1940. The principle established in these laws is that securities activities of an incidental nature to the bank do not have to be placed into a separate affiliate and functionally regulated.

Proposed Amendment

This provision would provide a statutory exemption for credit unions similar to that already provided banks and allow credit unions, like banks, to avoid complicated filings with the Securities and Exchange Commission for incidental activities.

Reasons for Change

- Federal credit unions are empowered to engage in specific activities enumerated in the FCUA and any other activities incidental to the enumerated activities. Among the specific broker-related activities currently authorized are third-party brokerage arrangements, sweep accounts, safekeeping, and custodial activities. Among the dealer-related activities are the purchase and sale of particular securities, including but not limited to municipal securities and "Identified Banking Products" for the credit union's own account.
- These incidental activities might trigger SEC registration if not exempted by law.
- This important regulatory relief and efficiency provision would reduce the cost and complication to credit unions having to approach the SEC on a case-by-case basis or through regulation—the only avenues now available to them for relief.
- While a Federal or State-chartered credit union might be granted authority to engage in otherwise lawful activities, the credit union might have to abandon the activity or outsource it to a third party at increased expense if this exemption is not provided.
- This exemption would not expand the types of securities activities that credit unions are authorized to engage in. It simply serves to provide parity with banks and thrifts regarding an exemption from SEC registration for the limited securities activities credit unions are authorized to engage in.

TECHNICAL CORRECTIONS TO THE FEDERAL CREDIT UNION ACT

Explanation of Proposed Amendment

Twenty-eight purely technical and clerical corrections to the Federal Credit Union Act have been identified as needed.

Reasons for Change

To make the Federal Credit Union Act accurate and correct.

NCUA'S VIEWPOINT REGARDING OTHER ITEMS UNDER CONSIDERATION

NCUA has reviewed additional items in order to determine whether it would also be advisable to maintain parallel treatment under the Federal Credit Union Act with our fellow financial regulators should the Committee include any of these suggestions in a legislative proposal. The proposals where NCUA would seek parallel treatment, and language to achieve that, follows.

ITEM 144. TECHNICAL AMENDMENT TO SECTION 8(i) OF THE FDI ACT

This item clarifies that a Federal banking agency may take enforcement action against a person for conduct that occurred during his or her affiliation with a banking organization even if the person resigns from the organization, regardless of whether the enforcement action is initiated through a notice or an order.

Section 206(k)(3) of the FCU Act parallels § 8(i) of the FDI Act. If § 8(i) is amended, we recommend the same amendment to the FCU Act.

Suggested Language:

Section 206(k)(3) of the Federal Credit Union Act (12 U.S.C. 1786(k)(3)) is amended by inserting "or order" after "notice" each place such term appears.

ITEM 147. CLARIFICATION THAT CHANGE IN CONTROL CONDITIONS ARE ENFORCEABLE

This item amends section 8 of the FDI Act (12 U.S.C. 1818) to clarify the appropriate Federal banking agencies' authority to take enforcement action against the institutions they supervise based on violations of conditions imposed in writing in connection with any action by the agency on an application, notice, or other request by an insured depository institution or institution-affiliated party (IAP).

Section 206 of the FCU Act has parallel sections to the portions of § 8 of the FDI Act this amendment changes. If the FDI Act is amended in this way, we recommend the same amendment to the FCU Act.

Suggested language:

Section 206 of the Federal Credit Union Act (12 U.S.C. 1786) is amended—

(a) in subsection (b) (1), in the first sentence, by striking "the granting of any application or other request by the credit union" and inserting "any action on any application, notice, or other request by the credit union or institution-affiliated party,";

(b) in subsection (g)(1)(A)(i)(III), by striking "the grant of any application or other request by such credit union" and inserting "any action on any application, notice, or request by such credit union or institution-affiliated party"; and

(c) in subsection (k)(2)(A)(iii), by striking "the grant of any application or other request by such credit union" and inserting "any action on any application, notice, or other request by the credit union or institution-affiliated party."

ITEM 153. PARITY IN STANDARDS FOR INSTITUTION-AFFILIATED PARTIES

This item deletes the phrase "knowingly or recklessly" from the definition of "institution-affiliated party" in the Federal Deposit Insurance Act (12 U.S.C. 1813(u)(4)). The FCU Act has an identical definition section, which should be similarly amended.

Suggested language:

Section 206(r)(3) of the Federal Credit Union Act (12 U.S.C. 1786(r)(3)) is amended by striking "knowingly or recklessly."

ITEM 155. RECEIVER'S OR CONSERVATOR'S CONSENT REQUIREMENT

This item would require the consent of the receiver or conservator before a party to a contract to which the depository institution is a party could exercise any right or power to terminate, accelerate, or declare a default under any contract, or to obtain possession of or exercise control over any property of the institution or affect any contractual rights of the institution.

Section 207(c)(12) of the FCU Act (12 U.S.C. 1787(c)(12)) parallels the section of the FDI Act this amendment changes. If the FDI Act is amended in this way, we recommend similar changes to the FCU Act.

Suggested language:

Section 207(c)(12) of the Federal Credit Union Act (12 U.S.C. 1787(c)(12)) is amended by adding the following new subparagraph—

"(C) Consent Requirement.—

(i) In general.—

Except as otherwise provided by this section, no person may exercise any right or power to terminate, accelerate, or declare a default under any contract to which the credit union is a party, or to obtain possession of or exercise control over any property of the credit union or affect any contractual rights of the credit union, without the consent of the conservator or liquidating agent, as appropriate, for a period of 45 days from the date of the appointment of the conservator, or for a period of 90 days from the date of the appointment of the liquidating agent.

(ii) Certain exceptions.—

No provision of this subparagraph shall apply to a director's or officer's liability insurance contract or a credit union bond, or to the rights of parties to certain qualified financial contracts pursuant to subsection (c)(8), or shall be construed as permitting the conservator or liquidating agent to fail to comply with otherwise enforceable provisions of such contract.

(iii) Rule of Construction.—

Nothing in this subparagraph shall be construed to limit or otherwise affect the applicability of title 11 of the United States Code.".

ITEM 156. ACQUISITION OF FICO SCORES

This item would amend the FCRA to define an FDIC request for FICO scores as part of its preparation for a resolution as a permissible purpose, enabling the FDIC to obtain FICO scores of bank borrowers by contacting credit reporting agencies and to obtain current consumer credit reports. The explanation states that this power is necessary so that FDIC can gain access to information that is helpful in evaluating the asset portfolios of troubled institutions.

Although this has not yet been an issue for NCUA, we believe it would be helpful to include NCUA in this amendment.

Suggested language: (additions to FDIC language bolded)

Section 604(a) of the Fair Credit Reporting Act (15 U.S.C. 1681b(a)) is amended by adding a new paragraph after paragraph (5) as follows:

"(6) To the Federal Deposit Insurance Corporation or the National Credit Union Administration as part of its preparation for its appointment or as part of its exercise of powers as conservator, [or] receiver or liquidating agent for an insured depository institution or insured credit union under the Federal Deposit Insurance Act or the Federal Credit Union Act or other applicable Federal or State law or in connection with the resolution or liquidation of a failed or failing insured depository institution or insured credit union.".

ITEM 157. ELIMINATION OF CRIMINAL INDICTMENTS AGAINST RECEIVERSHIPS

This item would amend the Federal Deposit Insurance Act to require that any criminal indictment against a bank be dismissed, if the FDIC is appointed receiver of that bank.

This has not yet been an issue for NCUA but it would be prudent to have a similar amendment to the FCU Act. The FCU Act does not have a parallel section to the section of the FDI Act being amended in this item, but we suggest adding similar language to the end of § 206.

Suggested language:

Section 206 of the Federal Credit Union Act (12 U.S.C. 1786) is amended by adding the following new subsection after subsection (v):

"(w) The Administration shall be exempt from all prosecution by the United States, any State, county, municipality, or local authority for any criminal offense arising under Federal, State, county, municipal, or local law, which was allegedly committed by a credit union, or persons acting on behalf of a credit union, prior to the appointment of the administration as liquidating agent.".

ITEM 158. RESOLUTION OF DEPOSIT INSURANCE DISPUTES

This item would amend § 11(f) of the FDI Act to clarify that the APA standard of review, the 60-day limitation period, and U.S. District Court jurisdiction apply to the FDIC's final determination of insurance coverage whether made pursuant to procedural regulations or not. The explanation states that the current version of the statute creates uncertainty about whether the statute of limitations applies in the absence of FDIC regulations and whether appellate or district courts have original jurisdiction to review FDIC's decisions about insurance coverage.

Section 207(f) of the FCU Act (12 U.S.C. 1787(f)) parallels § 11(f) of the FDI Act. If § 11(f) is amended, we recommend a similar amendment to the FCU Act.

Suggested language:

Paragraphs (3), (4), and (5) of section 207(f) of the Federal Credit Union Act (12 U.S.C. 1787(f)(3)) are amended to read as follows:

"(3) RESOLUTION OF DISPUTES.—The Administration's determination regarding any claim for insurance coverage shall be treated as a final determination for purposes of this section. In its discretion, the Board may promulgate regulations prescribing procedures for resolving any disputed claim relating to any insured deposit or any determination of insurance coverage with respect to any deposit.

(4) REVIEW OF BOARD'S DETERMINATION.—A final determination made by the Board shall be a final agency action reviewable in accordance with chapter 7 of title 5, United States Code, by the United States district court for the Federal judicial district where the principal place of business of the credit union is located.

(5) STATUTE OF LIMITATIONS.—Any request for review of a final determination by the Board shall be filed with the appropriate United States district court not later than 60 days after such determination is issued.".

ITEM 160. RECORDKEEPING AMENDMENT

This item would permit the FDIC to destroy records that are 10 or more years old at the time of its appointment as receiver, unless directed not to do so by a court or a government agency or prohibited by law.

This provision amends section 11(d)(15)(D) of the FDI Act, which parallels section 207(b)(15)(D) of the FCU Act. If the FDI Act is amended in this way, we recommend similar changes to the FCU Act.

Suggested language:

Section 207(b)(15)(D) of the Federal Credit Union Act (12 U.S.C. 1787(b)(15)(D)) is amended—

(1) by striking "Recordkeeping requirement.—After the end of the 6-year period" and inserting

"(i) In general.—Except as provided in clause (ii), after the end of the 6-year period'; and

(2) by adding at the end the following new clause:

"(ii) Old records.—-In the case of records of an insured credit union which are at least 10 years old as of the date the Board is appointed as liquidating agent of such credit union, the Board may destroy such records in accordance with clause (i) any time after such appointment is final without regard to the 6-year period of limitation contained in such clause.".

ITEM 161. PRESERVATION OF RECORDS BY OPTICAL IMAGING AND OTHER MEANS (§ 605 OF H.R. 1375)

This item would allow FDIC to rely upon records preserved electronically, such as optically imaged or computer scanned images.

This has not yet been an issue, but if FDIC has this option, we recommend explicitly granting this option to NCUA as well in case electronic imaging becomes more cost-effective. The provision of the FDI Act being amended does not have an exact parallel in the FCU Act. Our suggested language adds the new provision to section 206(s) of the FCU Act.

Suggested language:

Section 206(s) of the Federal Credit Union Act (12 U.S.C. 1786(s)) is amended by inserting at the end the following new paragraph:

"(9) Preservation of Records.—

"(A) In general.—The Board my cause any and all records, papers, or documents kept by the administration or in the possession or custody of the administration to be—

"(i) photographed or micrographed or otherwise reproduced upon film; or

"(ii) preserved in any electronic medium or format which is capable of

"(a) being read or scanned by computer; and

"(b) being reproduced from such electronic medium or format by printing or any other form of reproduction of electronically stored data.

"(B) Treatment as original records.—Any photographs, micrographs, or photographic film or copies thereof described in clause (A)(i) or reproduction of electronically stored data described in clause (A)(ii) shall be deemed to be an original record for all purposes, including introduction in evidence in all State and Federal courts or administrative agencies and shall be admissible to prove any act, transaction, occurrence, or event therein recorded.

"(C) Authority of the administration.—Any photographs, microphotographs, or photographic film or copies thereof described in paragraph (9)(A) or reproduction of electronically stored data described in paragraph (9)(B) shall be preserved in such manner as the administration shall prescribe and the original records, papers, or documents may be destroyed or otherwise disposed of as the administration may direct.".

ITEM 164. ISSUE OF MORE THAN ONE NCUA BOARD MEMBER WITH CREDIT UNION EXPERIENCE

This not strictly a regulatory matter in that it does not involve specific functions of the NCUA as they relate to credit union supervision or insurance. NCUA does note, however, that it is the only Federal financial regulator with this restriction on board members with industry experience. This could be interpreted as a negative assessment of the ability of an individual with credit union experience to perform the duties of an NCUA board member in a fair and impartial manner.

Conclusion

Thank you for the opportunity to appear before you today on behalf of NCUA to discuss these important and needed regulatory enhancements efficiency for NCUA, credit unions and 85 million credit union members across America. I am pleased to respond to any questions the Committee may have or to be a source of any additional information that may assist you in this worthwhile endeavor.

PREPARED STATEMENT OF LINDA JEKEL

DIRECTOR OF CREDIT UNIONS

WASHINGTON DEPARTMENT OF FINANCIAL INSTITUTIONS

DIVISION OF CREDIT UNIONS AND

CHAIRMAN, NATIONAL ASSOCIATION OF STATE CREDIT UNION SUPERVISORS

MARCH 1, 2006

NASCUS History and Purpose

Good morning, Chairman Shelby, and distinguished Members of the Committee on Banking, Housing, and Urban Affairs. I am Linda Jekel, Director of Credit Unions for the Washington Department of Financial Institutions and the Chair of the National Association of State Credit Union Supervisors (NASCUS). I appear today on behalf of NASCUS, which represents the 48 State and territorial credit union agencies that charter and supervise the Nation's more than 3,600 State-chartered credit unions. NASCUS is advised by the NASCUS Credit Union Advisory Council, composed of more than 500 State-chartered credit union chief executive officers dedicated to defending the dual chartering system for credit unions.

Since its inception in 1965, the mission of NASCUS has been to enhance State credit union supervision and regulation and to promote policies that ensure a safe and sound State credit union system. NASCUS is the sole organization dedicated to the promotion of the dual chartering system and to advancing the autonomy and expertise of State credit union regulatory agencies. We achieve these goals by serving as an advocate for a dual chartering system that recognizes the traditional and essential role that State government plays in the national system of depository financial institutions.

NASCUS appreciates this Committee's commitment to regulatory relief for financial institutions. We believe it is an important part of ensuring a safe and sound environment for credit unions and the consumers they serve.

We have provided input for the financial services regulatory relief matrix, started during the 108th Congress. We are pleased to have this additional opportunity to share our priorities for regulatory relief. When drafting regulatory relief legislation, we encourage Committee Members to consider the provisions we present.

NASCUS Priorities for Regulatory Relief

The financial services regulatory relief matrix details regulatory relief provisions that further the safety and soundness of credit unions. NASCUS priorities for regulatory relief focus on reforms that will strengthen the State system of credit union supervision and enhance the capabilities of State-chartered credit unions. The ultimate goal is to meet the financial needs of consumer members while assuring that the State system is operating in a safe and sound manner.

In this testimony, I address regulatory relief provisions that are vital to the future growth and safety and soundness of State-chartered credit unions. They are as follows:

- Reforming credit union capital.
- Providing for representation on the NCUA Board by an individual with State credit union regulatory experience.
- Allowing non-federally insured credit unions to join the Federal Home Loan Banks (FHLB's).
- Expanding member business lending provisions to 20 percent of total assets of a credit union, furthering the goal to provide loans for consumer members.
- Amending the definition of a member business loan (MBL) from $50,000 to at least $100,000.
- Providing Securities and Exchange Commission (SEC) regulatory modernization for credit union parity with other financial institutions;
- Preserving the dual chartering system and protecting against the preemption of State laws.
- Converting a State-chartered credit union to another financial institution charter is a matter that should be determined by State law and regulation, not dictated in Federal legislation.

Credit Union Capital Reform

Credit unions need capital reform in three distinct areas. First, the definition of net worth in the Federal Credit Union Act (FCUA) should be changed to include more than just retained earnings; second, credit unions need access to risk-based capital; and third, credit unions should have access to alternative capital. From a State regulatory perspective, capital reform that addresses these three issues makes logical sense for the safety and soundness of credit unions and the members they serve.

Amending the Definition of Net Worth in the FCUA

To begin, credit unions need an amendment to the Prompt Corrective Action (PCA) provision of the FCUA. This amendment would obligate federally insured credit unions to include all forms of capital when calculating the required net worth ratio. Under the current Federal statute, credit union net worth is defined as and limited to retained earnings.

The exclusive reliance on retained earnings limits a credit union's ability to implement new programs or expand services to meet the changing needs of American consumers within its membership. The failure to authorize these credit unions to include all forms of capital in their PCA net worth calculation distorts the credit union's actual financial position. NASCUS believes this change has been necessary since 1998, when the current PCA standards for credit unions were established in Federal statute. We have consistently noted this important provision in prior testimony, as well as in the financial services regulatory relief matrix.

NASCUS is encouraged by the May 2005 American Institute of Certified Public Accountants (AICPA) letter to the NCUA acknowledging the disparity in regulatory reporting among insured institutions. AICPA correctly recognizes that credit unions may use only retained earnings when calculating net worth. Further, it noted that all other Federal agencies recognize total equity as determined in accordance with GAAP, as a basis for calculating regulatory capital. In addition, the AICPA further states that retained earnings are only one component of GAAP equity.

NASCUS supports this position and firmly believes that the equity section of a credit union's balance sheet should include more than just retained earnings. NASCUS asks for this Committee's support in amending the definition of net worth in the FCUA to include more than retained earnings. This would provide consistency in capital standards with the other federally insured depository institutions. In addition, it would allow credit unions to better serve their members.

Addressing the Unintended Consequences of FASB Standard No. 141

Another benefit to amending the definition of net worth is that it will cure the unintended consequences for credit unions of the Financial Accounting Standards Board (FASB) amendments to business combination accounting rules. FASB's Financial Accounting Standard No. 141 would require the acquisition method for business combinations and effectively eliminate the pooling method for the combinations of mutual enterprises.

In brief, the acquisition accounting method would require the valuation of the target credit union at fair value, the recognition of identifiable intangibles, when relevant (that is, core deposit intangibles and/or goodwill), and the application of a market-based acquisition model to a nonbargained transaction. The retained earnings of the merging institution would no longer be combined with those of the continuing credit union. This creates a potentially significant dilution of statutory net worth and an unintended impediment to credit union mergers. Mergers are a safety and soundness tool both Federal and State regulators use to protect funds deposited by American consumers and to preserve the National Credit Union Share Insurance Fund (NCUSIF).

NASCUS is pleased by the introduction of H.R. 1042, and its passage in the House of Representatives. The legislation amends the definition of net worth to include the net retained earnings of a merging credit union with that of the surviving credit union. We understand that H.R. 1042 has been forwarded to the Senate Committee on Banking, Housing, and Urban Affairs for review. Similar language is also included in provision number 24 in the regulatory matrix.

There are important reasons to address the consequences of FASB Standard No. 141. As a regulator, it concerns me that credit unions cannot be merged due to PCA concerns caused by the inability to add the capital of a merged credit union. This may cause credit unions in a weakened condition to face liquidation. There may also be more requests for NCUA to provide financial assistance in merger transactions. An increase in liquidations may cause greater reputation risk, severe loss of confidence for the credit union industry, greater losses to the NCUSIF, and increased costs to the industry and ultimately to consumers. It eliminates an important tool for regulators when we have to determine the most appropriate method to handle a troubled credit union; a method that has the least impact on American consumers.

The entire credit union community agrees on the importance of this provision. It is also included in Section 104 in H.R. 2317 and in Section 314 of H.R. 3505. We respectfully request this Committee introduce similar provisions in the regulatory relief bill that is currently being drafted. Hopefully, the consequences of FASB 141 will soon be resolved.

Risk-Based Capital

NASCUS has a long-standing policy supporting risk-based capital for credit unions. Risk-weighted capital reform should be flexible. NASCUS believes that any new regulations should be progressive and not designed to regulate to the lowest common denominator.

We believe risk-based capital is a sound and logical approach to capital reform for credit unions. Today, every insured depository institution, with the exception of credit unions, uses risk-based capital to successfully build and monitor capital levels. In fact, after more than 15 years of successfully applying risk-based capital, the financial community is devising methods to make risk-based capital an even better tool. Risk-based capital enables financial institutions to measure capital adequacy and to avoid additional risk on their balance sheets. It is a system that acknowledges diversity of complexity in financial institutions. It provides for increased capital levels for financial institutions that choose to maintain a more complex balance sheet, while reducing the burden of capital requirements for institutions with less complex assets.

NASCUS supports a risk-based capital plan. We believe additional enhancements that work in tandem with risk-based capital would be prudent and provide even greater safety and soundness for credit unions. NASCUS' support of risk-based capital is reflected in the financial services regulatory relief matrix.

Alternative Capital for Credit Unions

We support capital reform beyond risk-weighted capital and a FASB merger fix. NASCUS believes that an important part of capital reform is providing credit unions access to alternative capital. We believe that alternative capital authority and a risk-based system are complementary capital reforms. The combination of current PCA requirements and a potentially changing economic landscape create a regulatory dilemma for many State-chartered credit unions. As noted above, the FCUA defines credit union net worth as retained earnings. The NCUA has determined that it lacks the regulatory authority to broaden the net worth definition to include other forms of capital as a part of PCA calculations. Thus, credit unions require an amendment to the FCUA to rectify this statutory deficiency.

NASCUS has long supported the concept of alternative capital for credit unions. After study, NASCUS created a white paper illustrating both equity and debt models for alternative capital. NASCUS believes that alternative capital is a viable method for credit unions to build net worth. The white paper demonstrates this belief. (Please find a copy of the white paper at the end of the NASCUS testimony.)

Additional Reasoning for Alternative Capital

Some State-chartered credit unions have indicated that alternative capital is necessary for them to continue meeting the financial needs of their members in a changing financial environment. This is especially true for credit unions striving to understand and meet specific member needs. These needs can include financing for homeownership, financial education, and even credit counseling, each an important component of managing one's personal finances.

We believe that even with the lower leverage ratio and risk-based capital proposed in H.R. 2317, some State-chartered credit unions may not be able to rely solely on retained earnings to meet the capital base required by PCA standards. As credit unions expand and serve the needs of more consumers, their assets grow. When assets grow, credit unions experience reduced net worth ratios as earnings retention lags growth in assets.

From a regulatory perspective, it makes sound economic sense for credit unions to access other forms of capital to improve their safety and soundness. We need to take prudent steps to strengthen the capital base of this Nation's credit union system. NASCUS requests your support in providing credit unions with access to alternative capital. Alternative capital for credit unions should be included in regulatory relief legislation proposed by this Committee.

Strong capital reform requires that State and Federal regulators work together. In 1998, the Credit Union Membership Access Act (CUMAA), H.R. 1151, provided that NCUA consult and cooperate with State regulators when constructing PCA and member business lending (MBL) regulations, as required by the FCUA. NASCUS always stands ready to discuss and assist in the implementation of new regulations affecting State-chartered credit unions. We firmly believe that cooperation results in better regulation and a stronger and safer credit union system.

Representation on the NCUA Board

NASCUS included a provision in the financial services regulatory relief matrix that would amend the FCUA to require that one NCUA Board member shall have State credit union regulatory experience.

We believe this will result in better regulation and a stronger and safer credit union system. About forty percent of credit unions are State-chartered. The majority of them have Federal insurance provided by the NCUSIF. This fund is managed by the NCUA. We believe that comprehensive experience in regulating State-chartered credit unions would provide a more balanced perspective when overseeing the NCUSIF. In addition, as the NCUA promulgates regulations to further safety and soundness, a person with State-chartered credit union supervisory experience will greater understand how proposed regulations will impact State-chartered, federally insured credit unions.

This is not a new idea. A similar provision requiring State bank supervisory experience is included in Section 1000 of the Federal Deposit Insurance Act.

We believe a person with State regulatory experience will create an even stronger and safer credit union system, and we would appreciate your support for this provision.

Privately Insured Credit Unions Should Be Eligible to Join Federal Home Loan Banks

As NASCUS has noted since the creation of the financial services regulatory relief matrix, not all credit unions operate with access to the same benefits. Federally insured credit unions have access to the Federal Home Loan Banks (FHLB's), while privately insured credit unions do not. NASCUS supports non-federally insured credit unions being eligible to join the FHLB's. This provision is included in H.R. 2317.

Today, there are approximately 200 credit unions that are non-federally insured. These credit unions are regulated and examined by State regulatory agencies to ensure they are operating in a safe and sound manner. Regulatory functions are a primary determinant of the safety and soundness of the credit union system. The function of the credit union regulator is to assure consumers that their deposits are safe and sound. This is accomplished through regulatory action, the examination process and by taking enforcement actions, when necessary.

Nine State legislatures have made private insurance available to their State-chartered credit unions. NASCUS promotes the rights of State legislators to determine what is in the best interest for State-chartered credit unions in their State.

If a State determines that State-chartered credit unions should have access to private insurance, NASCUS supports its decision. NASCUS does not advocate for private insurance; however, we do believe in the rights of State legislators to determine if State-chartered credit unions in their State should have access to private insurance.

These credit unions should be allowed access to the same privileges as their federally insured counterparts (the competition down the street with Federal insurance).

Both Federal and private share insurance systems have been established to protect credit union shareholders. To manage and price insurance risk, each share insurer relies significantly on the examination reports of the institution's primary regulator. Nearly all State credit union agencies use the NCUA Automated Integrated Regulatory Examination Software (AIRES) examination platform when they examine State-chartered credit unions for safety and soundness purposes. NASCUS agencies participate in the development and testing of NCUA's AIRES examination program and procedures. In short, there is an excellent working relationship between NASCUS agencies and the NCUA, as well as substantially similar examination standards for both Federally and State-chartered credit unions.

In addition, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established a series of safety and soundness requirements for both entities that offer private deposit insurance to credit unions and for credit unions which would opt for private deposit insurance.

FDICIA also dictates the manner and extent to which institutions opting for private deposit insurance disclose fully that their deposits are privately insured. Therefore, there should be no concern that these credit unions are not operated in a safe and sound manner.

Permitting non-federally insured institutions to join the FHLB System would not establish a new precedent. When the Federal Home Loan Bank Act of 1932 was passed, insurance companies were allowed access to the system. At the time, they were a means to mortgage lending. Insurance companies continue to have access to FHLB system. Insurance companies have never been federally insured; they are State chartered and regulated by State governments without Federal oversight or insurance.

As of December 31, 2005, 111 insurance companies enjoyed access to the FHLB system. There are no federally insured insurance companies, negating the argument that insurance status is the reason institutions may or may not have access to the FHLB system.

Access to the FHLB system brings many safety and soundness benefits, including the ability to borrow funds and better manage assets and liabilities. And, providing access to State-chartered privately insured credit unions does not inflict any new or unusual exposure on the FHLB system.

Moreover, it provides an additional layer of financial analysis and market discipline for privately insured credit unions. The FHLB system performs ongoing credit analysis of members, particularly for those who borrow. Each FHLB has a sophisticated credit screening system to assure that any borrower, Federally insured or not, is credit worthy. In addition, every advance is secured by marketable collateral. Indeed, even during the savings and loan debacle, we understand that no FHLB suffered a loss on advances extended to their members.

NASCUS believes that credit unions in States that allow private insurance should not be disadvantaged by a lack of access to the FHLB System and the benefits it provides. A credit union's choice of insurance should not determine its access to a wholesale lending system that would allow it to best serve its members.

In the past, Congress has expanded the membership eligibility for the FHLB system to help local financial institutions meet the housing and homeownership needs of their communities. Enabling State-chartered, privately insured credit unions to be eligible to join the FHLB System, is merely one more step in making homeownership a reality to credit union members. We urge the Committee to include this provision to help achieve our Nation's housing and homeownership goals.

Expanding Member Business Lending Authority

Regulatory relief is important for credit unions in the area of member business lending. NASCUS has a vision of providing well-thought-out member business lending regulations to best position credit unions to serve their members. The financial service regulatory relief matrix includes the following provisions, which are also included in H.R. 2317.

Title II of H.R. 2317 provides an opportunity for economic growth for credit unions through member business lending. Credit unions should be given greater authority to meet their member business lending needs; this better positions them to service consumers. Raising the statutory limit on credit union MBL's to 20 percent of total assets, as proposed in Section 201 of H.R. 2317, facilitates member business lending without jeopardizing safety and soundness at participating credit unions.

Further, we support Section 202 of H.R. 2317, which amends the current definition of an MBL by granting NCUA the authority to exempt loans $100,000 or less. This increases the definition of business loans subject to the current amount of $50,000 to $100,000. We urge that the statutory definition of a credit union MBL be changed from the current $50,000 limit contained in the FCUA. In fact, we support redefining credit union MBL's to the Fannie/Freddie conforming loan limit of $417,000, increased in January 2006. We believe this is a safe and sound, well established and readily understandable index that has served lenders and the public interest well for many years.

Both of these provisions provide credit unions with regulatory relief as it concerns member business lending. We request that these provisions be included in regulatory relief bill drafted by this Committee. Additionally, you will find these provisions in the financial services regulatory relief matrix.

Regulatory Modernization

It is time to update regulations to reflect parity of treatment between credit unions and other financial institutions. It makes sound business sense and provides for equitable competition. NASCUS supports the following provisions, as included in the financial services regulatory relief matrix.

NASCUS believes that all federally insured credit unions should have the same exemptions as banks and thrift institutions from Federal Trade Commission premerger notification requirements and fees, a requirement of the Clayton Act. In fact, we believe this provision should be expanded to include all State-chartered credit unions. This provision is in Section 311 of H.R. 2317 and in Section 312 of H.R. 3505.

Additionally, NASCUS supports providing federally insured credit unions parity treatment with commercial banks with regard to exemptions from SEC registration requirements. Banks were provided these exemptions in the Gramm-Leach-Bliley Act. NASCUS is pleased this provision is included in Section 312 of H.R. 2317 and in Section 313 of H.R. 3505.

If State-chartered credit unions are not accorded the same SEC treatment as commercial banks and savings institutions, we believe the powers granted to credit unions by State legislatures and State regulators might be unnecessarily preempted by SEC regulation. Unless appropriate regulatory relief is provided, credit unions offering these services may be subject to redundant and costly examination. We urge that credit unions be accorded similar regulatory treatment as other financial institutions.

Federal Preemption of State Regulation

The debate about State and Federal powers is not a new discussion. I can imagine our Founding Fathers in 1787 at the Constitutional Convention participating in many healthy debates about how to protect the powers of the States. The question confronting our Founding Fathers was how to limit the central government's power so it could not take away from people's rights.

Today, we are confronted by this same issue. In fact, preventing Federal preemption of State laws and regulations continues to be a priority for State legislatures and State regulators. Federal preemption overrides States' rights in several fundamental ways. It preempts State legislatures from creating laws for the citizens of a State. Potentially, laws that override State laws and regulations affecting the consumers in a State could be decided by individuals not elected by the citizens of a State. Preemption does not stop here; it has the potential to stop a State's Governor, a State's Attorney General and a State's financial regulators from making decisions for their State. NASCUS believes States are in the best position to decide the laws and regulations for consumers in their States.

NASCUS is uncomfortable with Federal rulemaking that preempts State authority or the trend of Federal banking authorities to preempt State consumer protection. Such initiatives have been touted as establishing exclusive national standards for regulating almost all aspects of consumer lending practices. We believe it overrides State law and provides less protection for consumers. NASCUS is concerned that there may be a contagion impact on the credit union dual chartering system as the powers of the State banking regulators are curtailed.

Each time a Federal agency acts to preempt State law, it is a chink in the armor of State protections that our Founding Fathers sought to preserve. It threatens the dual chartering system as we know it. Congress should resolve the conflicts rather than delegate these fundamental issues to the Federal financial institution regulators to determine.

When I think of dual chartering of financial institutions, I think of strong communities. I think of economic enhancements and job creation. Dual chartering and the State supervision that comes with it have been essential elements of the credit union system since its beginning. State credit union regulatory agencies have been instrumental in making new rules and regulations that have influenced even the Federal credit union system. States have rightfully been called the laboratories for innovation. Federal preemption takes away innovations created by the State system.

One current issue confronting the credit union system is credit union conversions to mutual savings banks. NASCUS believes that State law should dictate the conversion process for State-chartered credit unions, as well as the terms and conditions that allow State-chartered credit unions to terminate Federal insurance.

The chartering of a State credit union is an issue determined by State law. Approval authority for a conversion is determined, likewise, by State law, which typically authorizes the State chartering authority to determine if a credit union may convert and the processes for a conversion. A conversion is a function of a credit union's original charter, separate from insurance oversight. As we have learned from recent events, NCUA regulations dictate disclosures and approval authority for State-chartered credit union conversions.

NASCUS asks for this Committee's support in changing conversion rules that would place the responsibility on the chartering authority. The authority for Federal credit unions resides with the Federal regulator; likewise, the authority for State-chartered credit unions should reside with State regulators.

Conclusion

In conclusion, NASCUS strongly supports the following issues for regulatory relief:

- NASCUS supports amending the definition of net worth in the FCUA to include more than just retained earnings.
- NASCUS supports amending the definition of net worth to include the retained earnings of a merging credit union with that of a surviving credit union, as included in both H.R. 1042, Section 104 of H.R. 2317 and in Section 314 of H.R. 3505.
- NASCUS supports a risk-based capital regime for credit unions.
- NASCUS believes credit unions should be permitted to issue alternative capital. NASCUS proposes three alternative capital models in its white paper that preserve the not-for-profit structure of credit unions.
- NASCUS supports representation on the NCUA Board by an individual with State credit union regulatory experience.
- NASCUS believes non-federally insured credit unions should be eligible to join the FHLB's.
- NASCUS supports expanding member business lending provisions to 20 percent of total assets of a credit union, furthering the goal to provide loans for consumer members. This is also included in Section 201 of H.R. 2317.
- NASCUS supports amending the definition of a member business loan from $50,000 to at least $100,000, as included in Section 202 of H.R. 2317.
- NASCUS supports that all federally insured credit unions should have the same exemptions as banks and thrift institutions from FTC premerger notification requirements and fees. Additionally, we support expanding this provision to include all State-chartered credit unions. This provision is in Section 311 of H.R. 2317 and in Section 312 of H.R. 3505.
- NASCUS supports amending the definition of bank in the SEC Act of 1934 to provide federally insured credit unions with the same registration exemptions as those provided to commercial banks. This provision is included in Section 312 of H.R. 2317 and in Section 313 of H.R. 3505.
- NASCUS encourages Congress to intervene and block the continuing preemption of State laws.
- NASCUS believes that the process for converting a State-chartered credit union to another financial institution charter is a matter that should be determined by State law and regulation, not dictated by Federal legislation.

NASCUS appreciates the opportunity to testify today and share our priorities for regulatory relief. The provisions discussed are outlined further in the financial services regulatory relief matrix. In addition, we attached a copy of the NASCUS white paper about alternative capital at the end of our testimony.*

We urge this Committee to protect and enhance the viability of the dual chartering system for credit unions by acting favorably on the provisions we have presented in our testimony. We welcome questions from Committee Members.

Thank you.

PREPARED STATEMENT OF BRADLEY E. ROCK

PRESIDENT AND CEO, BANK OF SMITHTOWN

ON BEHALF OF THE

AMERICAN BANKERS ASSOCIATION

MARCH 1, 2006

Mr. Chairman and Members of the Committee, my name is Bradley Rock. I am Chairman, President, and CEO of Bank of Smithtown, an $900 million community bank located in Smithtown, New York, founded in 1910. I am also the Vice Chairman of the American Bankers Association (ABA). ABA, on behalf of the more than two million men and women who work in the Nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies and savings banks—makes ABA the largest banking trade association in the country.

I am glad to be here today to present the views of the ABA on the need to eliminate unnecessary, redundant, or inefficient regulatory burdens that increase costs for banks and reduce the amount of credit available to our communities. By now, it should not come as news that banks are struggling under the weight of increasing levels of regulatory burdens, many of which do not serve the objective of making the Nation's banks operate more soundly or to provide meaningful protections to consumers. These regulatory burdens raise the cost to banks and, consequently, place an unnecessary strain upon banks' abilities to efficiently serve their customers.

The USA PATRIOT Act, the Sarbanes-Oxley Act, and the Gramm-Leach-Bliley Act are all valuable pieces of legislation that strive to serve the public interest. However, overly complex or redundant compliance requirements render these laws far less effective than they would be otherwise. Banks, particularly community banks, are strained to the breaking point under the weight of thousands of pages of regulation, guidance, and other mandates. When the cumbersome layering of additional requirements, issued by the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), the American Institute of Certified Public Accountants (AICPA), and the Internal Revenue Service (IRS) are also taken into account, it is abundantly clear that bank resources are being stretched too thin.

The ABA would like to take this opportunity to thank the many Members of the Senate Banking Committee that signed a joint letter to then-SEC Chairman Donaldson, expressing serious concerns with the SEC's proposed regulations implementing the "push-out" provisions of Title II of the Gramm-Leach-Bliley Act and urging the SEC not to finalize those regulations. As the Committee is aware, the proposal would create costly and unnecessary regulatory burdens on banks that offer traditional banking products and services. To date, the SEC has not issued final regulations and we, in the banking industry, are hopeful that the SEC will follow the guidance outlined by Members of this Committee to work with the bank regulators to propose a new regulation for public comment that is consistent with Congressional intent and that does not "impose burdensome and wholly unjustifiable compliance costs on the entire banking industry."

In addition, ABA has submitted comments to regulators on a wide range of regulatory relief priorities, which would make a real difference in the vitality of our Nation's banks. We are pleased the regulators have acted on some of our recommendations and that our message is apparently being heard. For example, I am particularly pleased with regulators' support for changes that involve the Bank Secrecy Act (BSA), including discontinuing cash transaction report (CTR) requirements for seasoned customers—changes that would not only provide relief to banks and our reg-

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* Held in Committee files.

ular customers, but also increase the security of our banking system by identifying criminal activity with greater precision. More can, and needs to be done, however.

In my testimony, I would like to make three key points:

- Excessive regulatory burden has a significant impact on bank customers and local economies.
- The regulatory burden is significant for banks of all sizes, but pound for pound, small banks carry the heaviest regulatory load. The community bank is in great danger of being regulated right out of business.
- There are many important regulatory issues that Congress should address this year, but several are especially pressing to maintain the competitive vitality of my industry. These include eliminating unnecessary CTR's, increasing the 500-shareholder threshold which triggers periodic reporting requirements that impose considerable financial and opportunity costs on smaller public companies; and preventing credit union capital erosion and widening credit union authority in higher-risk lending.

Excessive Bank Regulation Harms Consumers, Communities' Economies

Outdated laws and regulations divert scarce resources of banks that could otherwise be used to provide financial services demanded by our customers. New laws, however well-intentioned, have added yet more layers of responsibilities on businesses like mine. While no single regulation by itself is overwhelming, the cumulative weight of all the requirements is overwhelming.

The burden of regulation has a significant impact on bank customers and local economies. Every new law, regulation or rule added means two things: More expensive bank credit and less of it. This is true for large and small businesses—likely hurting small businesses the most, as they need low-cast financing but cannot go directly to the capital markets. The result is slower economic growth.

During the past 25 years, the compliance burden has grown so large and is so pervasive throughout all levels of bank management that it is extremely difficult to measure. Research done by the ABA and the Federal Reserve[1] indicates that the total cost of compliance *today* for banks—*excluding* compliance costs due to legislation enacted in the last 5 years, such as the USA PATRIOT Act and Sarbanes-Oxley—would range from $36 billion to $44 billion per year. Compliance costs are expected to grow at an even faster pace in the coming years.

Certainly, some of the regulatory cost is appropriate for safety and soundness reasons. But consider the direct impact on bank lending and economic growth if this burden could be reduced by 20 percent and redirected to bank capital; it would support additional bank lending of $72 billion to $88 billion. This would clearly have a big impact on our economies. In fact, it represents nearly 10 percent of all consumer loans or 11 percent of all small business loans.

Community Banks Hit Especially Hard

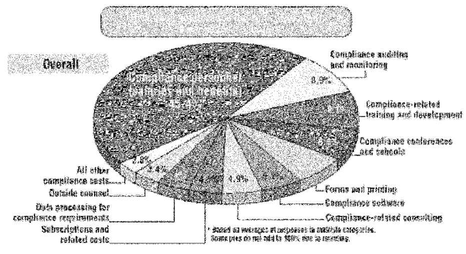
Regulatory costs are significant for banks of all sizes, but small banks carry the heaviest regulatory load. For the typical small bank, about $1 out of every $4 of operating expense goes to pay the costs of government regulation. For large banks as a group, total compliance costs run into the billions of dollars annually.

The cumulative effect of new rules and regulations is already leading many community banks to look for merger partners to help spread the costs; some will go out of business altogether or consolidate with larger banks, as some have already done. Our members routinely mention regulatory burden as the first or second critical factor threatening the viability of their community banks. I can tell you, Mr. Chairman, the pressures to comply with all the regulations and still meet the demands of our customers are enormous. We feel that we must grow the bank rapidly to generate more revenues simply to pay for the ever-increasing regulatory cost. The sad part is that too much time and effort is now devoted to compliance and not to serving our customers.

Bankers at all levels, from bank directors and CEO's to compliance managers and tellers, spend endless hours on compliance paperwork. Because of the complexities involved, my bank pays more than $100,000 each year to outside firms to help us with the big compliance issues. On top of this, one person on my staff has a full-time job just to coordinate all the activities throughout the bank related to regulatory compliance. I personally spend about one-and-a-half days per week just on compliance issues. Some CEO's tell me that they are now spending nearly half of their time on regulatory issues. In addition, banks spend billions annually on com-

[1] "Survey of Regulatory Burden," ABA, June 1992; Elliehausen, "The Cost of Banking Regulation: A Review of the Evidence," Staff Study, Board of Governors of the Federal Reserve System, April 1998.

pliance training, outside compliance support (including accounting firms, consultants and attorneys), compliance related hardware and software, printing, postage, and telephone connections.



Source: *Compliance Watch, 2003. Nationwide Bank Compliance Officer Survey.* ABA Banking Journal, June 2003.

Banks that can least afford increasing compliance costs are hit the hardest. There are more than *2,491 banks and thrifts with fewer than 20 employees; nearly 900 banks and thrifts have fewer than 10 employees.* In order to fulfill their compliance obligations, banks of this size often are forced to hire an additional full-time employee just to complete government-mandated reports. According to the Small Business Administration's Office of Advocacy, the total cost of regulation is 45 percent higher per employee for firms with fewer than 20 employees compared to firms with more than 500 employees due to the fixed costs associated with regulations.[2] The cost versus benefit analysis fails to make the case for many of the rules and regulations banks must follow and the reports that we generate.

The bottom line is that too much time and too many resources are consumed by compliance paperwork, leaving too little time and resources for providing actual banking services. I am sure I speak for all bankers when I say that I would much rather spend my time talking with our customers about their financial needs and how my bank might fulfill them than poring over piles of government regulations. The losers in this scenario are bank customers and the communities that banks serve.

CTR's, Shareholder Thresholds for Reporting Requirements, and Credit Union Expansions

In the appendix to this testimony is a list of recommended actions, every one of which would provide meaningful and much needed regulatory relief to banks. There are three issues in particular that I would like to emphasize.

ELIMINATE CTR FILINGS FOR SEASONED CUSTOMERS [MATRIX 176]

ABA and its members strongly believe that the current cash transaction reporting program has been rendered virtually obsolete by several developments: Enhanced customer identification programs, more robust suspicious activity reporting, and the use of the more focused and intensive 314(a) inquiry/response process. We believe that the current CTR screen at the current level generates too many reports that capture extensive immaterial activity wasting law enforcement time and resources that could be spent more effectively on detection and investigation of criminal and terrorist activity.

In fact, as published in the U.S. Money Laundering Threat Assessment released earlier this year, the number of CTR's filed on an annual basis now tops 13.1 million with no signs of abating. Even at FinCEN's conservative estimate of around 25 minutes per report for filing and recordkeeping, it means that the banking industry as a whole devoted around 5½ million staff hours of work to handling CTR's in 2005. Based on our recent survey, the industry paid around $187 million in wages for this staff time.

Based on that same survey, three-quarters of the filings were for business customers who had been with the bank for over a year. That means that the industry spent around four million staff hours and over $140 million last year filing notices on well-established customers!

A typical bank with $2 billion of assets filed 1,400 CTR's in 2005. The filings took 583 staff-hours. And 438 of the staff-hours were simply to report on long-standing customers.

[2] Crain, "Impact of Regulatory Costs for Small Firms," Small Business Administration, 2005.

This trend is only likely to accelerate and demand more and more staff to report on more and more transactions further burying the real needles of money laundering under an exponentially growing mound of the hay of legitimate business transactions mindlessly recorded at great expense and increasing opportunity cost.

CTR's have been Superseded by SAR's and 314(a) Inquiries

When establishing the BSA regulatory regime, Congress sought to require reports or records when they have "a *high* degree of usefulness" for the prosecution and investigation of criminal activity, money laundering, counter-intelligence, and international terrorism. ABA and its members strongly believe that the current CTR reporting standards have long departed from this standard of achieving a high degree of usefulness.

To continue to require CTR filings for business customers whose identity has been verified under a bank's Customer Identification Program (CIP) and tested under a period of experience with the bank and that remain subject to risk-based suspicious activity reporting is an inefficient use of resources by bankers and law enforcement. It also diverts scarce examiner resources by focusing on compliance with *technical* reporting standards, rather than evaluating bank internal controls for detecting transactions that possess a likelihood of involving money laundering and terrorist financing.

Exempt Seasoned Customers from CTR's

Accordingly, *we believe that the best way to improve the utility of cash transaction reporting is to eliminate the routine reports being filed on legitimate American businessmen and businesswomen.* This can be achieved by establishing a seasoned customer exemption for business entities, including sole proprietorships, as endorsed by FinCEN last year in testimony before Congress.

It is important to remember that cash transaction data will not be lost, but rather will continue to reside in the normal bank account data for each seasoned customer. It will, therefore, be available to law enforcement whenever sought in connection with an inquiry from government enforcement entities. In particular, by using the USA PATRIOT Act 314(a) inquiry process, law enforcement will be able to obtain information in far greater detail on the accounts of suspects. Of course, all seasoned business customers would continue to be subject to suspicious activity monitoring and reporting, thereby alerting law enforcement to the kind of conduct that has been investigated and affirmatively considered as having a heightened potential for being illegal.

Eliminating CTR filings for seasoned customers would have the following benefits:

- The vast majority of the over 13 million CTR's filed annually would stop, saving many hours a year in filling out forms and law enforcement resources devoted to processing them.
- There would be an improvement in the quality of SAR's, eliminating those that are filed on routine, legitimate cash transactions that approach but do not reach current CTR levels. Banks would be able to focus their energies on detecting genuinely suspicious handling of currency regardless of artificial thresholds.
- We would make an enormous stride forward in focusing our anti-money laundering efforts—by both law enforcement and the banking industry—on the real crooks and terrorists with far greater likelihood of detecting and stopping their activities.

The redundancy of CTR filings for seasoned customers with transaction accounts and the need to eliminate this inefficient use of resources by bankers and law enforcement was echoed by the Financial Crimes Enforcement Network (FinCEN) and all the bank regulators in Congressional testimony over the last year.

Simplifying the CTR Exemption Process Falls Short

ABA has worked cooperatively with FinCEN and the Federal banking regulators to encourage institutions to make better use of statutory exemptions when they were changed in the late 1990's. Our Association did extensive outreach to our members, and while many institutions adjusted their CTR filing policies and utilized the two-tier exemption process, the general response was lukewarm at best.

Unfortunately, the compliance technicalities for, and examiner second-guessing of, banker use of the exemption and the renewal processes have discouraged many institutions from utilizing the tier-two exemptions. ABA has even received reports from members that examiners have threatened penalties and other formal criticisms for simple late filing of biennial renewal forms, a regulatory climate that demands overhaul. We do not believe that improvements to this process will make a significant dent in the overwhelming number of CTR's filed each year that do little more than record the legal transactions of law-abiding citizens, thereby drawing attention and resources away from the effort to catch and stop criminal activity. Consequently, in adopting a seasoned customer exemption, we must ensure that the regulatory process and requirements that follow do not frustrate the goal of reducing unnecessary CTR filing.

INCREASE SHAREHOLDER THRESHOLD FOR REGISTRATION

Currently, Section 12(g) of the Securities Exchange Act of 1934 requires a company with $10 million in assets and 500 shareholders to register its securities with the SEC. Once registered with the SEC, a company comes under a significant weight of Federal securities regulation, including requirements to file with the SEC annual and quarterly reports, and insider and beneficial owner reports, and to comply with the SEC's proxy and information statement rules. The 500 shareholder threshold has never been updated since it was initially set in 1964; in contrast the asset requirement has been updated incrementally from $1 million to $10 million since 1964.

These periodic reporting requirements impose considerable financial and opportunity costs on smaller public companies—costs that are ultimately borne by the company's shareholders and the Nation as a whole as the job and economic creativity of small businesses are unnecessarily burdened. For example:

- Average auditing fees for smaller public companies, defined as companies with less than $1 billion in revenue, rose from $532,000 in 2003 to $1,044,000 in 2004, a 96 percent increase. Large public companies also face very large increases in auditing fees—58 percent from $3,631,000 to $5,734,000.
- Three-fourths of community banks surveyed by Grant Thornton last year indicated that director and officer liability insurance had increased significantly in 2003.
- The legal costs of public companies have increased dramatically, disproportionately impacting smaller public companies that do not have the requisite legal staff to draft committee charters, corporate governance principles, codes of ethics, director independence surveys, and board of director and committee assessments.
- Significant opportunity costs have dampened the growth of business as capital that is currently used to fund unnecessary compliance programs is not available to fund expansion, including the opening of bank branches. In addition, lost productivity as a result of complying with these reporting requirements is estimated at $1 million per year for companies with revenues of less than $1 billion.

To reduce these costs and burdens, the 500-shareholder threshold should be increased to more accurately reflect the current size and conditions of the investment market. As noted above, updating the benchmarks for SEC registration is not without precedent as the asset size parameter has been increased to $10 million from $1 million initially set in 1964. Good public policy suggests that the shareholder threshold should be correspondingly increased. According to SNL Financial data, raising the threshold to 3,000 would exempt about 6 percent of the banking industry in terms of assets, or six hundred and eighteen bank holding companies. Even updating the threshold to 1,500 shareholders would exempt about 5 percent of the banking industry in terms of assets, or about five hundred bank holding companies.

The SEC regulations also provide that a company cannot seek to de-register until the number of shareholders of record is below 300. Sections 12(g)(4) and 15(d) of the Securities Exchange Act of 1934 should be similarly updated to place the threshold for de-registration within the range of 900 to 1,800 shareholders of record.

REJECT EFFORTS TO EXPAND CREDIT UNION BUSINESS LENDING AUTHORITY

ABA strongly opposes the use of regulatory relief legislation to expand the commercial lending authority and/or prudent regulation of capital levels of credit unions. Such changes would reduce the safe and sound supervision of credit unions while fueling even more rapid extension of the government subsidies for an ever-increasing segment of the credit union industry, especially when the industry has failed to demonstrate that it is using its subsidies to benefit the underserved.

A fundamental change has occurred within the credit union industry that has divided the industry into two distinct groups—diversified conglomerate credit unions that act like and advertise themselves as commercial banks, and traditional credit unions that are more likely to embody credit unions' mission to serve people of modest means. Today, more than 100 credit unions surpass $1 billion in assets. These credit unions are much larger than the typical community bank in their local market, which has a median asset size of $106 million as of September 2005. The current government subsidies for these diversified credit unions and lack of equivalent regulation have created huge competitive inequities in the local marketplace and represents an ever-increasing abuse of the credit union tax subsidy. Moreover, large-scale business lending is inconsistent with Congress's original charge that credit unions serve "people of small means" and should not be encouraged further.

Conclusion

In conclusion, the cost of unnecessary paperwork and red tape is a serious long-term problem that will continue to erode the ability of banks to serve our customers and support the economic growth of our communities. We thank you for continuing to look for ways to reduce the regulatory burden on banks and thrifts, and to restore balance to the regulatory process. Mr. Chairman, the ABA is committed to working with you and the Members of this Committee to achieve this goal.

TESTIMONY

BEFORE THE
SENATE COMMITTEE ON
BANKING, HOUSING AND URBAN AFFAIRS

REGARDING

THE CONSUMER IMPACT OF REGULATORY RELIEF PROPOSALS AFFECTING BANKS, THRIFTS AND CREDIT UNIONS

MARCH 1, 2006

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on behalf of their organizations and clients as well as:

ACORN
Center for Responsible Lending
Consumers Union
National Community Reinvestment Coalition

Chairman Shelby, Senator Sarbanes, and Members of the Committee, this written testimony accompanies the verbal comments provided to you today by Travis Plunkett of the **Consumer Federation of America,**[1] Margot Saunders of the **National Consumer Law Center**[2] on behalf of its low income clients, and Edmund Mierzwinski of the **U.S. Public Interest Research Group**[3]. We thank you for the opportunity to provide comments on the many issues that may arise as you consider proposals for financial services regulatory reform. This testimony is also provided to you on behalf of **ACORN,**[4] the **Center for Responsible Lending,**[5]**Consumers Union,**[6] and the **National Community Reinvestment Coalition.**[7]

There are many proposals for changes to the laws governing financial services currently under consideration in the Congress. We support some of these proposals, we have no positions on others, and we have grave concerns regarding a number of others. However, in this testimony, we only focus on provisions we understand to be under serious consideration by the committee;[8] we do not comment on all 187 or more items in the so-called "regulatory reform matrix," although we certainly oppose others.

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[1]The **Consumer Federation of America** is a nonprofit association of about 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through research, advocacy and education.

[2]The **National Consumer Law Center** is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen examples of predatory practices against low-income people in almost every state in the union. It is from this vantage point--many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities--that we supply these comments. We have led the effort to ensure that electronic transactions subject to both federal and state laws provide an appropriate level of consumer protections. We publish and annually supplement fifteen practice treatises which describe the law currently applicable to all types of consumer transactions.

[3] The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

[4]**ACORN** is the nation's largest community organization of low- and moderate-income families, with over 175,000 member families organized into 800 neighborhood chapters in 80 cities across the country.

[5]The **Center for Responsible Lending** (CRL) is a non profit, nonpartisan organization focused on policy research and advocacy to stop predatory lending practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development lenders, whose mission is to create and protect homeownership opportunities for low-wealth families through home and small business ownership.

[6]**Consumers Union**, the nonprofit publisher of Consumer Reports magazine, is an organization created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. Consumers Union's publications carry no advertising and receive no commercial support.

[7]**National Community Reinvestment Coalition** (NCRC) is the nation's trade association for economic justice whose members consist of local community based organizations. Since its inception in 1990, NCRC has spearheaded the economic justice movement. NCRC's mission is to build wealth in traditionally underserved communities and bring low- and moderate-income populations across the country into the financial mainstream. NCRC members have constituents in every state in America, in both rural and urban areas.

[8] For example, many of the undersigned organizations also strongly oppose changes to Section 404 of Sarbanes-Oxley (Matrix item 175).

As the Committee evaluates which of these many proposals to include in a bill labeled "Regulatory Relief," it is critical that the *consumer interest* be the focal point of the process. A fair bill cannot be limited to proposals requested by financial institutions. A fair bill must include regulatory measures that would benefit consumers. In particular, our organizations urge you to take the long-overdue step of updating the jurisdictional limits and statutory damages allowed under the Truth in Lending Act (TILA) and the Consumer Leasing Act.

A fair bill must also exclude measures that would harm consumers. An analysis of the proposals suggested by the financial services industry indicates that many would do substantial harm to consumers by overriding important state laws with weak substitutes, undermining key consumer protections under federal law, and jeopardizing the safety and soundness of the deposit insurance system. Of particular concern are proposals that would:

- Exempt check diversion companies from consumer protections required under the Fair Debt Collection Practices Act, allowing these *for-profit collection* companies to operate outside the limitations of federal consumer protection and force consumers to pay fees that are not authorized by state law in order to avoid criminal prosecution.
- Expand the ability of Industrial Loan Companies to offer new products, such as business checking, and branch into states without permission, threatening the safety and soundness of the banking system and taxpayers.
- Override the interest rate ceilings put in place by the people of Arkansas, removing the state's ability to impose any limits on any loans in the state.
- Exempt financial institutions from providing some important privacy notices, and
- Override the few remaining states that prevent rent-to-own stores from overcharging consumers.

In this process, federal agencies and financial institutions often argue that various consumer protection regulations have an adverse impact on competition. Actually, it is the *removal* of consumer protection regulations that would most likely reduce the competitive advantage of responsible financial institutions in the marketplace. Consumer protection requirements are imposed on depository institutions not only for the benefit of consumers, but also to ensure that competition is appropriately fostered. Without the minimum consumer protections required by federal law, institutions that choose to provide more balanced and consumer friendly products would find themselves at a competitive disadvantage compared to institutions that choose not to treat consumers as fairly.

The consumer protections provided by such laws as the Truth in Lending Act, the Fair Debt Collection Practices Act, the Electronic Fund Transfer Act and others are often the only tools available to consumers to balance their bargaining power with influential federally chartered and insured financial institutions. After all, the broad range of consumer protections traditionally provided by state law in consumer transactions may no longer be applicable to federally chartered or insured financial institutions.[9]

It has been recognized for centuries that borrowers and lenders often do not enter credit contracts on an equal footing. The absence of equal bargaining power may manifest itself in different ways. It is a

[9] See Regulations of the Office of Comptroller of the Currency, 12 C.F.R. Parts 7 and 34; and Regulations of the Office of Thrift Supervision, 12 C.F.R. part 560.

fact of the modern consumer credit market that creditors, not borrowers, draft loan documents, and that the terms of credit contracts offered to consumers are basically non-negotiable. A potential borrower can "take it or leave it" and go elsewhere, though sometimes the "elsewhere" is not so easy to find or involves identical terms. Moreover, the increased complexity of credit makes it difficult for consumers to do any meaningful comparison shopping to determine whether it is best to "leave it" or not. The ubiquity of adhesive credit contracts, combined with the ignorance of almost all consumers about the implications of the fine print contained in these contracts, leads to opportunities for the exploitation of typical borrowers that are just as great as those present with the classic desperate borrower.

The consumer protections provided by the federal laws under consideration in the present review generally provide the only antidote for consumers to protect them from overcharging and adhesion contracts with complex terms. In fact, as the refrain "predatory lending" should be quite familiar to this Committee, everyone should agree that the current panoply of federal consumer protections is clearly insufficient. As a result, to promote safety and soundness, ensure fairness and protect consumers, we urge the Committee to adopt *pro-consumer legislation.*

Additionally, any proposed reduction in federal consumer protections must be justified not only by the clearest showing that the burden on the financial services industry is unreasonably high, but also by an equivalent finding that the benefit to consumers provided by the protections being reduced is *de minimus.*

I. IMPORTANT PROPOSALS TO UPDATE FEDERAL LAWS TO PROTECT CONSUMERS

A. Update Truth in Lending Act and Consumer Leasing Act (Senate matrix Item 129).

TILA's jurisdictional limit for non-dwelling secured consumer credit transactions was set when the law was first passed in 1968 at $25,000. That amount was more than sufficient at that time to ensure that most automobiles and credit card transactions were included within TILA's umbrella. However, the value of $25,000 in 1968 dollars is $142,456.90 in today's money. [10] As a result, today most car loans as well as other consumer credit transactions are not protected by TILA.[11]

The same issue exists for statutory damages under TILA. The equivalent for the statutory damages amount of $1,000 in 1968 would be almost $6,000 today. The numbers in the current statute need to be updated, and an inflation factor built in. The Consumer Leasing Act requires similar treatment.[12]

B. The application of the Truth in Lending Act to overdraft "bounce" loans should be clarified (Senate matrix Item 127).

[10] See http://data.bls.gov/cgi-bin/cpicalc.pl.

[11] Amendment: Amend Section 104(3) of the Truth in Lending Act (15 U.S.C. § 1603(3)) and Section 181(1) of the Consumer Leasing Act (15 U.S.C. § 1667(1)) by deleting "$25,000" wherever it appears and replacing it with "$150,000".

[12] Amendment: Amend Section 130 of the Truth in Lending Act (15 U.S.C. §1640) by deleting "$100" or "$200" wherever either appears, and replacing both items with "$500", and by deleting "$1,000" or "$2,000" wherever either appears and replacing both items with "$5,000".

The Federal Reserve Board issued final rules last year to cover overdraft extensions of credit under the Truth in Savings Act, Reg DD, instead of recognizing that "bounce loan protection" should be regulated under the Truth in Lending Act as the extension of credit that it clearly is. The Board's rule is a completely inadequate response to the real need consumers have for information about the exorbitant costs of these loan products. Congress should step in and require--at the least--that overdraft "bounce" loans be treated just as all other extensions of credit are treated under the federal Truth in Lending Act. This equivalent treatment would simply--and most importantly--require that creditors of overdraft "bounce" loans *inform* consumers about the true costs of this credit and get affirmative consent to borrow money through use of a debit card at an ATM or point of sale terminal or by writing checks that overdraw the account.

Bounce "protection"[13] is a new form of overdraft protection that over 90 percent of banks are using to boost their non-interest revenue.[14] A 2005 study by the Center for Responsible Lending conservatively estimates that consumers paid over $10 billion in a year for overdraft loans.[15] As we wrote to this Committee last year, banks that use "courtesy overdraft" programs charge steep fees, take payment in full directly out of consumers' next bank deposit, and encourage consumers to overdraw their accounts, unlike traditional overdraft protection that consumers apply for and that guarantees coverage of overdrafts with reasonable fees and affordable repayment terms.

Bank overdraft "bounce protection" is a systematic attempt to induce consumers into using overdrafts as a form of high-cost credit. These plans offer short-term credit at triple-digit rates.[16] When a consumer uses bounce credit, the bank deducts the amount covered by the plan plus the fee by setting off the consumer's next deposit, even where that deposit is protected income, such as a welfare or Social Security check. The fee is often the same amount charged for an NSF fee on a returned check, and in some cases the bank also charges an additional, per-day fee.

Banks covering overdrafts do not ask for consumers' affirmative consent to borrow from the bank, do not guarantee to pay overdrafts, and do not disclose the loan's interest rate. Some regulators even allow their banks to deceive consumers about how much money they have in their accounts when they request an account balance inquiry.[17] Banks that advance cash at the ATM or point of sale when

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[13]Bounce "protection" is a euphemism used by banks to describe this high-cost credit product.

[14]For more information on bounce credit, see Consumer Federation of America & National Consumer Law Center, Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks (2003), available at www.consumerlaw.org/initiatives/test_and_comm/appendix.html.

[15] Center for Responsible Lending, "Underregulated & Overpriced: The $10 Billion Overdraft Loan Market," May 26, 2005.

[16]For example, a $100 overdraft will incur at least a $20 fee. If the consumer pays the overdraft back in 30 days, the APR is 243 percent. If the consumer pays the overdraft bank in 14 days, which is probably more typical for a wage earner, the APR is 521 percent. This arrangement is much more expensive than alternatives that most banks offer, such as overdraft lines of credit, linking the account to a credit card, and transfers from savings.

[17] The brochure issued by the OCC last summer entitled "Writing a Check: Understanding Your Rights," warns consumers: "Be sure that the available account balance you're counting on does not include funds from your bank's 'overdraft protection' program." See http://www.occ.treas.gov/ftp/release/2005-75a.pdf (last visited 25 February 2006). The OCC brochure intends to explain all check rights; we are not aware that OCC allows national banks to deceive consumers in this

consumers overdraw bank accounts turn consumers' debit cards into credit cards without the benefit of credit card protections. The Office of the Comptroller of the Currency has recognized that bounce loans are credit as defined by TILA.[18] Some state regulators have reached the same conclusion.[19] All federal bank regulators, except the Office of Thrift Supervision, acknowledge that overdrafts are credit. The Joint Guidance on Overdraft Protection Programs, issued by most federal bank regulatory agencies early last year, acknowledges that "When overdrafts are paid, credit is extended."[20] Yet consumers do not get credit protections.

Overdraft loan fees clearly meet Regulation Z's definition of a finance charge. Section 226.4(c)(3) of Regulation Z, which excludes fees for traditional overdrafts, provides that overdraft fees are finance charges when "the payment of such items and the imposition of the charge were previously agreed upon in writing." Although banks offering bounce credit have sought to avoid Regulation Z's coverage by claiming that the bank's payment of an overdraft in a "bounce protection" plan is "discretionary" and that such payments have not been agreed to in writing, these assertions fail. First, bounce credit is not discretionary. These plans are administered through computer software and thus are formal, systematic programs rather than an occasional customer courtesy. Moreover, banks extend bounce credit pursuant to an agreement in writing, whether through advertisements, correspondence, or on a website. Consumer assent is not necessary, and consumers often are held accountable for fees unilaterally imposed by banks.

A study by the Consumer Federation of America found that over eighty percent of the largest banks, controlling over half the deposit dollars in the United States, include fine print in account agreements that permits those banks to make overdraft loans through automated teller machines and at the point of sale.[21] These overdraft loans go beyond covering paper checks that would otherwise be returned unpaid and permit consumers to borrow the bank's money without notice, consent, or comparable cost disclosures. While it violates federal law for banks to repay cash advances on credit cards by withdrawing funds from consumers' checking accounts at the same bank, banks routinely repay their extensions of credit and fees on overdraft loans by exercising their right of setoff.

Congress must clarify that overdraft "bounce" loans are covered by the basic consumer protections found in the Truth in Lending Act. Federally insured depository institutions should be required to get affirmative consent for overdraft loans and to warn consumers when ATM and debit card

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manner.

[18]Daniel P. Stipano, Deputy Chief Counsel, Office of the Comptroller of the Currency, Interpretive Letter #914, September 2001.

[19]Indiana Department of Financial Institutions, Newsletter--Winter 2002 Edition (Nov. 2002), at 2; Letter from Assistant Attorney General Paul Chessin, Colorado Department of Law, Consumer Credit Unit, Mar. 21, 2001 (in response to referral from the Administrator for the Colorado Uniform Consumer Credit Code).

[20] Department of the Treasury, Joint Guidance on Overdraft Protection, Federal Reserve System Docket No. OP-1198, 70 Fed. Reg. 9,127 (February 24, 2005) p. 7.

[21] Consumer Federation of America, "Overdrawn: Consumer Face Hidden Overdraft Charges From Nation's Largest Banks," June 9, 2005.

transactions will overdraw an account and trigger a fee. They should also be required to provide affordable repayment terms when making these loans.

C. Expand the Electronic Fund Transfer Act to apply to all forms of electronically processed payments (Senate matrix Item 130).

Payment methods are increasingly converging, but the consumer rights available differ vastly depending on how the payment is processed. A consumer who pays by debit card, for example, has the protections of the federal Electronic Fund Transfer Act, including a 10 business day right of recredit of all disputed funds. The consumer never has to be without his or her funds for more than 10 business days when paying by electronic debit. When a consumer pays by check, however, the applicable consumer rights are much more murky. A paper check, or a check which is processed wholly electronically under bank to bank image exchange agreements, is subject to the Uniform Commercial Code and carries no baseline federal consumer protections and no promise of how long it can take to return the disputed funds to the consumer. Even though image exchange is an electronic processing method, the EFTA exemption for checks means that consumers don't get the crucial 10 day right of recredit, and thus are at the mercy of their banks or the courts to win a timely return of disputed funds. When the check is processed using a substitute check, the Check 21 Act provides a 10 business day right of recredit, but the Federal Reserve Board's narrow interpretation of the availability of this right in its regulations restricts this right to those consumers who were provided with a physical substitute check, and the final regulations do not even require that banks provide that document on request. If, instead of image processing (no federal rights) or Check 21 processing (limited federal rights), the check is processed through lockbox conversion or point of sale conversion, it is covered by the EFTA (full federal rights).

When something goes wrong with a check payment, the consumer shouldn't have to sort out how that check was processed after it left the consumer's hands in order to learn his or her rights. Congress can take a significant step toward solving this mess by amending the EFTA to include all checks which are processed in whole or in part by the transmission of electronic information.

D. Prohibit the misuse of banks and bank accounts by high priced payday lenders (Senate matrix Item 128).

The Federal Deposit Insurance Corporation, the only bank regulatory agency to permit its banks to partner with payday lenders, has recently taken steps to curtail the role of banks in facilitating payday lending. Last year, the FDIC issued a cease and desist order that led County Bank of Rehoboth Beach, DE to withdraw from the payday loan business. According to company announcements and filings with the SEC, the FDIC has asked the remaining "rent-a-banks" to stop partnering with payday lenders to make single-payment and installment loans. Last week, First Bank of Delaware announced that it will cease making these loans. Since the FDIC does not make public the content of supervisory letters, we do not know whether all banks will permanently be barred from renting their charters to storefront and online payday lenders.

The FDIC is the last of the federal bank regulators to take firm regulatory action to stop the use of "rent-a-bank" arrangements, designed to allow payday lenders to evade state usury and small loan laws.[22]

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[22]See report from Consumer Federation of America titled "Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury," which documents the failure of the Federal Deposit Insurance Corporation to protect

Last year the FDIC revised its guidelines, directing banks to halt payday lending once consumers had been in debt three out of the prior twelve months. The 11th Circuit decision in *BankWest v. Baker*[23] found that the Federal Deposit Insurance Act does not preempt state laws that attempt to regulate banks' payday loan partners. To close this misuse of banks once and for all, we urge you to clarify that bank charters are not for rent by enacting S. 1878, Senator Akaka's "Predatory Payday Loan Prohibition Act of 2005."

In addition to prohibiting rent-a-bank payday lending, this bill prohibits the relatively new practice of holding a check as security for a loan. Using the check as security for the payment of a payday loan is the key to the coercive collection tactics used by the lenders. As the lender holds the check, at the end of the short term loan, the consumer is generally forced to choose among three untenable options: 1) allowing the check to be debited from their bank account where it will deplete money needed for food and other living necessities, 2) allowing the check to bounce, exposing the borrower to coercive collection tactics when lenders threaten civil or criminal liability for unpaid checks, and from the risk of losing their bank account or check-writing privileges, or 3) renewing the loan at the original high cost. Loans based on personal checks drawn on the borrower's bank account that will be deposited to repay the loan on the next payday is the modern version of lending secured by wage assignments, a credit practice long recognized as inherently unfair which violates FTC rules.

The Senate should not condone predatory lending based on enticing cash-strapped consumers to write checks without money in the bank to cover them.

E. Protect members of the military from predatory loans targeted at them.

One of the major problems that the Congress has considered, but failed to complete action on, is the growing threat to our nation's military readiness caused by predatory lenders targeting military families. High interest rates, unaffordable repayment terms, and the risk of losing valuable assets characterize lending to the military. Military personnel must live under the terms of the Uniform Code of Military Justice and security and evaluation criteria that place a premium on sound financial management.

We are particularly alarmed about payday lenders that entice military personnel, who are required to have a bank account in order to receive direct deposit of their pay, to borrow money by handing over personal checks for the loan and the finance charge. These quick cash loans cost over three hundred percent annual interest and must be repaid in full on the borrower's next payday. Payday loan users are often trapped in a cycle of debt, paying the finance charge every payday to keep checks afloat but unable to make the balloon payment required. A study recently published in the Ohio State Law Journal conclusively demonstrates that payday lenders target military personnel. A survey of twenty states, including nearly 15,000 payday loan outlets and over a hundred military bases, found that payday lender locations show greater concentrations per capita near military populations. An *Army Times* investigation documented that there are four times as many payday loan outlets per 100,000 population near Fort Lewis and McChord Air Force Base than in the rest of Washington.

As Navy Master Chief Petty Officer Terry D. Scott testified before a House Ways and Means subcommittee in February, "I am not being dramatic in my strong belief that loans from predatory lenders

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consumers and the safety and soundness of state-chartered, federally-insured banks that partner with store front payday lenders.

[23] 2005 WL 1367795 (11th Cir. June 10, 2005).

to our troops are a threat to our military readiness and our ability to fight effectively the Global War on Terror. Our country does not need Sailors distracted by the debt incurred from predatory loan establishments. In addition, the security risks from Sailors in debt who could be compromised are significant; the biggest factors in Sailors losing security clearances crucial to doing their jobs in the defense of our country are financial problems."

Two positive steps you could take would be to enact S. 418, by Senator Enzi and several other members of the Committee as well as other Senators, and also to enact legislation based on Senator Dole's original amendment to the Defense Authorization bill to cap rates for loans made to military personnel. As noted already, we also endorse Senator Akaka's S. 1878 to prohibit loans based on checks or debits drawn on the borrower's bank account.

S. 418, the Military Personnel Financial Services Protection Act, is a good response to abuses in the sales of periodic payment plans – both mutual funds and other investments, such as investments disguised as insurance products -- to military personnel. These abuses have been documented in the *New York Times* over the last several years. The bill would ban the sale of the most egregious products and would clarify that state insurance commissioners have jurisdiction over violations on military bases. The NASD already has this jurisdiction.

While the House has passed H.R. 458, that bill unfortunately suffers from a number of unacceptable deficiencies. Title II, Lending to Armed Forces Personnel, was presented as a consumer protection against payday lending. Due to the narrow coverage of the bill, it actually does not apply to many payday lenders or payday loan transactions made to military borrowers. For example, the only lenders covered are those that make over 10 percent of their loans to service members. Advance America, the country's largest payday loan chain, filed a challenge to Jacksonville's payday loan ordinance in 2005 and stated that less than five percent of its customers were members or spouses of military in Jacksonville, home of the Naval Base.

H.R. 458 *appears* to protect military borrowers, but is actually likely to cause harm by undermining existing protections for excluded borrowers, lenders, and loans.

- **H.R. 458 is likely to *reduce* existing rights for members of the military**. As it only covers a small portion of the predatory loans actually made to military personnel, transactions *not* covered may be less protected than under current law. The bill purports to prohibit some bad things (waiver, garnishment, assignment of wages) for only some loans, made by only some lenders. Yet under current law, the terms this bill would prohibit are generally already illegal. For example, if the "protections" only apply if the loans are made by lenders who target military borrowers, by inference these provisions would not apply to all other military borrowers, other loans or other lenders. By failing to protect all military borrowers from all predatory loans from all lenders, the effect is likely to provide credence to arguments that the prohibited terms are legal for all other loans.[24]

[24] The "rule of construction" in the amendment does not adequately protect from these negative inferences. If the rule were effective, it would render the underlying protections in the bill meaningless. The basic rules of statutory construction require that a law have some real effect. If the amendment adds any protections, then that must mean that in those situations that are not covered by the amendment, those protections would not be applicable. As a result, either the protections listed in the amendment are new – and thus inapplicable to non-covered transactions (which reduces existing protections) – or the amendment is meaningless.

- **The effect of the notice required for some loans would facilitate predatory lending, rather than reduce it.** The notice that would be provided to some military personnel by some lenders in some loans could mislead the members reading it into believing that there are meaningful protections applicable to those loans, when in fact there are not. This is likely to alleviate concerns that the member might otherwise have about entering into such a loan – although the bill's provisions provide no valuable protection from the dangers of such a loan.[25]

- **Generally most of the "protections" offered in H.R. 458 already exist in current law or Department of Defense regulations.** These provisions include:
    - Prohibition against garnishment of wages – yet federal law already provides significant protections against garnishment of wages for enlisted personnel.[26] High cost lenders typically use check holding or vehicle titles to ensure repayment, rather than using the courts to collect on payday and title loans.
    - Prohibition against assignment of wages – yet federal law already prohibits the assignment of wages of enlisted members.[27]
    - Prohibition against a covered lender contacting or threatening to contact the borrower's chain of command to collect a covered loan -- yet officers are directed by DOD not to assist creditors in collecting "exorbitant" debts.[28]
    - Prohibition against including any waiver of rights under federal or state law including the Servicemembers Civil Relief Act -- yet such waivers are already generally prohibited.[29]
    - Prohibition against lenders claiming to be endorsed by the Armed Forces or Department of Defense -- yet DOD regulations already prohibit endorsement by officials or the use of

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[25] In the limited instances the notice would be provided, military borrowers would not be warned about harmful consequences of predatory payday and title loans, such as repeat presentment of checks that trigger bounced check fees or loss of the vehicle whose title is signed over for a short term loan. Merely warning some borrowers about repeat borrowing does not protect against predatory products or coercive collection tactics.

[26] These restrictions exist under DOD regulations (32 C.F.R. Part 112), which include restrictions on the amount of wages that can be garnished, ensure that the member has the opportunity to contest the garnishment, ensure that all of the provisions of the Servicemembers Civil Relief Act have been complied with, and ensure that the exigencies of military duty do not provide a basis for prohibiting the garnishment. Garnishments may only follow a court decision against the borrower.

[27] Assignment of pay for all enlisted personnel is void. 37 U.S.C.A. Section 701. Also, the FTC Credit Practices Rule prohibits the assignment of wages. 24 CFR Part 444. Military allotments to repay debt are categorized as discretionary and voluntary according to DOD Financial Management Regulation Vol. 7A, Chapter 41. Arguably, an allotment used to repay predatory loans can be terminated at any time by the military borrower.

[28] DOD Directive 1344.9, par. 4.3.2. gives the commander contacted by a creditor discretion in assisting the creditor, within the context and rules of the state, and specifically states that assistance shall not be provided to creditors "whose claims are obviously exorbitant." Payday loans at 400% APR and car title loans at 300% APR should be considered "exorbitant."

[29] The SCRA prohibits the waiver of rights when the member enters into the contract. 50 U.S.C. App. § 517. However, the protections of the SCRA do not apply to loans entered into during the period of active duty. As a result the prohibition against this waiver in H.R. 458 purporting to deal with predatory loans made to active duty personnel is meaningless. Most state and federal consumer protection laws do not permit waivers.

organization names to suggest official endorsement or preferential treatment of any non-federal entity.[30]

F. Credit unions should be permitted to provide check cashing and remittance services to anyone in their field of membership (Senate matrix Item 9).

All consumers face the problem of skyrocketing bank fees. Numerous studies by our organizations have documented both that bank fees are rising and that credit unions offer a substantially better deal to their members than banks do to their customers.[31]

Yet, America's estimated 11 million or more un-banked and under-banked families (13 percent of all families) face even greater problems than bank customers do, when they seek to obtain financial services from the high-priced companies that make up the fringe banking system: check cashing stores, rent-to-own stores,[32] refund anticipation loan purveyors,[33] payday loan companies, and wire transfer or remittance operators. Some products from banks, such as over-priced, deceptively marketed "bounce protection," also look more and more like fringe banking products.[34]

We support the proposal to allow credit unions to offer check cashing and remittance services to anyone in their field of membership, not only to members, increasing competition in two very over-priced financial services. Not only would the consumers who take advantage of the services benefit, so would others, since the competitive effect of the credit union services would lower prices in the marketplace overall.

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[30] DOD 5500.7-R, Joint Ethics Regulation, par. 3-209. A commercial entity that advertised military endorsement is covered by the Federal Trade Commission Act and state consumer protection laws against unfair and deceptive practices.

[31] See "Big Banks, Bigger Fees," October 2001, U.S. Public Interest Research Group, finding that "the average annual cost of regular checking at the three hundred largest banks was $266, but only $191 at small community banks, and only $101 at credit unions." Also see "Banks Charge More Fees and Higher Fees Than Credit Unions," Consumer Federation of America, March 1998, available at http://www.consumerfed.org/bankchgpr.pdf The Federal Reserve Board of Governors publishes annual reports to Congress on "Fees and Services of Depository Institutions," finding consistently that fees are rising and that larger multi-state banking institutions impose higher fees than community banks. The Federal Reserve studies at this time do not include credit unions. Its 2003 report is available at http://www.federalreserve.gov/boarddocs/rptcongress/2003fees.pdf and previous reports can be accessed at http://www.federalreserve.gov/boarddocs/rptcongress/. H.R. 1224, the Business Checking Freedom Act, which has passed the House, includes a provision reinstating and improving the now lapsed requirement that the Federal Reserve Board conduct annual fees surveys. We support the fee study provision only, but as discussed in detail in the testimony, strongly oppose the underlying bill, H.R. 1224, which grants unacceptable authority to Industrial Loan Companies.

[32] For an archive of materials on rent-to-own stores see http://www.pirg.org/consumer/rtoloan.htm.

[33] See "All Drain, No Gain: Refund Anticipation Loans Continue to Sap the Hard-Earned Tax Dollars of Low-Income Americans," Consumer Federation of America and National Consumer Law Center, January 2004, available at http://www.consumerfed.org/RefundAnticipationLoanReport.pdf

[34] See "Bounce Protection: How Banks Turn Rubber into Gold by Enticing Consumers to Write Bad Checks, An Examination of Bounce Protection Plans." April 2003, Consumer Federation of America and National Consumer Law Center, available at http://www.nclc.org/initiatives/test_and_comm/appendix.shtml/.

Remittances. The problem of the high cost of remittances especially affects immigrant families. According to now-Federal Reserve Chairman Ben Bernanke, "typical nonbank fees for remittances remain high on an absolute basis, and consumers who deal with the less-scrupulous providers of remittance services may bear a significant financial cost."[35]

According to a recent Pew Hispanic Center report, "Billions in Motion,"[36] while the average cost of remittances has declined significantly (e.g., to just under 10 percent, or $20 for a $200 wire transfer to Central America), an increase in competition could lower costs even further. As Sheila Bair, then-Assistant Secretary of the Treasury for Financial Institutions pointed out at a conference in 2002, "[t]he industry continues to be dominated by a small number of money transmitters that generally tend to charge higher fees than banks or credit unions. By increasing competition, the price of remittances should continue to drop." The report estimates that a cost reduction to an average of 5 percent of the amount sent could transfer a billion dollars from high-priced operators to working families.

Credit unions could help provide that competition if they could provide remittance services to any consumer who qualifies to join their field of membership, instead of just to their members. A secondary benefit is that these consumers, frustrated by high bank fees, would be attracted to becoming full –fledged credit union members.

Of course, consumer groups believe that consumer protections for remittances should be provided, regardless of who provides remittance services. For example, the Electronic Fund Transfer Act should cover these transfers. There should be a limit on fees, minimum timing requirements for delivery of funds, limits on increases in exchange rate between the time the consumer hands over money and the transmittal is received on the other end. Consumers should get receipts and/or similar documentation and have access to a dispute resolution procedure. The sender should be responsible for losses if the remittance was not delivered to the right person or was delivered in the incorrect amount.

Check cashing services for non-members. When consumers cannot afford bank accounts, they often cash their paychecks at check cashing stores, or even at banks, which also impose high non-customer checking fees.[37] Many consumers may not be able to afford high bank fees, if they live from paycheck to paycheck, or they may have previous bounced check activity or other circumstances that prevent them from obtaining a bank account.

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[35] "Financial Access for Immigrants: The Case of Remittances." Remarks by Governor Ben S. Bernanke at the Financial Access for Immigrants: Learning from Diverse Perspectives conference, Federal Reserve Bank of Chicago, Chicago, Illinois, April 16, 2004, available at http://www.federalreserve.gov/boarddocs/speeches/2004/200404162/default.htm

[36] See "Billions In Motion: Latino Immigrants, Remittances and Banking," the Pew Hispanic Center and the Multilateral Investment Fund, November 2002.

[37] A relatively new and rapidly growing industry is marketing under-regulated payroll cashing cards that work at ATMs but are not connected to bank accounts. Employers lower their check transaction costs and the un-banked find them convenient, but the cards are no substitute for a bank account in terms of the potential for building wealth, nor are they free, since the cost of frequent ATM transactions can easily equal or exceed the cost of a bank account. Consumers Union has compiled resources on the pitfalls of payroll cards as an alternative. See, e.g., "Questions for Employees to Ask About Payroll Cards." By Gail Hillebrand, 2004, available in English at http://www.consumersunion.org/pub/core_financial_services/000920.html and in Spanish at http://www.consumersunion.org/pub/core_financial_services/000921.html

These consumers pay significant fees – ranging from 1-20 percent of face value -- to cash their checks at fringe banking outlets. Fees are highest for personal checks, lower for payroll and government checks. In the last several years, many retail companies, from 7-11 to Wal-Mart—have cashed in on the profitable business. Credit unions could cash checks for consumers in their field of membership at lower cost, while encouraging consumers to become members. We also believe that while credit unions provide these essential services to non-members they must also continue to meet their charter obligations to provide facilities and services in underserved communities.

G. Other important pro-consumer regulatory reforms should be enacted:

1. Repeal the CRA "Sunshine Law" (Senate matrix Item 7) (Section 48 of the FDI Act, 12 U.S.C. Section 1831y). This is an example of an extremely ill-conceived and misguided provision adopted into law. It imposes undue burdens on lenders, community and consumer groups, and regulators – that is why there is support from all quarters for its repeal.

2. End federal preemption of state regulation of consumer protection practices (Senate matrix Item 75). In passing their respective rules preempting the application of state consumer protections to national banks and federally chartered savings associations, as well as their operating subsidiaries, the OCC and OTS have seriously hampered the protection of consumers. While some federal agencies – the Federal Trade Commission and the Federal Reserve Board – are specifically charged with this task as well, nowhere in the National Banking Act is there any mention of the role of the OCC or the OTS to protect consumers. The states have traditionally paved the way for the protection of their citizens by creating state-specific laws designed to balance the needs of the credit industry with the need to ensure that consumers are protected from overly aggressive lending tactics.

National banks and federal savings associations, their subsidiaries and their affiliates are in business to make money. Many insured depository institutions and their affiliates profit from predatory lending in numerous ways, including:

making direct loans;
investing in loan portfolios that contain predatory loans;
providing securitization services for trusts which contain predatory loans.

Unfortunately, many predatory practices are not illegal under federal law. This is why many states have stepped in and declared certain practices to be illegal. However, the OCC and the OTS have exempted national banks and federal thrifts and their operating subsidiaries from the obligation to comply with state laws, thus leaving consumers who borrow money from non-exempt lenders potentially more protected than those who borrow money from banks. The experiment of deregulation and preemption of state consumer protection laws has resulted in a huge increase in foreclosures, bankruptcies and escalating consumer debt.

3. Improve liability coverage and other consumer protections for non-credit card payment mechanisms (debit cards, stored value cards and similar access devices). In 2003, consumers in the United States conducted more transactions with debit cards than with credit cards for the first time in history. When the Electronic Fund Transfer Act was passed in the 1970s, debit cards were only used as ATM cards, not used as substitutes for credit cards. Many other forms of stored value cards, including payroll cards, Electronic Benefits Transfer (EBT) cards, specialized temporary EBT cards such as Katrina relief cards, pre-paid debit cards and merchant or bank gift cards did not even exist.

When a consumer uses a credit card, he or she is protected by a broad array of Truth in Lending Act rights, including its $50 liability limit38 and its Fair Credit Billing Act[39] rights to dispute mistakes and fraudulent charges. Conversely, debit cards are governed by the weaker Electronic Fund Transfer Act, which does not include Fair Credit Billing rights and has three tiers of liability, from $50, to $500, to all the money in a consumer's checking or savings account plus in any linked overdraft accounts. As the Federal Reserve warns consumers: "It's important to be aware of the potential risk in using an EFT card, which differs from the risk on a credit card. On lost or stolen credit cards, your loss is limited to $50 per card. On an EFT card, your liability for an unauthorized withdrawal can vary."[40]

The EFTA's protections are inadequate for debit cards, which are increasingly used as if they are credit cards. Consumers should not face higher liability when they use these cards, especially because the use of the cards is being aggressively promoted at this time through the use of rewards.[41] In addition, some of the other cards are covered by neither law. While the Federal Reserve Board recently announced positive changes to EFTA's Regulation E to extend its coverage to payroll cards, gift cards, certain pre-paid debit cards and other stored value cards are not covered by either the TILA or the EFTA.

As card types continue to converge, as non-credit cards are increasingly used on the Internet and in other transactions where the risk of loss or liability is high, and as new uses are developed for existing card platforms and new access devices, it becomes more critical that protections be harmonized upward and universally.

4. Shorten check hold times. Under both the new Check 21 Law and the fast-spreading practice of converting paper checks to electronic payments, the checks consumers write can clear much faster, but financial institutions do not have to give consumers quicker access to their deposits. The mismatch between checks clearing faster and the continued delays on check deposits increases the risk of bouncing a check, which comes with high consumer fees. The Federal Reserve Board has the authority to reduce check hold periods by regulation as check clearing speed increases. It has not, however, acted.

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[38] TILA Part B, §133, 15 U.S.C. §1643.

[39] Several of our organizations, in recent comments to the Federal Reserve Board, make detailed comments on ways to improve Fair Credit Billing Act rights. See http://www.federalreserve.gov/SECRS/2005/March/20050329/R-1217/R-1217_153_1.pdf (last visited 25 February 2006).

[40] Consumer Handbook To Credit Protection Laws, see http://www.federalreserve.gov/pubs/consumerhdbk/electronic.htm (last visited 25 February 2006).

[41] See testimony of Edmund Mierzwinski, on behalf of U.S. PIRG and the Consumer Federation of America, hearing on The "The Law and Economics of Interchange Fees," House Committee On Energy and Commerce, Subcommittee on Commerce, Trade and Consumer Protection, 15 February 2006, http://energycommerce.house.gov/108/Hearings/02152006hearing1774/Mierzwinski2730.htm (last visited 25 February 2006).

II. HARMFUL PROPOSALS TO CONSUMERS

H. No amendments to the Fair Debt Collection Practices Act are appropriate.

The matrix used by the Committee includes two proposals to amend the Fair Debt Collection Practices ("FDCPA") Act in a way that would harm consumers: Items 79 and 91. Additionally, the House Financial Services Committee included at the last minute four harmful amendments to the FDCPA in the Manager's Amendment to H.R. 3505. *All of these amendments would hurt consumers.*

1. Check diversion exemption. The first provision in the Manager's Amendment (Sec. 901) would exempt private, "check diversion companies" operating under contracts with local prosecutors from all provisions of the FDCPA. This amendment would undermine decades of consumer protection laws restricting unfair, deceptive and illegal collection of bad checks. It would harm consumers because it would allow these for-profit companies to threaten criminal prosecution if consumers fail to pay not only the bad check, but also **high fees (often $100 to $200) that are not authorized by state law** for classes which may not provide a benefit to consumers. Also, the FDCPA's important **30-day right to verification of the debt would not be applicable** to these collection efforts.

Check diversion companies are debt collectors that enter into contracts with District Attorneys to collect bounced checks for local merchants. These companies send letters on the DA's letterhead threatening criminal prosecution if the consumer does not attend a "financial responsibility" class, and pay high extra fees for these classes. Many consumers have been deceived by these companies into believing that if they did not pay these extra fees they would be criminally prosecuted, even when no prosecutor had ever determined that a crime had been committed, and the local prosecutor would never actually prosecute.

The federal FDCPA does not stop or inhibit the legal activities of check diversion companies. In fact, most collectors of bounced checks operate fruitful businesses while fully complying with the FDCPA. However, check diversion companies are so profitable that they share their income with the DA's office, providing funds to this government office rather than receiving money from it to perform a governmental function. Yet, in these check diversion programs the DAs have not done any investigation to determine the critical requirement of the crime, an intent to defraud. Indeed most of these consumers have not intended to defraud, and quickly pay off the checks upon receiving notice. As a result, many consumers who have inadvertently bounced small checks are deceived into paying as much as $100 to $200 extra to avoid a criminal prosecution which would never occur if the DA were actually handling the case. Indeed, regardless of the involvement of the for-profit check diversion program, the majority of bounced check cases are not criminally prosecuted because there is no intent to defraud, a required element of the crime.

The FDCPA only limits the activities of check diversion companies in its requirements that no deception be committed, that consumers be advised of their right to request validation of the debt, and that only *authorized* fees be collected. These are requirements that all debt collectors collecting bounced checks are able to comply with and still successfully collect. Specifically, check diversion companies have consistently been found by the courts, or have settled cases alleging three types of illegal conduct:

- **Deceptive behavior.** The check diversion companies' letters to consumers are deceptive because they look like they actually came from the District Attorney and imply that the DA had determined the consumer had committed a crime. In fact no DA ever reviews the individual cases before the letter threatening criminal prosecution is mailed. In many situations, if the DA had reviewed the case, no intent to defraud would have been found, and no criminal prosecution would have been threatened.

- **Failure to provide notice of the right to verify the debt**. Unlike all other private debt collectors collecting debts, including bounced checks, the check diversion companies refuse to provide notice to consumers that they have the right to request verification of the debt. In many situations this right would allow consumers to explain that they have already paid off the check, or do not believe they owe it.

- **Attempted collection of illegal fees**. Generally, state laws specifically provide the extra fees that consumers owe when they write a check that bounces. Often the courts can impose monetary penalties after a conviction for writing a bounced check (which must include a finding of intent to defraud). Yet the check diversion programs insist upon the payment of these fees even when no court has found – or would find – the consumer guilty of bouncing a check. For consumers, this often turns a mistake of a $10 or $20 bounced check into a cost approaching $200.

The majority of District Attorneys in the nation do not use check diversion companies, finding alternative, far less abusive ways to enforce laws against writing checks which bounce for insufficient funds. Many DAs use dispute settlement programs to resolve bounced check issues between merchants and consumers. Other DAs simply write their own letters explaining the process to consumers. These letters do not require the payment of the exorbitant additional fees charged by the check diversion companies, they simply advise of the process involved when a payee of a check which has bounced brings the case to the criminal court. These DAs find that even without employing private companies that make millions of dollars in profit from consumers who have inadvertently bounced a check, only a very few cases are criminally prosecuted.

Check diversion companies do not need an exemption from the FDCPA. They can operate profitable, effective businesses without this exemption, simply by complying with the law. This would only mean that 1) the check diversion company not imply that the DA has reviewed the consumer's case and found that a crime has been committed, unless the DA has done so; 2) the letter to the consumer include the required notice of the consumer's right to request validation of the debt; and 3) the company only collect fees that can be legally charged.

The Fair Debt Collection Practices Act does not inhibit the collection of debts; it only prohibits deception and abuse, and requires that consumers be allowed an opportunity to show they do not owe the debt. These requirements are appropriate and necessary for private individuals who are collecting debts – whether they are acting for private creditors or government officials. As Congress determined when passing the FDCPA, once the incentive of profit is injected into the collection effort, more protections are required.

The provisions in H.R. 3505 do not replace the protections of the FDCPA. H.R. 3505 provides no meaningful right to verify the debt; it permits the collection companies to charge fees which are not authorized by state law, and there is no prohibition against harassment, or unfair or deceptive collection practices. We urge you to resist the effort of one small part of the collection industry to evade compliance with the Fair Debt Collection Practices Act. Bounced checks can be collected quite effectively by collectors complying with this important consumer protection law.

2. Three *Other* Amendments to FDCPA in House Manager's Amendment. Without a public hearing, three additional harmful amendments, were made to the FDCPA in the Manager's Amendment to H.R. 3505:

a) The first amendment (page 25, lines 6 – 9) exempts formal pleadings from the requirement **to include** the notice about the **right to request verification of the debt.** If the only communication provided to the consumer is the lawsuit **itself**, consumers would lose the essential right of requesting information about the underlying debt. It is a very different matter to request verification of a debt from a debt collector than it is for many low income consumers to have to go to court and defend themselves. If this amendment passes, consumers will likely have default judgments entered against them for debts that they do not owe.

b) The second amendment (page 25, lines 14 – 21) creates a new exemption for all notices required under other law which do not explicitly include a request for payment. The stated reason for this amendment is to exempt things like privacy notices from the Act's requirements for initial communications. However, the actual language goes much further. **The effect of the current language would be to exempt most notices required under state law from ALL protections of the FDCPA**. For example, notices provided under a state right to cure mortgage defaults (which generally need not explicitly include a request for payment, but simply require an explanation of what needs to be done to avoid foreclosure) would – if this amendment were to pass – be able to be deceptive, unfair, state amounts which are illegal and incorrect, and could be provided in a harassing manner. Also, debt collectors would be able to send IRS form 1099s – implicitly threatening to report to the IRS that the unpaid debt is taxable income – without being governed by the prohibitions against unfairness and deception (often collectors use this threat as a collection tactic, not to further tax collection).

c) The third amendment (page 25, line 22) purports to allow **debt collectors to continue collection activities during the 30 day verification period.** Both we and the FTC have consistently said we do not oppose this concept – as it is the current law – so long as the collection activities do not contradict or overshadow the consumer's right to request verification of the debt. Unfortunately, as the language in the amendment does not include the protection, the result would be that the **essential right to request verification of the debt would be lost in most cases.**

Consumers need more protections in dealings with mortgage servicers, not fewer. Although some may view the notice required by 807(11) as relatively insignificant, it nevertheless has been held to trigger important consumer protections under the FDCPA for bad acting mortgage servicers.[42] In a case in the 7th Circuit Court of Appeals, the court, obviously appalled by the bad faith acts of the servicer, held that the FDCPA applied to the servicers because it had sent the 807(11) notice. Clearly frustrated with the lack of available remedies against a servicer who so completely mistreated consumers, the court used one of the few remedies available. There are too few laws limiting the damage that mortgage servicers can do to homeowners. Full application of the FDCPA should not be restricted in this current legal environment.

If servicers have difficulty complying with the FDCPA, a much narrower amendment can be drawn. One stated rationale for this amendment is that servicers are purchasing mortgage loans in such

[42] See Schlosser v. Fairbanks Capital Corp., 323 F.3d 534 (C.A.7,2003).

large quantities that they often cannot determine between the time of purchase and the time the first notice is sent out, whether the loan is delinquent such that the FDCPA applies and the 807(11) notice must be included in the first communication. This claim is hard to believe. Since the servicer's job is to send billing notices, and an accurate billing notice has to tell the homeowner whether the loan is in default, one would think that the servicer would know whether the loan was in default at the time it sent out the bill. However, if the issue is really timing, then a narrower amendment would be to allow some period of time after the purchase of the loan by the servicer to pass before this notice is required. This would be far preferable to eliminating the requirement altogether.

Existing protections should only be exchanged for new protections. Consumers have experienced increasing problems with mortgage servicers in the past decade -- both those who are collecting delinquent mortgage accounts, and others. Given the current legal regime, if some consumer protections applicable to the relationship with servicers were to be eliminated, they should be replaced with other protections. Despite the extensive documentation of serious problems with mortgage servicers, there have been no updates to the FDCPA or RESPA in favor of consumers in two decades.

I. Expansion of industrial loan companies is dangerous to the banking system and taxpayers.

A number of pieces of legislation have been offered in the last few years that take the very dangerous step of allowing financial firms and some commercial entities to set up a new, nationwide commercial banking system through industrial loan corporations (ILCs) that is subject to much less rigorous oversight than under the current structure. This has enormous negative implications for the safety and soundness of these banks and thus for taxpayers who, of course, support the deposit insurance system. Our organizations agree with the Federal Reserve Board that the establishment of such a parallel, poorly regulated banking scheme would be very harmful. ILCs were intended to be limited purpose institutions. They are state-chartered banks insured by the Federal Deposit Insurance Corporation that were established at the beginning of the 20th century to make small loans to industrial workers. ILCs now seek to emulate the powers of big commercial banks without the oversight these banks receive. Allowing them to offer business checking or to branch nationwide would be a mistake.

A bill passed by the House last year (H.R. 1224) would allow many ILCs to offer interest on business checking accounts. Another bill that was reported to the Floor by the House Financial Services Committee (H.R. 3505) would allow many existing and new ILCs to branch into all 50 states, whether these states approve or not. Presently, ILCs are chartered and operate in only five states, although 17 states would permit ILCs to branch. Business checking can only be provided by very small ILCs with less than $100 million in deposits. Under these two proposals, huge financial firms like Merrill Lynch, American Express, and Morgan Stanley--all of which currently own ILCs--would soon be able to offer federally insured commercial banking services indistinguishable from those offered by real banks at hundreds of their offices throughout the country. Commercial firms that currently own ILCs, like General Motors and BMW, would also be permitted to expand.

Additionally, banks and securities companies would be allowed to set up new ILCs, an option many would likely take advantage of because of the decreased regulatory burden and the prospect of a national market. This risk may pose even greater threats to the financial system. If large financial firms were to place their commercial banks under ILC oversight rather than Federal Reserve oversight, this could rapidly increase the number of ILCs and dilute the number of large financial systems that are subject to the important safety and soundness rules that the current system requires.

One requirement of both bills could prevent some large commercial firms from offering interest on business checking accounts or branching de novo into some states in the future. Regarding ILCs established in the future, the states would be permitted to deny the establishment, acquisition or operation of an ILC branch – or, in the case of H.R. 1224, to deny the establishment of business checking accounts that pay interest -- if the states determine that the ILC is directly or indirectly controlled by a commercial firm receiving more than 15 percent of its annual revenue from non-financial sources. However, this minor limitation is overwhelmed by the fact that the overall number of ILCs and the amount deposited in them would likely escalate without a corresponding increase in the oversight of safety and soundness at these institutions. Even worse, while the Federal Reserve Board has the power to examine the parent of a commercial bank and impose capital standards, in an industrial loan company structure only the bank can be examined and regulators cannot impose capital requirements on the parent companies.

We should also note that proposals to allow the expansion of ILCs have not been restricted to the House. A Senate bill introduced in 2003 (S. 1967) would allow industrial loan companies to offer interest bearing checking accounts to businesses. The bill provides that the authority would take effect two years after the date of enactment. There is a requirement that the Secretary of the Treasury and the federal banking agencies issue joint regulations within two years after the date of enactment, but the authority goes into effect after two years whether the joint regulations are issued or not. This bill is a straightforward expansion of the authorities of industrial loan companies that we strongly oppose.

Our organizations have several specific concerns with both the House and Senate proposals:

1. The ILC loophole to the Bank Holding Company Act is being abused and should be closed --not expanded. Our organizations support the proposal identified in the Senate matrix as Item 101, which would eliminate the ILC exception in the BHCA. The Federal Reserve Board has also recommended that the ILC exemption be eliminated, while the GAO recently urged Congress to consider eliminating or modifying it.

ILCs were never intended to be large, nationwide banks that offered services indistinguishable from commercial banks. In 1987, Congress granted an exception to the BHCA for ILCs because there were few of them, they were only sporadically chartered in a small number of states, they held very few assets and were limited in the lending and services they offered. In fact, this exception specifically applied only to ILCs chartered in five states (Utah, California, Colorado, Nevada and Minnesota) that have either assets of $100 million or do not offer checking services. Since that time, however, everything about ILCs has grown: the number that exist, the amount of assets and federally insured deposits in them and the services and lending products that they can offer.

According to the General Accounting Office (GAO), ILC assets grew by over 3,500 percent between 1987 and 2004, from $3.8 billion to over $140 billion. In 2004, six ILCs were among the 180 largest financial institutions in the country with $3 billion in assets.[43] According to the Federal Reserve, the majority of ILCs had less than $50 million in assets in 1987, with assets at the largest ILC at less than $400 million. As of 2003, one ILC owned by Merrill Lynch had more than $60 billion in assets (and more than $50 billion in federally insured deposits).

[43] "Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority," General Accounting Office, September 2005, GAO-05-621.

Moreover, some of the states that are allowed to charter ILCs are aggressively chartering new institutions, allowing them to call themselves "banks" and giving them almost all of the powers of their state chartered commercial banks. These states, especially Utah, are also promoting their oversight as a less rigorous alternative to those pesky regulators at the Federal Reserve. For example, the web site of the Utah Department of Financial Institutions has trumpeted its "positive regulatory environment" and declares that "ILCs offer a versatile depository charter for companies that are not permitted to, or that choose not to, become subject to the limitations of the Bank Holding Company Act."

2. Large financial firms should not be permitted to establish a parallel banking system that is not subject to the rigorous oversight required for real banks. This represents an enormous and unacceptable risk to taxpayers. Securities firms that own ILCs have taken the lead in promoting the ILC expansions in this bill. They have not been shy about stating that they want to expand ILC powers because they do not want to deal with the regulatory oversight they would face from the Federal Reserve if they purchased a bank, as allowed under the Gramm-Leach-Bliley Act. Instead, they prefer to set up a "shadow" banking system through ILCs. They want to be able to offer the same services and loans as commercial banks without the same regulatory oversight.

According to the Federal Reserve, however, the deposits in ILC accounts are not as secure as those in real banks. As mentioned above, ILCs are exempt from BHCA, which allows the Federal Reserve to conduct examinations of the safety and soundness not just of banks, but of the parent or holding company of these banks. The BHCA also grants the Federal Reserve the power to place capital requirements and impose sanctions on these holding companies. The Federal Deposit Insurance Corporation (FDIC), which regulates ILCs, does not have these powers. In its recent report, the GAO concurred with this assessment:

> Although FDIC has supervisory authority over an insured ILC, it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of bank and thrift holding companies. Therefore, from a regulatory standpoint, these ILCs may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company.... Further, FDIC's authority has not been tested by a large ILC parent during times of economic stress.[44]

Oversight of the holding company is the key to protecting the safety and soundness of the banking system. It is immaterial whether the owner of the bank is a financial or a commercial entity. Holding company regulation is essential to ensuring that financial weaknesses, conflicts of interest, malfeasance or incompetent leadership at the parent company will not endanger the taxpayer-insured deposits at the bank Years of experience and bank failures have shown this to be true.

Moreover, the involvement of investment banking firms in recent corporate scandals has provided plenty of evidence of the need for rigorous scrutiny of these companies as they get more involved in the banking industry. In particular, the participation of some securities firms in the Enron and Wall Street analyst scandals has shown that these firms were rife with conflicts of interest that caused them to take actions that ultimately harmed their investors. Given this track record, it would be a serious dereliction

[44] Ibid, "What the GAO Found."

of duty on the part of Congress to tie the hands of regulators in looking at bank holding companies.

3. The bill violates long-standing principles of banking law that commerce and banking should not mix. Although the "15 percent rule" in the House bill may in some limited situations make it more difficult for some large commercial companies that do not presently own ILCs to acquire, establish or operate an ILC branch in states that move to block this action, it allows a large number of existing commercial ILC parent organizations to expand ILCs nationwide and to offer business checking services without limits. This includes firms such as General Motors, General Electric, Pitney Bowes, BMW, Volkswagen and Volvo. Moreover, the determination of whether ownership of an ILC is commercial in nature (thus preventing the branching of that ILC into particular states) would be made individually by each state. These are the very states that would likely seek to have ILC branches locate within their borders for economic reasons. The states have a clear conflict of interest in making this determination in an accurate manner. They might be tempted to skirt the "15 percent rule" to allow a large retail firm, for example, to purchase an ILC and set up branches in each of its stores.

Pressure is clearly increasing on Congress to take a clear position on increased attempts by commercial firms to mix banking and commerce through the use of the ILC exemption. As the GAO said in its recent report, "GAO finds it unusual that a limited ILC exemption would be the primary means for mixing banking and commerce on a broader scale and sees merit in Congress more broadly considering the advantages and disadvantages of a greater mix of banking and commerce." In its report, the GAO highlighted the fact that three of the six ILC charters that were approved in 2004 were for commercial entities.[45] Wal-Mart, the largest retailer in the world, applied for an ILC charter in Utah last year and is currently awaiting approval of this transaction from the FDIC. A number of consumer and community organizations have urged the FDIC to deny this approval, primarily because of concerns about the mixing of banking and commerce.

Moreover, recent corporate scandals show the serious risks involved in allowing any commercial entity to own a bank without significant regulatory scrutiny at the holding company level. Accounting scandals at Sunbeam, Enron, Worldcom, Tyco, Adelphia and many others involved deliberate deception about the financial health of the companies involved. If these companies had owned banks, not only would employees, investors and the economy have suffered, but taxpayers as well.

4. ILCs should not be allowed to skirt state restrictions by getting a charter in one of only five states and then branching to other states without their permission. Right now, only 17 states have agreed under the Riegle-Neal Act's "opt in" provision to a reciprocal arrangement that allows banks chartered in each state to compete in all of them. This means that, under this bill, Congress would be forcing 33 states to allow the entry of under-regulated banks that clearly represent a risk to the companies that might do business with these banks. Congress should not be tying the hands of states that wish to protect their residents from under-regulated ILCs.

J. Do not preempt the right of Arkansas to establish usury laws.

Item 77 on the matrix, as well as § 504 of H.R. 3505, would completely preempt the right of the state of Arkansas to establish any limits on interest rates for loans made in that state. **Preemption of the**

[45] Ibid, "What the GAO Found."

voter mandated Constitutional interest rate ceilings in the state of Arkansas is bad policy and unfair to Arkansas voters. Every state in the nation currently has the right to establish legal rates of interest for loans made by non-bank lenders in their state. This provision would treat Arkansas differently and not allow this basic right to the legislature or the citizens of that state.

Section 504 of the House Reg Relief bill, as well as S. 904 from the last Congress, would amend the Federal Deposit Insurance Act to remove usury limits currently applicable to Arkansas lenders under the state's constitution. This amendment not only undermines states' rights, it also will mean that Arkansas consumers will pay far more than necessary for credit and risk exposure to discriminatory lending practices -- that is why this proposal is opposed by a broad coalition of national civil rights, labor and consumer rights organizations.

The people of Arkansas have determined that there should be a usury limit and have passed one in their state Constitution. Nevertheless, § 504 of the House Bill and S. 904 deliberately exempt state lenders from this constitutional provision and the express wishes of the people of Arkansas. Despite the clear intent of the majority of voters in Arkansas that they be protected from high interest rates, § 504 would allow "any other lender" doing business in the state to avoid the interest caps set by the people and the legislature of the state of Arkansas.

The proponents of § 504 argue that the bill is necessary to remove the Arkansas interest rates caps to make credit more available in the state. Conversely, they argue that as many out-of-state lenders are already permitted to ignore the state usury limits, the bill is needed to bring more jobs to the state from credit facilities that cannot now operate under state law. Opponents of the bill argue that adequate credit is fully available to consumers in Arkansas, that lifting the usury ceiling would simply result in higher priced credit and abusive lending and that the people of Arkansas should be permitted to determine their own fate on this issue.

Status of interest rate caps in Arkansas. Like most states, Arkansas has a general usury ceiling that limits the amount of interest that can be charged on loans.[46] Unlike most states, Arkansas has not enacted a series of exceptions to the general usury law, allowing for either higher rates of interest, or unregulated interest rates on different kinds of loans. Arkansas is also unusual in that its usury ceiling is set by its state Constitution, rather than by statute, so that change must be agreed to by the voters of the state, rather than simply by the state legislature.

Despite the difficulties in changing the Constitutional provision on usury caps, the voters of Arkansas did change it in 1982, establishing a floating cap of 5 percent over the Federal Discount Rate.[47] The courts of the state of Arkansas have upheld both the constitutionality and the enforcement of this provision repeatedly since its enactment.[48]

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[46] For a general review of the usury laws in the states, their importance, and the exceptions to them, see National Consumer Law Center, The Cost of Credit: Regulation and Legal Challenges (2d ed. 2000) § 2.4.

[47] Const. Art. 19, § 13(a).

[48] See, e.g., Luebbers v. Money Store, Inc. 344 Ark. 232, 40 S.W. 3d 745 (2001).

Exceptions to the usury ceiling. There are two ways that loans can be made in Arkansas by an insured depository institution. As a result of the Gramm-Leach-Bliley Act, banks operating in Arkansas can charge the same rates as out-of-state banks which have branches within the state.[49] The second way is for a loan to be made by an out-of-state lender using a loan contract, which includes a choice of law provision naming the lender's state as the governing law, so long as the other state has a reasonable relationship with the loan transaction.[50]

Availability of credit in Arkansas. Proponents of § 504 have argued that because depository institutions can charge unlimited rates of interest, and other lenders cannot, that local lenders have a competitive disadvantage.[51] It has also been intimated that because of the usury cap in Arkansas, many consumers are turned down for car loans, when, presumably, they would have qualified for them if higher interest rates were permitted.[52] However, if there is real competition for interest rates, then a ceiling on interest rates should pose no problem, because lenders would be competing with each other to offer the lowest interest rates. Secondly, all indications are that there is no lack of available credit to Arkansas consumers. Conversations with the leading consumer lawyers in the state indicate that there are no complaints from consumers about lack of access to credit. In fact, just the opposite is evident to these long-time consumer advocates-- recent decreases in interest rates have led to the increased availability of low priced car financing, enabling many more consumers to afford car loans than in recent history.[53]

Effect of interest rate ceilings on jobs in Arkansas. Some jobs in the credit industry might be gained in Arkansas if the usury ceiling were lifted. Creditors located outside of the state could relocate in the state and make the loans directly, without having to invoke the legal fiction of the choice of law provision in the contract. However, the question is--how many jobs? And, at what cost to Arkansas consumers? First, the cost to Arkansas consumers: if § 504 passes, Arkansas would be at the complete opposite end of the spectrum for consumer protections compared to its current position. Instead of having the most protective of state statutes, it would have the least. If § 504 passes, unlike every other state in the union, Arkansas will have absolutely no usury ceiling, and no legal way of ever imposing any limits on interest rates. The number of jobs that would be gained in Arkansas if § 504 passes is speculative, at best. However, even if creditors make a firm promise to move a specific number of jobs to the state, the people of Arkansas--not Congress--should have the opportunity to determine whether a gain in jobs is an appropriate trade for a dramatic decrease in consumer protections.

Effect of interest rate ceilings on discriminatory lending. Currently, there is a practice in

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[49]Pub. L. No. 106-102 (199), Section 731, amending 12 U.S.C. §1831u(f).

[50]Evans v. Harry Robinson Pontiac-Buick, Inc. 336 Ark. 155, 983 S.W.2d 946 (1999).

[51]See Letter to Senators Shelby and Sarbanes from Senator Blanche Lincoln, September 16, 2003.

[52]See Letter to Senators Lincoln and Pryor from Jeb Joyce, representing the Arkansas Fair Credit Coalition, October 20, 2003.

[53]Conversation with Susan Purtle, consumer attorney with Legal Aid of Arkansas, October 21, 2003; conversation with Mona Teague, Executive Director of Legal Aid of Arkansas, October 16, 2003; conversation with Jean Turner Carter, Executive Director, Center for Arkansas Legal Services, October 10, 2003. This sentiment was expressed by other consumer attorneys in Arkansas as well.

automobile financing which is the subject of significant litigation. It is alleged in a variety of lawsuits around the nation that car dealers routinely obtain higher referral fees from lenders for loans made to African American borrowers, than occurs on loans made to white borrowers.[54] These kickbacks to the car dealers are then recouped by lenders in the form of higher interest rates on the loans used to finance the cars. Studies show that in states that have interest rate caps on auto financing, there is less discrimination between borrowers of different races, because there is less room to increase the loan rates to cloak these referral fees. As a result, state interest rate ceilings not only have the effect of keeping interest rates low, they also have the effect of reducing discriminatory kickbacks on car loans. Indeed, these studies have shown that there is less discriminatory impact in Arkansas than in most other states, presumably as a result of the state cap on interest rates.

K. Do not exempt certain banks from requirements to provide consumers with annual privacy notices.

Senate matrix Items 63, 108, 134 and 174 all propose to eliminate or modify annual privacy notice disclosures required under Title V of the Gramm-Leach-Bliley Financial Services Modernization Act of 1999 and its regulations, which also require annual notice of the right to opt-out of "other" information-sharing under the Fair Credit Reporting Act. We strongly oppose each of these provisions. Annual privacy notices serve many important purposes in addition to disclosing that (limited) opt-out. In addition, because the agencies have both an open rulemaking on notice simplification and have yet to complete the rulemaking under the FACT Act's provision providing for a "marketing use" opt-out (if the consumer opts-out, information could still be shared, but could not be used for marketing), it makes little sense to alter these requirements at this time.

Nor can this provision be seen as benefiting only small institutions, often a justification for so-called regulatory relief items. Perhaps as a result of pressure from the annual privacy disclosures, even "Bank of America does not sell or share your personal information with marketers outside Bank of America who may want to offer their own products or services."

The notices also describe the many ways that non-public information is shared among affiliates and with related third parties under a "no-opt" regime. This sharing is not subject to opt-out and consumers should be made aware of this annually. For example, Bank of America lists the affiliates it shares with and describes its information practices. The notices also require an annual disclosure of the "other" information opt-out provided by the Fair Credit Reporting Act, which allows consumers to learn about and prevent the sharing of information gathered from their credit reports, their applications and their references provided to an entity with its *affiliated* companies. For example, again, as Bank of America states: "You may request that Application Information, Consumer Report Information and Information from Outside Sources not be shared among Bank of America companies."

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[54] Jones v. Ford Motor Credit Company, 00 Civ. 8330 (S.D. N.Y.); Cason v. Nissan Motor Acceptance Corp., C.A. No. 3-98-0223 (M.D. TN); Coleman v. General Motor Acceptance Corp., C.A. No. 3-98-0211 (M.D. TN); Baltimore v. Toyota Motor Credit Corporation, CV 01-05564 (C.D. CA); Smith v. Chrysler Financial Company L.L.C., C.A. No. 00-6003 (D. N.J.);. In addition, four cases were filed in 2002 against banks. Osborne v. Bank of America, C.A. No. 02-CV-364 (M.D. TN); Russell v. Bank One, C.A. No. 02-CV-365 (M.D. TN); Claybrook v. Primus Automotive Financial Services, Inc., C.A. 02-CV-382 (M.D. TN); and Bass v. Wells Fargo Financial Acceptance, Inc., C.A. No. 02-CV-383 (M.D. TN); Rodriguez v. Ford Motor Credit Company, C.A. No. 01 C 8526 (N.D. IL). Information concerning these cases may be found at **www.consumerlaw.org** and **www.faircreditlaw.com**.

L. S. 603, entitled, "The Consumer Rental-Purchase Agreement Act of 2005" is *not* a consumer protection bill -- it is solely designed to protect the rent-to-own industry from having to provide meaningful consumer protections.

Despite its name, The Consumer Rental-Purchase Agreement Act of 2005, S. 603 (also listed as Senate matrix Item 76) is not what it purports to be; it is *not* a consumer protection bill. This bill only provides protections for industry, not for consumers.[55] Although the bill pretends to advance consumer protections in rent-to-own (RTO) transactions, in actuality it does no such thing. Instead, the bill preempts the state laws providing the strongest protections for the consumers of these transactions. Congress should not overturn state laws that prevent predatory financial practices.

Rent-to-own businesses are essentially appliance and furniture retailers which arrange lease agreements rather than typical installment sales contracts for those customers who cannot purchase goods with cash or who are unsophisticated about money management. These lease agreements contain several special features. First, the leases are short term, so that "rental payments" are due weekly or monthly. Second, the lease agreements contain purchase options which typically enable the consumers to obtain title to the goods by making an additional payment at the end of a stated period, such as eighteen months. Third, the leases are "at will." In other words, the leases theoretically need not be renewed at the end of each weekly or monthly term.

The RTO industry aims its marketing efforts at low-income consumers by advertising in minority media, buses, and public housing projects. Statistics from the FTC show that the RTO customer base is among the poorest, and that the vast majority of their customers enter into these transactions with the expectation of buying an appliance and are seldom interested in the rental aspect of the contract. This attitude is encouraged by RTO dealers who emphasize the purchase option in their marketing even while they are minimizing its importance in the written contract.

The chief problems with RTO contracts are that these supposed leases are used to mask installment sales, and that these sales are made at astronomic, and undisclosed, annual percentage rates. Under most RTO contracts, the customer will pay between $1000 and $2400 for a TV, stereo, or other major appliance worth as little as $200 retail, if used, and seldom more than $600 retail, if new. This means that a low-income RTO customer may pay 1 ½ to 12 times what a cash customer would pay in a traditional retail store for the same appliance.

There should be no misunderstanding about S. 603: it is *not* designed to protect consumers. The entire purpose of this bill is to preempt stronger state laws that provide more meaningful consumer protections (*see* Sec. 1018(b)). A cursory reading of the bill might lead one to believe that some of the

[55] When S.603 was introduced in the Senate in the last Congress, as S. 884, a letter opposing the bill was sent to the entire Senate. The letter was signed by ACORN; Coalition for Responsible Lending; Consumer Federation of America; Consumers Union; International Union, UAW; National Association of Consumer Advocates; National Community Reinvestment Coalition; National Consumer Law Center; National Council of La Raza; U.S. Public Interest Research Group; Center for Civil Justice of Saginaw, Michigan; Coalition of Religious Communities; Community Legal Services of Philadelphia; Consumers League of New Jersey; Florida Legal Services; Mid Minnesota Legal Assistance; and Mountain State Justice Inc (WV).

provisions would actually help consumers. However, a close evaluation reveals that there are no meaningful protections whatsoever in this bill. The section that comes closest to requiring some helpful information to consumers (Sec. 1010), would require disclosures about the cost of the RTO transactions to be displayed on a tag attached to the item. However, the penalty to a dealer for failing to comply with this provision is meaningless--only equaling one quarter of one month's lease payment--thus providing no incentive for dealers to comply with even the minimal protection provided in S. 603.

The RTO customer base, almost exclusively low-income, could certainly benefit from meaningful consumer protections from an industry which preys upon consumers' lack of perceived options. Mostly these consumers need protection from high costs and unfair practices. There are numerous ways in which RTO legislation can be improved, none of which are included in a meaningful way in S. 603. Instead, RTO consumers would truly benefit from protections such as the following:

1. **Limitations on the total of payments** that a consumer should be required to pay for the purchase of the item. Some states have these limits already, but many do not.

2. **Limits on "fees"** such as late fees, insurance fees, home pick-up fees, reinstatement fees, etc. Some states have limits already, many do not.

3. **Reinstatement rights** that clearly allow the consumer to have payments made on previous contracts applied to new contracts for the same types of items. While S. 603 has a minimal provision on this point (Sec. 1005(a)(4)), it provides little protection to consumers, and there is no enforcement mechanism.

4. **Price tag disclosures,** as well as contract disclosures. By the time the customer gets the contract, the decision to proceed with the transaction has often been made. Yet, S. 603, while requiring price tag disclosures--in section 1010--does not provide an effective remedy for a dealer's failure to comply with this requirement.

5. **Meaningful penalties** for dealers who violate the provisions of the RTO statute. The maximum penalty to be assessed against a dealer who violates the minimal *disclosure* requirements of S. 603 is effectively only 25 percent of one month's rental payment. A single term's rental payment is generally less than $100, leaving the maximum amount of damages due for a violation of this Act, only $100 – hardly a sufficient incentive to ensure compliance with the law.[56]

6. A disclosure like the **annual percentage rate (APR)** which shows the consumer the true cost of renting to own, to allow comparison with other methods of purchasing personal items.

7. **Limits on maximum RTO interest rates**, as New Jersey requires.

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[56] S. 603 establishes a penalty for violations of the Consumer Leasing Act in 15 U.S.C. § 1640. See Sec. 1012(a). The statutory penalty for violating the Consumer Leasing Act is 25 percent of the total of the payments required under the lease, with a minimum of $100 and a maximum of $1,000. However, leases under the Consumer Leasing Act are always at least four months long (this is required to be covered by the Consumer Leasing Act, (15 U.S.C. § 1667(1)), and thus 25 percent of the total amount might amount to some real dollars. By contrast, leases governed by S. 603 are by definition only one term – one week or one month – automatically renewable in each of the following terms by the making of the payment. As a result, the penalties for violating S. 603's provision will almost never be more than the statutory minimum of $100.

S. 603 only serves to preempt the state laws of Wisconsin, Michigan, Minnesota, Vermont, North Carolina, and New Jersey--all of which provide more protections to consumers. It does not, in any way, advance consumer protection.

Finally, do not be deceived by proponents of the bill, who will tell you the bill does not preempt the states. S. 603 includes one change added in recent Congresses, which proponents use to make their claim that it now serves as a federal floor of protection and allows states to enact stronger laws. However, a close reading of this language indicates that it does not prevent preemption. The bill's intent remains the same: the explicit preemption of any state law that treats rent-to-own transactions as loans or credit sales. While the bill now allows the states to enact additional *rental* provisions, these provisions would not add significant benefits to consumers. In other words, the bill still preempts any state law that seeks to rein in unjustified rent-to-own costs.

M. Do not alter the TILA right of rescission

Item 64 on the Matrix would authorize the Federal Reserve Board to issue regulations permitting consumers to waive the three-day right of rescission in wider circumstances than the law currently permits, including voluntary waiver by borrowers seeking immediate access to funds with a signed written statement voluntarily waiving or modifying any rights to rescind the transaction. This proposal would require lenders to provide the closing documents three days prior to closing and incorporate the right of rescission into this three-day period. Item 104 is a similar proposal to repeal the right to rescind 1) for federally insured depository institutions; 2) when refinancing with a new lender when no new money is advanced; and 3) for home equity lines of credit.

In the meetings around the nation, many industry representatives shared our concerns about weakening or eliminating the right of rescission. The right of rescission should not be watered down. The right to rescind a consumer credit transaction that places the family home at risk is one of the most important protections of the Truth in Lending Act. The right of rescission means that the family has three days after signing to review the transaction and back out of the loan if it is abusive or different than the lender promised - or if, upon reflection, it is simply an unwise step for the family to take. If the lender misrepresented the terms of the loan in the Truth in Lending disclosure statement, the right to rescind can extend for up to three years. This extended right of rescission is a primary tool in stopping foreclosures resulting from predatory mortgage lending.

The right of rescission was created in recognition of the obvious truth that most consumers need more than the few minutes available to them at the time of closing to absorb and process the critical information relating to the costs of credit and the terms of the loan. Given the rush and confusion inherent in most home loan closings, Congress created the right of rescission just to ensure that homeowners have those additional three days to study the documents, familiarize themselves with the terms of the transaction and walk away from it – for any reason whatsoever. The right of rescission is used by consumers who find that the transaction is not what was promised when they applied for the loan.

Industry request for waivers of rescission rights. There is no need for a change in the law, as TILA already recognizes that there may be circumstances in which a consumer will need the money immediately for a bona fide emergency, and will truly not be able to wait even the three days for the rescission period to pass. To modify or waive the right to rescind, the consumer must give the lender a dated written statement (and not a form printed for this purpose) that:

- Describes the emergency;
- Specifically modifies or waives the right to rescind; and
- Bears the signature of all consumers entitled to rescind.[57]

Moreover, there are also already temporary waiver rules for disaster areas. Under the temporary authority of the Depository Institutions Disaster Relief Act of 1992,[58] the Federal Reserve Board has been provided with authority to make exceptions for TILA in areas declared by the President to be disaster areas in a number of instances in which homeowners have suffered through natural disasters and may need funds immediately to deal with these situations.[59] These regulations are temporary, generally expiring within a period of months. This temporary waiver has worked well in the past and is all that is necessary to deal with homeowners' need for immediate funds after disasters.

Industry request to provide the closing documents three days prior to closing and incorporate the right of rescission into this three-day period. The right of rescission keeps lenders honest. It deters bait and switch tactics, because lenders know that the consumer will have the opportunity to study the actual terms of the loan after the closing and compare them to what was promised. Knowing that consumers can rescind loans for any reason, for three days after closing, keeps unscrupulous lenders in line. They know that if they make the loan terms too onerous, the consumer may rescind and the lenders will lose all of their fees.

The right of rescission is critical to increasing and preserving homeownership. It gives homeowners an opportunity to reflect on the wisdom of placing their homes at risk. While the right of rescission is by no means sufficient to prevent predatory mortgage lending, it provides essential protection against abusive loans.

Industry proposal to repeal the right to rescind for federally insured depository institutions. Unfortunately insured depository institutions are not above predatory lending. Many of the most egregious predatory lending cases have involved just such institutions. There are numerous examples of pending and closed cases against national banks or their operating subsidiaries involving violations of law and/or predatory loans. These are illustrative of the range of illegal or predatory lending activities currently engaged in by national banks, their affiliates and their subsidiaries throughout the nation.[60] Given the unfortunate but unmistakable complicity of insured depository institutions in predatory lending, there is no reason to deprive consumers of one of their prime consumer protections when dealing with these institutions.

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[57] Reg. Z Sections, 226.15(e), 226.23(e).

[58] Pub. L. No. 102-485, 106 Stat. 2771, Sec. 3, (Oct. 23, 1992).

[59] Reg. Z, Sec. 226.23(e)(2), (3), and (4).

[60] For just a sampling of a list of predatory lending cases against federally insured financial institutions, see comments of the National Consumer Law Center, Consumer Federation of America, National Association of Consumer Advocates, U.S. Public Interest Research Group, to Office of Comptroller of the Currency, Real Estate Lending and Appraisals, Docket No. 03-16, October 6, 2003 in discussion beginning in text surrounding Note 18. http://www.consumerlaw.org/initiatives/test_and_comm/10_6_occ.shtml.

Industry proposal to repeal the right to rescind when no new money is advanced. The proposal set forth in Item 64 would allow lenders to nullify the critical right of rescission simply by having the consumer sign a waiver of the right to rescind.

Currently, perhaps the most prevalent form of predatory mortgage lending is the refinancing of existing home loans. Unscrupulous lenders and mortgage brokers target homeowners who are behind on their mortgages and sign them up for loans refinancing with no new money to the homeowner, just higher up-front fees and generally higher payments. Too often the lender will make a high-cost loan that refinances a subsidized mortgage, a Habitat for Humanity mortgage, or a low-cost prime mortgage. Eliminating the right to rescind refinance loans would have devastating consequences on consumers' abilities to fight predatory mortgages.

Industry proposal to repeal the right to rescind for home equity lines of credit. Finally, as to home equity lines of credit, the right to rescind is particularly important because of the limited information the consumer gets at closing. With a closed-end mortgage, the consumer is told the total finance charge, the payment amount, and the number of payments. For a home equity line of credit, the consumer gets none of these disclosures. In fact, some sellers finance consumers' purchases with an open-end line of credit for this very reason -- because they need not tell the consumer these important terms. To eliminate rescission for home equity lines of credit would only create greater incentives for sellers to set up spurious open-end credit as a means of financing purchases.

The industry has argued that few consumers exercise the right to rescind within the three-day period after closing. However, reduced actual use is not indication of its value. The right to rescind has a deterrent effect on bait and switch tactics and creates incentives for lenders to make sure their borrowers understand the terms of the loan and that the loan is appropriate for them. The existence of the right provides the incentive to lenders to avoid its use by resolving the problem. If the number of loans that are rescinded is low, it means that the right to rescind is working.

N. Reducing the number of financial institutions required to provide HMDA disclosures would be a serious mistake at this critical juncture (Senate matrix Item 105).

The Home Mortgage Disclosure Act (HMDA) is one of a class of laws enacted by Congress to ensure that depository and non-depository mortgage lending institutions serve their communities by providing credit in a fair and non-discriminatory manner. Some in the banking industry have advocated using regulatory relief legislation as a vehicle for amending HMDA to reduce the number of banking institutions that presently report under this law. We believe that reductions in HMDA reporting would undermine the utility and effectiveness of this vital information source and therefore, strongly oppose such changes to the HMDA statute.

Congress enacted HMDA in 1975 to make mortgage markets work more efficiently. The data source serves a number of important public purposes. First, HMDA provides the public and banking regulators with data that help to show whether lenders are serving the housing needs of the neighborhoods and communities in which they are located. Second, HMDA also helps public officials to target public investment to promote private investment where it is needed. Third, HMDA provides loan level data that assist in identifying possible discriminatory lending patterns and to assist with the enforcement of anti-discrimination, community reinvestment, and consumer protection statutes. HMDA is also relied upon for a number of other regulatory and public policy research purposes, which include serving as the core database for the establishment of the annual affordable housing goals for Fannie Mae and Freddie Mac.

To accomplish these purposes, a comprehensive database is required. By design, HMDA now covers more than 80 percent of all home lending. Federal Reserve Board Governor Susan Schmidt Bies recently noted that "Congress believed those objectives would be served by requiring depository institutions to disclose mortgage loan information publicly, not just on an aggregate basis, but institution by institution and application by application."[61]

Accordingly, HMDA requires certain mortgage lenders with offices in metropolitan areas to collect, report, and disclose annual data about applications, originations, home purchases, and refinancing of home purchase and home improvement loans. At the same time, HMDA exempts the smallest depository institutions from these reporting requirements (those with assets under $34 million for calendar year 2005). This threshold is indexed annually.

Industry representatives have suggested that the HMDA reporting threshold be raised to $250 million. While such an adjustment may seem relatively minor, it is worth noting that about 60 percent of the nation's depository institutions have assets between $34 million and $250 million (5,348 of 8,861 banks and thrifts). Of this number, we estimate that approximately 2,300 of these currently report under HMDA. In 2004, nearly 9,000 lenders (including non-depository mortgage companies) reported 37 million HMDA loan applications, up from 8,100 lenders in 2003.[62] Thus raising the threshold to the $250 million mark would newly exempt about 25 percent of depository institutions and 25 percent of current HMDA filers from submitting HMDA reports.[63]

The elimination of loan level HMDA reporting for 2,300 lenders would hamper enforcement of the laws, such as the Equal Credit Opportunity Act, the Fair Housing Act, and the Community Reinvestment Act (CRA). Consider that since 1990 over 1,200 institutions with between $34 million and $250 million in assets received below satisfactory CRA ratings.[64] Instead these institutions received the two lowest ratings of "Needs to Improve" or "Substantial Non-Compliance" that require depository institutions to redress their poor performance of meeting the credit needs of the communities where they take deposits. The lack of HMDA reporting for many of these institutions significantly complicates ongoing regulatory oversight to ensure that lending occurs in a fair and non-discriminatory manner. For example, small bank CRA exam procedures require the regulators to assess anomalies in the spread of loans found in the HMDA data between different geographic areas. It notes that "If available, review HMDA data" (first in a list of possible data sources) to assess the lending patterns inside and outside the

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[61] Remarks by Governor Susan Schmidt Bies at the Financial Services Roundtable Annual Meeting, March 31, 2005.

[62] Remarks by Governor Edward M. Gramlich to the National Association of Real Estate Editors, Washington, D.C., June 3, 2005.

[63] CFA analysis of Federal Deposit Insurance Corporation (FDIC), Statistics of Depository Institution database, downloaded June 16, 2005, data as of March 31, 2005.

[64] CFA analysis of Federal Financial Institutions Examination Council (FFIEC) CRA Rating database, downloaded June 16, 2005, data as of April 1, 2005.

bank's assessment area.[65] However, if an institution is not required to report HMDA data, the institution is not required to collect mortgage data for the regulators during their CRA evaluation and instead the regulators sample the institution's lending pattern.[66] By eliminating the HMDA requirement for 2,200 lenders, the entire spread of home mortgage activity would essentially be eliminated from CRA consideration.

Two arguments are often offered to support additional exemptions to HMDA. In the first, advocates of weaker reporting requirements contend that while the number of lenders to be exempted is great, they represent a relatively small share of the collective assets in the banking system. Such reasoning ignores the plain reality that in many states lenders in this size category represent the vast majority of all banking institutions. For example, depository institutions with assets between $34 million and $250 million represent over 70 percent of all banks and thrifts chartered in Alabama, Iowa, Kentucky, Louisiana, and West Virginia, and over 60 percent of the assets in some 20 additional states. Further, within particular local markets these lenders could very well account for significant shares of the mortgage market. The best way to ensure that these lenders are lending fairly to all is for them to report under HMDA.

The second argument advanced by proponents of less reporting is that HMDA poses an unfair regulatory burden on smaller depository institutions. As mentioned previously, HMDA already exempts the smallest lenders and non-metropolitan based lenders. For the others, this argument seems to be a carryover from the days when HMDA was reported manually. Today, software for HMDA reporting is readily available and relatively inexpensive. The Federal Financial Institutions Examination Council offers free HMDA software on its website for any institution that wants to use it.[67] It has been our experience that lenders in all size categories routinely submit their HMDA reports to the regulators in electronic form, making the literal paperwork burden for HMDA compliance limited.

For these reasons, we urge the Committee not to make changes to HMDA reporting thresholds.

O. Congressional oversight is critical to ensure that CRA regulations are not weakened.

The Community Reinvestment Act (CRA) is an extremely vital tool for stimulating bank lending and improving access to banking services for the nation's underserved urban and rural communities. While we applaud the banking regulatory agencies for enacting final changes that improved upon the proposed changes originally issued in 2004, we still remain concerned that, if adopted, the new rules could permit banks under the $1 billion asset threshold level to reduce their levels of branches, availability of low-cost banking accounts and international remittance services, and community development loans and investments to low- and moderate-income communities. We urge the Committee to exercise the necessary level of oversight to ensure that cutbacks in these vital activities do not occur.

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[65] See, Federal Financial Institutions Examination Council, "Small Institution CRA Examination Procedures, November 13, 1995.

[66] FFIEC, "Community Reinvestment Act; Interagency Questions and Answers Regarding Commuity Reinvestments; Notice," Fed. Reg. 66 No. 134, July 12, 2001 at 36645.

[67] See http://www.ffiec.gov/crahmdacf/default2.cfm.

P. Other proposals that would harm consumers:

1. Federal Home Loan Bank benefits for some privately-insured credit unions. Section 301 of H.R. 3505 (and Senate matrix Item 22) would allow privately-insured credit unions meeting certain criteria the same access to the benefits of Federal Home Loan Bank membership as taxpayer-insured credit unions, essentially granting less expensive financing options such as the discount loan window to privately-insured firms. If credit unions switched from government-backed to private share insurance to take advantage of the benefits provided by Federal Home Loan Bank membership, it could risk the safety and soundness of the credit union system.

2. Repealing references to the main place of business of a national bank. Section 110 of H.R. 3505 (and Senate matrix Item 35) would replace "obsolete" language with the modern term "main office." Although this is being promoted as a "technical amendment" it appears to be a weakening of the current definition in the National Bank Act regarding what is done at a particular place to make it the main place of business of a national bank. The current legal standard uses language along the lines of "The place where its operation of discount and deposit are to be carried on." The replacement language is much more general – "The place where the main office of the national bank is, or is to be, located." This could effect rate exportation – allowing rates to be exported from a different state than where the main banking activities occur – just because the bank declares a particular state to be where the main office is located.

3. Allowing banking regulators to forgo or delay bank examinations that are currently required. Section 601 of H.R. 3505 (and Senate matrix Item 42) would provide federal banking agencies with greater discretion to adjust the exam cycle of insured depository institutions. There are potentially serious CRA implications from this proposal. Allowing examiners discretion to schedule CRA exam cycles will undoubtedly reduce the enforcement of CRA at some institutions. To uphold the Community Reinvestment Act, it is the responsibility of the federal banking agencies to provide a sufficient number of CRA examiners to ensure that the lending and credit needs of low- and moderate-income communities are met. To do so, CRA exam cycles should be as consistent and regular as possible.

4. Allowing banking agencies to forgo or delay bank examinations that are currently required for certain banks with less than $1 billion in assets. This proposal (Senate matrix Item 112) would weaken the effectiveness of CRA by allowing mid-sized banks to be examined infrequently. Currently, banks with assets *above* $250 million are required to undergo a CRA exam once every two years, while banks with assets *under* $250 million undergo a CRA exam approximately once every 5 years if they received an "outstanding" on their previous exam, once every 4 years if they received a "satisfactory" on their previous exam, or as deemed necessary by their federal regulator if they received a rating of less than "satisfactory record of meeting community credit needs." This provision would quadruple that threshold and permit banks with under $1 billion in assets to adhere to this stretched out exam schedule.

This provision will significantly weaken the effectiveness of CRA and hurt communities in need of loans and investments. When banks are examined infrequently, they have little incentive to affirmatively and continually adhere to their reinvestment obligations. They will have reduced incentives to make sufficient numbers of loans to low- and moderate-income borrowers during the lengthy period of time between exams, and may only focus their efforts during the last year or two before exams. It is commonsense that infrequent examinations lead to infrequent commitments to reinvestment, while more frequent examinations lead to more consistent commitments to reinvestment.

Instead, through a consistent exam process, such as the current exam schedule used to implement CRA exams, regulators can keep a more watchful eye on banks which may stray from their obligations to their communities and can better enforce its laws set by Congress. In addition, we would oppose similar proposals (Senate matrix Item 169), such as one proposed by the Conference of State Bank Supervisors that would provide relief from exam cycles, if they have CRA implications and conflict with the existing CRA exam schedule.

5. Increased CRA compliance flexibility for limited purpose credit card banks. This proposal (Senate matrix Items 135, 178 and 179) would permit limited purpose credit card banks to invest in, or directly offer, residential mortgage, small business and agriculture loans targeted at low and moderate income persons to meet the obligations of the CRA. Despite the references to CRA and the appearance of good faith efforts by the credit card banks to meet their CRA obligations, the implications of each item have a significant negative impact. Item 135 is a request to allow credit card banks to provide direct consumer services such as residential mortgage lending, small business and agricultural loans that they currently cannot provide as limited purpose credit card banks. Item 178 would further expand credit card banks services into community development loans. Item 179 then allows with broad and general language, "loans that would help meet the credit needs of low-and-moderate income people and neighborhoods while maintaining the institution's Bank Holding Company Act exemption." Therefore credit card banks would be allowed to expand into direct consumer services and community development lending while maintaining their exemption from the Bank Holding Company Act. They would also remain removed from any comprehensive regulatory supervision by the Federal Reserve Board.

The potentially damaging effects of these proposals are illustrated in the following example of the acquisition of Associates National Bank in 2000. Associates National Bank was a limited purpose credit card bank with a number of affiliates, such as Associates Financial Services and Associates Housing Finance, which issued subprime loans that many community groups and regulators concluded were predatory. When Citigroup purchased Associates National Bank and its affiliates, there was no regulatory application on which CRA was considered. Associates National Bank benefited from the Bank Holding Company Act exemption, and the only applications were to the OCC and FDIC, under the Change in Bank Control Act, which did not include CRA review. Community groups, consumers and the public were not able to provide any public comment under CRA, despite the predatory lending issues that were on record.

The net effect of these proposals is that limited purpose credit card banks like GE Capital Consumer Card Company (GECCCC) would no longer have to spin off into affiliates mortgage finance operations that they acquire. They would be able to bring these affiliates in-house and expand their lending inside the supposedly "limited purpose" credit card bank. Since they would enjoy an exemption under the BHCA, these expanded lending services would not be subject to any comprehensive regulatory supervision. Should these credit card banks be acquired (as was Associates National Bank), they would enjoy a streamlined and CRA-less application process, excluding the public and important issues of the type mentioned in the example of Associates National Bank.

In addition, many of the affiliates are subprime lenders and have been found to issue predatory loans, as was the case with Associates. Since the CRA does not examine with respect to interest rates, subprime loans would count towards their CRA obligations along with other non-credit card lending. Currently, credit card banks are not subject to a rigorous CRA exam nor are they constrained from meeting their CRA obligations. These proposals are another attempt to exploit the loophole in the BHCA and undermine the intent and spirit of CRA enforcement by operating with an exemption.

We recommend that the exemption of so-called non-bank banks from the Bank Holding Company be limited or even eliminated, rather than expanded. Already, CRA enforcement is being made impossible with regard to banks like Associates National Bank, due to this exemption.

Q. Proposals that the Committee should more thoroughly investigate.

There are a number of additional regulatory relief proposals that merit much further investigation and analysis by the Committee. While our organizations have yet to take a formal position on these proposals, we are concerned that the very serious public policy implications of each have not yet been adequately reviewed. We urge the Committee not to act on these proposals until more information about the implications of each is obtained and assessed.

Section 109 of H.R. 3505 (Senate matrix Item 30) would allow national banks to organize as Limited Liability Corporations for the first time. Section 105 of H.R. 3505 (matrix Item 33) would eliminate the ability of states to place capital requirements on banks branching into their territory. Section 211 of H.R. 3505 (matrix Item 54) eliminates current state authority to evaluate qualified thrift lenders on a state-by-state basis. Four more provisions of H.R. 3505, sections 208, 216, 217, and 505, (matrix Items 82, 89, 90, 99, and 183) would remove current federal restrictions on thrift consumer lending, acquisition, agency and ownership of credit card savings associations. Thrifts currently enjoy significant advantages under federal law. These proposals would broaden the jurisdiction of thrifts considerably beyond the current federally mandated focus on mortgage lending. It is important that the Committee closely evaluate the impact of all of these changes taken together on consumers and lending markets and not proceed in a piecemeal fashion.

Attachment 1

AFL-CIO
Americans for Democratic Action
American Federation of Teachers
Association of Community Organizations for Reform Now (ACORN)
Common Cause
Consumer Federation of America
Consumers Union
Lawyers' Committee for Civil Rights Under Law
Leadership Conference on Civil Rights (LCCR)
National Association for the Advancement of Colored People (NAACP)
National Association of Consumer Advocates
National Community Reinvestment Coalition
National Consumer Law Center
National Council of Churches
National Council of La Raza
National Gay and Lesbian Task Force
National Urban League
Unitarian Universalist Association
United Food and Commercial Workers
United Mine Workers of America
U. S. Public Interest Research Group

October 16, 2003

The Honorable Blanche Lincoln
United States Senate
Washington, DC 20510

The Honorable Mark Pryor
United States Senate
Washington, DC 20510

Dear Senators Lincoln and Pryor:

We, the undersigned national civil rights, labor and consumer rights organizations, are writing to express our opposition to S. 904, which will likely be offered as an amendment to the "National Consumer Credit Reporting System Improvement Act of 2003." S. 904 would amend the Federal Deposit Insurance Act to remove usury limits currently applicable to Arkansas lenders under the state's constitution. This amendment not only undermines states' rights, it also will mean that Arkansas consumers will pay far more than necessary for credit and risk exposure to discriminatory lending practices.

The people of Arkansas have determined that there should be a usury limit and have passed one in their state Constitution. Nevertheless, S. 904 deliberately exempts state lenders from this constitutional provision and the express wishes of the people of Arkansas. Despite the clear intent of the majority of voters in Arkansas that they be protected from high interest rates, S. 904 would allow "any other lender" doing business in the state to avoid the interest caps set by the people and the legislature of the state of Arkansas.

S. 904 extends most-favored-lender status to non-bank finance companies. The "other lenders" who would be able to evade state credit and usury limits under this amendment would range from car dealers to auto finance companies, buy-here-pay-here subprime auto dealers, furniture stores, home improvement-based mortgage lenders, and appliance and electronic stores. Removal of such usury limits would open the door to unscrupulous and discriminatory lending practices by these lenders.

Recent studies have shown that African-American and Latino consumers are likely to pay higher markups for auto loans than white consumers when usury limits are not in place.1 Several auto finance companies and others have been sued by African-American and Latino consumers for such discriminatory markup practices in a number of states.2 In Arkansas, however, as the constitutional usury limits restrict the ability of automobile dealers to markup higher interest rates at their discretion, this type of discrimination appears to be less of a significant problem.3 Yet, S. 904 would eliminate this protection from discrimination and produce a financial environment where discriminatory pricing could prosper. We urge you not to allow this to occur.

While the amendment appears to only impact Arkansas, it sets a dangerous precedent for overturning the credit laws of all states. While depository institutions are subject to some supervision and examination, non-depository credit companies are less regulated. Many states exempt *banks* from usury and interest rate limits, permitting rates as agreed between the parties to be charged, largely because of the allowed exportation of interest rates by national banks. In contrast, most states have extensive laws and regulations that apply to non-depository institution lenders to protect at-risk consumers who have less bargaining power and to restrain abusive credit practices.

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[1]Mark Cohen, *Report on the Racial Impact of GMAC's Finance Markup Policy, In the Matter of Addie T. Coleman v. GMAC*, pp. 22, Aug. 29, 2003.

[2] *Jones v. Ford Motor Credit Company*, 00 Civ. 8330 (S.D. N.Y.); *Cason v. Nissan Motor Acceptance Corp.*, C.A. No. 3-98-0223 (M.D. TN); *Coleman v. General Motor Acceptance Corp.*, C.A. No. 3-98-0211 (M.D. TN); *Baltimore v. Toyota Motor Credit Corporation*, CV 01-05564 (C.D. CA); *Smith v. Chrysler Financial Company L.L.C.*, C.A. No. 00-6003 (D. N.J.);. In addition, four cases were filed in 2002 against banks. *Osborne v. Bank of America*, C.A. No. 02-CV-364 (M.D. TN); *Russell v. Bank One*, C.A. No. 02-CV-365 (M.D. TN); *Claybrook* v. *Primus Automotive Financial Services, Inc.*, C.A. 02-CV-382 (M.D. TN); and *Bass v. Wells Fargo Financial Acceptance, Inc.*, C.A. No. 02-CV-383 (M.D. TN); . *Rodriguez v. Ford Motor Credit Company*, C.A. No. 01 C 8526 (N.D. IL). Information concerning these cases may be found at www.consumerlaw.org and www.faircreditlaw.com.

[3] Id.

S. 904 ignores this important distinction between banks and non-depository institution lenders.

If the people of Arkansas, or any other state, feel that the state limits on credit charges are hurting access to credit, the people of Arkansas can change those limits. It is entirely inappropriate for Congress to preempt the historical powers of the state to protect consumers in this regard. If the Congress grants this privilege to non-bank lenders in Arkansas, the industry will demand the same preemption privilege for the other forty-nine states. This is a very dangerous and an extremely controversial amendment. We strongly oppose adding this amendment to the Fair Credit Reporting Act bill.

Sincerely,

William Samuel
AFL-CIO

Charlotte Fraas
American Federation of Teachers

Darrell Fagin
Americans for Democratic Action

Maude Hurd
Association of Community Organizations for Reform Now (ACORN)

Chellie Pingree
Common Cause

Travis Plunkett
Consumer Federation of America

Janell Duncan
Consumers Union

Barbara Arnwine
Lawyers' Committee for Civil Rights Under Law

Wade Henderson
Leadership Conference on Civil Rights

Hilary O. Shelton
National Association for the Advancement of Colored People (NAACP)

Ira Rheingold
National Association of Consumer Advocates

John Taylor
National Community Reinvestment Coalition

Margot Saunders
National Consumer Law Center

Bob Edgar
National Council of Churches

Brenda Muniz
National Council of La Raza

Shanna Smith
National Fair Housing Alliance

Matt Forman
National Gay and Lesbian Task Force

William Spriggs
National Urban League

Meg Riley
Unitarian Universalist Association

Patricia Scarelli
United Food and Commercial Workers

Cecil E. Roberts
United Mine Workers of America

Edmund Mierzwinski
U. S. Public Interest Research Group

cc: The Honorable Richard Shelby
The Honorable Paul Sarbanes

PREPARED STATEMENT OF F. WELLER MEYER

CHAIRMAN, PRESIDENT, AND CEO,
ACACIA FEDERAL SAVINGS BANK, FALLS CHURCH, VA AND
CHAIRMAN, BOARD OF DIRECTORS,
AMERICA'S COMMUNITY BANKERS, WASHINGTON, DC

MARCH 1, 2006

Chairman Shelby, Senator Sarbanes, and Members of the Committee, I am F. Weller Meyer, Chairman, President and CEO of Acacia Federal Savings Bank, Falls Church, Virginia. Acacia Federal Savings Bank has more than $1.25 billion in assets. Acacia Federal is a member of the UNIFI Group of companies, which are a diversified group of insurance and financial services businesses.

I am here this morning representing America's Community Bankers. I am the Chairman of ACB's Board of Directors. I want to thank Chairman Shelby for calling this hearing. We appreciate the leadership of Senator Crapo in crafting legislation to address the impact of outdated and unnecessary regulations on community banks and the communities they serve.

ACB is pleased to have this opportunity to discuss recommendations to reduce the regulatory burden placed on community banks. When unnecessary and costly regulations are eliminated or simplified, community banks will be able to better serve consumers and small businesses in their local markets. ACB has a long-standing position in support of a meaningful reduction of regulatory burden.

The need to adopt regulatory relief legislation is urgent. In 1990, the 10 largest U.S. banks held 25 percent of U.S. banking assets. But by the end of 2004, the 10 largest U.S. banks held 53 percent of banking assets. We believe that increased regulatory burden has played a significant role in the sharp decrease in banking assets controlled by community banks. All banks operate under a regulatory scheme that becomes more and more burdensome every year. But, community banks bear a greater relative burden of regulatory costs compared to large banks. In the face of the increasingly complex regulatory requirements, many community banks have chosen to give up their separate charters and seek mergers with larger institutions. Community banks stand at the heart of cities and towns everywhere, and to lose that segment of the industry because of over regulation would be debilitating to those communities.

Community banks today are subject to a host of laws, some over a half-century old that originally were enacted to address concerns that no longer exist. These laws stifle innovation in the banking industry and put up needless roadblocks to competition without contributing to the safety and soundness of the banking system. Further, every new law that impacts community banks brings with it additional requirements and burdens. This results in layer upon layer of regulation promulgated by the agencies frequently without regard to the requirements already in existence.

The burden of these laws results in lost business opportunities for community banks. But, consumers and businesses also suffer because their choices among financial institutions and financial products are more limited as a result of these laws, and, in the end, less competition means consumers and businesses pay more for these services.

Community banks must also comply with an array of consumer compliance regulations. As a community banker, I understand the importance of reasonable consumer protection regulations. As a community banker, I also see how much it costs, both financially and in numbers of staff hours to comply with the often-unreasonable application of these laws. As a community banker, I see projects that will not be funded, products not offered, and consumers not served because I have had to make a large resource commitment to comply with the same regulations with which banks hundreds of times larger must comply.

ACB has a number of recommendations to reduce regulations applicable to community banks that will help make doing business easier and less costly, further enabling community banks to help their communities prosper and create jobs.

Priorities for Regulatory Relief

ANTI-MONEY LAUNDERING AND CORPORATE GOVERNANCE

Two areas of regulatory compliance that cause the greatest concern for all community bankers are the implementation of anti-money laundering laws and implementation of corporate governance requirements. ACB believes that significant changes in these two areas are warranted either through regulatory or legislative action.

Anti-Money Laundering

Community bankers fully support the goals of the anti-money laundering laws, and we are prepared to do our part to fight crime and terrorism. Community banks are committed to ensuring our Nation's physical security and the integrity of our financial system. However, we are concerned about the unintended consequences caused by existing statutory and regulatory requirements.

First, community banks are concerned that law enforcement does not review or use much of the information that depository institutions must report to the Federal Government regarding customers' financial transactions. FinCEN and law enforcement report that the Cash Transaction Report (CTR) database is littered with unhelpful CTR's.

Therefore, ACB suggests increasing the dollar value threshold that triggers CTR reporting. The current $10,000 threshold was established in 1970. When adjusted for inflation, $10,000 in 1970 is equivalent to more than $52,000 today. We understand that when the regulations were first implemented, there was very little activity over the $10,000 threshold. Today, however, such transactions are routine, particularly for cash intensive businesses. Raising the threshold does not mean that institutions will be relieved from monitoring account activity for suspicious transactions below the CTR reporting requirement. Increasing the threshold would enable financial institutions to alert law enforcement about activity that is truly suspicious or indicative of money laundering, as opposed to bogging down the data mining process by filing reports on routine business transactions.

Raising the CTR reporting threshold would provide benefits beyond regulatory relief for depository institutions. Increasing the threshold would help meet a 1994 Congressional mandate to reduce CTR filings by 30 percent and would provide law enforcement a cleaner, more efficient database.

Based upon data that FinCEN provided to the Bank Secrecy Act Advisory Group's (BSAAG) CTR Subcommittee, increasing the reporting threshold to $20,000 would decrease CTR filings by 57 percent and increasing the threshold to $30,000 would decrease filings by 74 percent. The impact of raising the dollar value is even more astonishing for community banks. An informal survey of ACB members conducted in June 2004 indicates that increasing the dollar amount to $20,000 would reduce community bank CTR filings by approximately 80 percent. Even with the dramatic change in the value of $10,000 over the past 30 years, ACB acknowledges that a $10,000 cash transaction is still a substantial amount of cash for an individual customer to deposit or withdraw from an institution. However, businesses of all sizes routinely conduct transactions over $10,000.

We also suggest that improvements be made to the exemption system that relieves financial institutions from filing CTR's on the cash transactions of certain entities, provided certain requirements are met. The exemption system was intended to reduce regulatory burden associated with BSA compliance, but many community banks report that the cost of using the exemptions outweighs any associated benefits. Many institutions have elected to automate the CTR reporting process and file on every transaction over $10,000. This compliance method is cost effective and exposes institutions to minimal compliance risk. But it also results in thousands, if not millions of CTR's being filed unnecessarily each year.

While many community banks do not use the exemption process, those that do would like to exempt customers more quickly than currently permitted by law. Before an institution can exempt a customer as a nonlisted business or payroll customer, the customer must have maintained a transaction account with the bank for at least 12 months. The 12-month rule was adopted to ensure that an institution is familiar with a customer's currency transactions. ACB suggests that banks and savings associations be allowed more flexibility in exempting business customers from CTR requirements by modifying or eliminating the current 12-month waiting period for new customer exemptions. ACB also supports the proposal adopted by the House Financial Services Committee in Title VII of the Financial Services Regulatory Relief Act of 2005 (H.R. 3505) to provide banks more flexibility in reporting of the cash transactions of their seasoned business customers.

Community banks are also concerned about the opportunity costs that result from the current statutory and regulatory regime. For example, new compliance software often costs more than $30,000 (and sometimes hundreds of thousands of dollars depending on the product) upfront and $5,000 each month thereafter. For many small community banks, this is a substantial investment. This is money that a bank could use to hire multiple tellers, hire a new loan officer to reach out to the community's small businesses, develop and market a new product or design special programs to reach unbanked persons.

Corporate Governance

The Sarbanes-Oxley Act contained much needed reforms, restoring investor confidence in the financial markets that were in turmoil as a result of the major corporate scandals at the beginning of this decade. Community bankers support that Act and other laws, like the Federal Deposit Insurance Corporation Improvement Act (FDICIA), that improve corporate governance, enhance investor protection, and promote the safety and soundness of the banking system. However, the implementation of the Sarbanes-Oxley Act by the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) and the interpretation of those regulatory requirements by accounting firms have resulted in costly and burdensome, unintended consequences for community banks, including, even, privately held stock and mutual institutions.

For example, the implementation of Section 404 of the Sarbanes-Oxley Act (Section 404) has created significant burdens for community banks. Section 404, which was modeled on internal control requirements in FDICIA, requires a statement in annual reports of management's assessment of the effectiveness of internal controls over financial reporting. Section 404 requires a company's independent auditors to attest to and report on management's assessment of the internal controls. However, in implementing Section 404, the SEC approved PCAOB Accounting Standard 2, which requires the external auditor to audit the internal controls of a company and opine directly on the effectiveness of the internal controls. Under FDICIA, the banking agencies generally permitted the external auditor to audit the CEO's attestation with respect to the internal controls—a much less costly auditing function. ACB believes that this change in practice is a significant cause of a dramatic increase in bank audit fees. Many publicly traded banks are reporting an increase in audit fees of 75 percent over prior years. Some banks are reporting audit fees equal to 20 percent of net income. Privately held and mutual banks also are experiencing significant increases in auditing fees because the external auditors are applying the same PCAOB standards to these nonpublic banks.

ACB has provided concrete suggestions to the banking regulators, the SEC, and the PCAOB on ways to reduce the cost of compliance with internal controls and other requirements, while still achieving the important goal of improved corporate governance and transparency. We are pleased that the FDIC raised the FDICIA threshold from $500 million to $1 billion for the internal control reporting and related audit requirements, which was a reform advocated by ACB. The change should significantly reduce costs for mutual and privately held stock banks under the $1 billion cap.

ACB urged the SEC and PCAOB to evaluate the significant audit costs involved with the implementation of Section 404 of Sarbanes-Oxley. ACB recommended that it is appropriate to provide relief from Section 404 to community banks that are already subject to heavy regulation and routine bank examinations.

The SEC's Advisory Committee on Smaller Public Companies will soon release for public comment recommendations that the SEC give exemptive relief from Section 404 to micro-cap and small-cap public companies that comply with enhanced corporate governance provisions. ACB supports the efforts of the panel to recommend a differentiated Section 404 regime based on the size of a public company's market capitalization and annual revenue. The proposals recognize that larger companies pose a proportionally greater risk to the investing public than smaller public companies, including community banks. ACB believes that through the Advisory Committee's efforts an appropriate balance can be struck between the goals of providing adequate regulation of internal controls and reducing unnecessary compliance costs for smaller companies.

INCREASING THE CAPACITY OF FEDERAL SAVINGS ASSOCIATION TO ENGAGE IN SMALL BUSINESS AND AGRICULTURAL LENDING (MATRIX NO. 53)

Today, savings associations are increasingly important providers of small business and agricultural credit in communities throughout the country. A high priority for ACB is a modest increase in the business-lending limit for savings associations. In 1996, Congress liberalized the commercial lending authority for federally chartered savings associations by adding a 10 percent "bucket" for small business loans to the 10 percent limit on commercial loans. The Office of Thrift Supervision permits some limited commercial lending through a service corporation.

Even with this small accommodation, the "10 plus 10" limit poses a significant constraint for an ever-increasing number of institutions. Expanded authority would enable savings associations to make more loans to small- and medium-sized businesses, thereby enhancing their role as community-based lenders. To accommodate this need, ACB supports eliminating the lending limit restriction on small business loans while increasing the aggregate lending limit on other commercial loans to 20 percent. Under ACB's proposal, these changes would be made without altering the requirement that 65 percent of an association's assets be maintained in assets required by the qualified thrift lender test.

Increasing commercial lending authority would also greatly benefit rural communities, where the number of financial institutions is limited, by increasing the number of financial institutions that are actively engaged in lending to farmers, ranchers and small businesses. To successfully engage in agricultural lending, a savings association must employ personnel with expertise in agricultural lending. The current limits on commercial lending authority is a deterrent to the investment of resources needed for agricultural lending.

UNNECESSARY AND REDUNDANT PRIVACY NOTICES (MATRIX NO. 63)

ACB strongly urges the elimination of required annual privacy notices for banks that do not share information with nonaffiliated third parties. Banks with limited information sharing practices should be allowed to provide customers with an initial notice, and provide subsequent notices only when terms are modified. We do agree a notice should be sent, but it becomes an expensive burden to send it multiple times when once will more than suffice. Moreover, redundancy in this case does not enhance consumer protection; rather it serves to numb our customers with volume.

PARITY UNDER THE SECURITIES EXCHANGE ACT AND INVESTMENT ADVISERS ACT (MATRIX NO. 52)

ACB vigorously supports providing parity for savings associations with banks under the Securities Exchange Act and Investment Advisers Act. Statutory parity will ensure that savings associations and banks are under the same basic regulatory requirements when they are engaged in identical trust, brokerage, and other activities that are permitted by law. As more savings associations engage in trust activities, there is no substantive reason to subject them to different requirements. They should be subject to the same regulatory conditions as banks engaged in the same services.

In proposed regulations, the SEC has offered to remove some aspects of the disparity in treatment for broker-dealer registration and the IAA, but still has not offered full parity. Dual regulation by the OTS, the SEC, and the States makes savings associations subject to significant additional cost and regulatory burden. Eliminating this regulatory burden could free up tremendous resources for local communities. ACB supports a legislative change. Such a change will ensure that savings associations will have the same flexibility as banks to develop future products and offer services that meet customers' needs.

ENHANCING EXAMINATION FLEXIBILITY (MATIRX NOS. 42 AND 169)

Current law requires the Federal banking agencies to conduct a full-scale, on-site examination of the depository institutions under their jurisdiction at least every 12 months. There is an exception for small institutions that have total assets of less than $250 million and are well-capitalized and well-managed and meet other criteria. Examination of these small institutions are required at least every 18 months.

A large majority of banks and savings associations are well-run institutions that do not require full-scale, on-site safety-and-soundness and compliance examinations every 12 months. ACB supports providing the Federal banking agencies flexibility in establishing examination schedules in order to allocate examination resources to higher risk institutions. Section 601 of the Financial Services Regulatory Relief Act of 2005, H.R. 3505, provides this flexibility. ACB also supports increasing the cap for the small institution examination cycle from $250 million to $1 billion, as provided in Section 607 of H.R. 3505. The proposal will reduce regulatory burden on low-risk, small institutions and permit the banking agencies to focus their resources. These two proposals would not alter the examination schedule for Community Reinvestment Act compliance.

REDUCING IMPEDIMENTS TO RESIDENTIAL DEVELOPMENT LENDING (MATRIX NO. 88)

Current law provides special authority to savings associations to lend the lesser of $30 million or 30 percent of capital to a single residential developer. However, the law limits this authority by artificially capping the per unit sales price in a development at $500,000—making this special authority unavailable in high-cost areas. The overall limit of $30 million or 30 percent of capital is sufficient to prevent concentrated lending to one residential developer. ACB supports eliminating the $500,000-per-unit limit as an unnecessary regulatory detail that creates an artificial market limit in high-cost areas.

HOME OFFICE CITIZENSHIP (MATRIX NO. 58)

ACB recommends that Congress amend the Home Owners' Loan Act to provide that for purposes of jurisdiction in Federal courts, a Federal savings association is deemed to be a citizen of the State in which it has its home office. For purposes of obtaining diversity jurisdiction in Federal court, the courts have found that a Federal savings association is considered a citizen of the State in which it is located only if the association's business is localized in one State. If a Federal savings association has interstate operations, a court may find that the federally chartered corporation is not a citizen of any State, and therefore no diversity of citizenship can exist. Now that the Supreme Court has settled the question of diversity jurisdiction for national banks, Federal savings associations are the only financial institutions that can be denied access to Federal courts based on diversity jurisdiction. The change benefits consumers as well as Federal savings associations by providing both sides clear authority to access Federal courts.

EASING RESTRICTIONS ON INTERSTATE BANKING AND BRANCHING (MATRIX NO. 26)

ACB strongly supports removing unnecessary restrictions on the ability of national and State banks to engage in interstate branching. Currently, national and State banks may only engage in *de novo* interstate branching if State law expressly permits. ACB recommends eliminating this restriction. The law also should clearly provide that State-chartered Federal Reserve member banks might establish de novo interstate branches under the same terms and conditions applicable to national banks. ACB recommends that Congress eliminate States' authority to prohibit an out-of-State bank or bank holding company from acquiring an in-State bank that has not existed for at least 5 years. The new branching rights should not be available to industrial loan companies with commercial parents (those that derive more than 15 percent of revenues from nonfinancial activities).

RESTRICTIONS ON AUTO LOAN INVESTMENTS (MATRIX NO. 82)

Federal savings associations are currently limited in making auto loans to 35 percent of total assets. However, the law places no limit on the *unsecured* consumer credit card debt held by a Federal savings association. A better policy is also to permit unlimited secured auto lending, which is a less risky activity than unsecured credit card lending. Removing this limitation will expand consumer choice by allowing savings associations to allocate additional capacity to this important segment of the lending market.

STREAMLINED CRA EXAMINATIONS (MATRIX NO. 78)

ACB strongly supports amending the Community Reinvestment Act to define banks with less than $1 billion in assets as small banks and therefore permit them to be examined with the streamlined small institution examination. According to a report by the Congressional Research Service, a community bank participating in the streamlined CRA exam can save 40 percent in compliance costs. Expanding the small institution exam program will free up capital and other resources for almost 1,700 community banks across our Nation that are in the $250 million to $1 billion asset-size range, allowing them to invest even more into their local communities.

BANK SERVICE COMPANY INVESTMENTS (MATRIX NO. 94)

Present Federal law stands as a barrier to a savings association customer of a Bank Service Company from becoming an investor in that BSC. A savings association cannot participate in the BSC on an equal footing with banks who are both customers and owners of the BSC. Likewise, present law blocks a bank customer of a savings association's service corporation from investing in the savings association service corporation.

ACB proposes legislation that would provide parallel investment ability for banks and savings associations to participate in both BSC's and savings association service corporations. ACB's proposal preserves existing activity limits and maximum investment rules and makes no change in the roles of the Federal regulatory agencies with respect to subsidiary activities of the institutions under their primary jurisdiction. Federal savings associations thus would need to apply only to OTS to invest.

Other Important Issues

INTEREST ON BUSINESS CHECKING (MATRIX NO. 3)

Prohibiting banks from paying interest on business checking accounts is long outdated, unnecessary, and anticompetitive. Restrictions on these accounts make community banks less competitive in their ability to serve the financial needs of many business customers. Permitting banks and savings institutions to pay interest directly on demand accounts would be simpler. Institutions would benefit by not having to spend time and resources trying to get around the existing prohibition. This would benefit many community depository institutions that cannot currently afford to set up complex sweep operations for their—mostly small—business customers. This new authority should not be available to industrial loan companies with commercial parents (those that derive more than 15 percent of revenues from nonfinancial activities).

ELIMINATING UNNECESSARY BRANCH APPLICATIONS (MATRIX NO. 62)

A logical counterpart to proposals to streamline branching and merger procedures would be to eliminate unnecessary paperwork for well-capitalized banks seeking to open new branches. National banks, State-chartered banks, and savings associations are each required to apply and await regulatory approval before opening new branches. This process unnecessarily delays institutions' plans to increase competitive options and increase services to consumers, while serving no important public policy goal. In fact, these requirements are an outdated holdover from the times when regulatory agencies spent unnecessary time and effort to determine whether a new branch would serve the "convenience and needs" of the community.

COORDINATION OF STATE EXAMINATION AUTHORITY (MATRIX NO. 70)

ACB supports the adoption of legislation clarifying the examination authority over State-chartered banks operating on an interstate basis. ACB recommends that Congress clarify home- and host-State authority for State-chartered banks operating on an interstate basis. This would reduce the regulatory burden on those banks by making clear that a chartering State bank supervisor is the principal State point of contact for safety and soundness supervision and how supervisory fees may be assessed. These reforms will reduce regulatory costs for smaller institutions.

LIMITS ON COMMERCIAL REAL ESTATE LOANS (MATRIX NO. 87)

ACB recommends increasing the limit on commercial real estate loans, which applies to savings associations, from 400 to 500 percent of capital, and giving the OTS flexibility to increase that limit. Institutions with expertise in commercial real property lending and which have the ability to operate in a safe and sound manner should be granted increased flexibility. Congress could direct the OTS to establish practical guidelines for commercial real property lending that exceeds 500 percent of capital.

INTERSTATE ACQUISITIONS (MATRIX NO. 89)

ACB supports the adoption of legislation to permit multiple savings and loan holding companies to acquire associations in other States under the same rules that apply to bank holding companies under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. This would eliminate restrictions in current law that prohibit (with certain exceptions) a savings and loan holding company from acquiring a savings association if that would cause the holding company to become a multiple savings and loan holding company controlling savings associations in more than one State.

APPLICATION OF QTL TO MULTI-STATE OPERATIONS (MATRIX NO. 54)

ACB supports legislation to eliminate State-by-State application of the QTL test. This better reflects the business operations of savings associations operating in more than one State.

APPLYING INTERNATIONAL LENDING SUPERVISION ACT TO OTS (MATRIX NO. 66)

ACB recommends that the ILSA be amended to clarify that the ILSA covers savings associations. Such a provision would benefit OTS-regulated savings associations operating in foreign countries by assisting the OTS in becoming recognized as a consolidated supervisor, and it would promote consistency among the Federal banking regulators in supervising the foreign activities of insured depository institutions.

OTS REPRESENTATION ON BASEL COMMITTEE ON BANKING SUPERVISION (MATRIX NO. 67)

ACB recommends another amendment to the ILSA that would add OTS to the multiagency committee that represents the United States before the Basel Committee on Banking Supervision. Savings associations and other housing lenders would benefit by having the perspective of the OTS represented during the Basel Committee's deliberation.

PARITY FOR SAVINGS ASSOCIATIONS ACTING AS AGENTS FOR AFFILIATED DEPOSITORY INSTITUTIONS (MATRIX NO. 90)

ACB recommends that the Federal Deposit Insurance Act be amended to give savings associations parity with banks to act as agents for affiliated depository institutions. This change will allow more consumers to access banking services when they are away from home.

INFLATION ADJUSTMENT UNDER THE DEPOSITORY INSTITUTION MANAGEMENT INTERLOCKS ACT (MATRIX NO. 49)

ACB supports increasing the exemption for small depository institutions under the DIMA from $20 million to $100 million. This will make it easier for smaller institutions to recruit high quality directors. The original $20 million level was set a number of years ago and is overdue for an adjustment.

MORTGAGE SERVICING CLARIFICATION (MATRIX NO. 79)

The FDCPA requires a debt collector to issue a "mini-Miranda" warning (that the debt collector is attempting to collect a debt and any information obtained will be used for that purpose) when the debt collector begins to attempt to collect a debt. This alerts the borrower that his debt has been turned over to a debt collector. However, the requirement also applies in cases where a mortgage servicer purchases a pool of mortgages that include delinquent loans. While the mini-Miranda warnings are clearly appropriate for true third party debt collection activities, they are not appropriate for mortgage servicers who will have an ongoing relationship with the borrower.

ACB urges the adoption of legislation to exempt mortgage servicers from the mini-Miranda requirements. The proposed exemption (based the Mortgage Servicing Clarification Act) is narrowly drawn and would apply only to first lien mortgages acquired by a mortgage servicer for whom the collection of delinquent debts is incidental to its primary function of servicing current mortgages. The exemption is narrower than one recommended by the FTC for mortgage servicers. The amendment would not exempt mortgage servicers from any other requirement of the FDCPA.

REPEALING OVERLAPPING RULES FOR PURCHASED MORTGAGE SERVICING RIGHTS (MATRIX NO. 92)

ACB supports eliminating the 90-percent-of-fair-value cap on valuation of purchased mortgage servicing rights. ACB's proposal would permit insured depository institutions to value purchased mortgage servicing rights, for purposes of certain capital and leverage requirements, at more than 90 percent of fair market value—up to 100 percent—if the Federal banking agencies jointly find that doing so would not have an adverse effect on the insurance funds or the safety and soundness of insured institutions.

LOANS TO EXECUTIVE OFFICERS (MATRIX NO. 93)

ACB recommends legislation that eliminates the special regulatory $100,000 lending limit on loans to executive officers. The limit applies only to executive officers for "other purpose" loans, that is, those other than housing, education, and certain secured loans. This would conform the law to the current requirement for all other officers, that is, directors and principal shareholders, who are simply subject to the loans-to-one-borrower limit. ACB believes that this limit is sufficient to maintain safety and soundness.

DECRIMINALIZING RESPA (MATRIX NO. 80)

ACB recommends striking the imprisonment sanction for violations of RESPA. It is highly unusual for consumer protection statutes of this type to carry the possibility of imprisonment. Under the ACB's proposal, the possibility of a $10,000 fine would remain in the law, which would provide adequate deterrence.

ELIMINATING SAVINGS ASSOCIATION SERVICE COMPANY GEOGRAPHIC RESTRICTIONS (MATRIX NO. 89)

Currently, savings associations may only invest in savings association service companies in their home State. ACB supports legislation that would permit savings associations to invest in those companies without regard to the current geographic restrictions.

STREAMLINING SUBSIDIARY NOTIFICATIONS (MATRIX NO. 95)

ACB recommends that Congress eliminate the unnecessary requirement that a savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary. Under ACB's proposal, a savings association would still be required to notify the OTS, providing sufficient regulatory oversight. No similar provision applies to national banks.

AUTHORIZING ADDITIONAL COMMUNITY DEVELOPMENT ACTIVITIES (MATRIX NO. 96)

Federal savings associations cannot now invest directly in community development corporations, and must do so through a service corporation. National banks and State member banks are permitted to make these investments directly. Because many savings associations do not have a service corporation and choose for other business reasons not to establish one, they are not able to invest in CDC's. ACB supports legislation to extend CDC investment authority to Federal savings associations under the same terms as currently apply to national banks.

ELIMINATING DIVIDEND NOTICE REQUIREMENT (MATRIX NO. 81)

Current law requires a savings association subsidiary of a savings and loan holding company to give the OTS 30 days' advance notice of the declaration of any dividend. ACB supports the elimination of the requirement for well-capitalized associations that would remain well capitalized after they pay the dividend. Under this approach, these institutions could conduct routine business without regularly conferring with the OTS. Those institutions that are not well capitalized would be required to prenotify the OTS of dividend payments.

REIMBURSEMENT FOR THE PRODUCTION OF RECORDS (MATRIX NO. 97)

ACB's members have long supported the ability of law enforcement officials to obtain bank records for legitimate law enforcement purposes. In the Right to Financial Privacy Act of 1978, Congress recognized that it is appropriate for the government to reimburse financial institutions for the cost of producing those records. However, the Act provided for reimbursement only for producing records of individuals and partnerships of five or fewer individuals. Given the increased demand for corporate records, such as records of organizations that are allegedly fronts for terrorist financing, ACB recommends that Congress broaden the RFPA reimbursement language to cover corporate and other organization records.

ACB also recommends that Congress clarify that the RFPA reimbursement system applies to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (Title III of the USA PATRIOT Act). Because financial institutions will be providing additional records under the authority of this new act, it is important to clarify this issue.

EXTENDING DIVESTITURE PERIOD (MATRIX NO. 98)

ACB recommends that unitary savings and loan holding companies that become multiple savings and loan holding companies be provided 10 years to divest nonconforming activities, rather than the current 2-year period. This would be consistent with the time granted to new financial services holding companies for similar divestiture under the Gramm-Leach-Bliley Act. The longer time gives these companies time to conform to the law without forcing a firesale divestiture.

CREDIT CARD SAVINGS ASSOCIATIONS (MATRIX NO. 100)

Under current law, a savings and loan holding company cannot own a credit card savings association and still be exempt from the activity restrictions imposed on companies that control multiple savings associations. However, a savings and loan holding company could charter a credit card institution as a national or State bank and still be exempt from the activity restrictions imposed on multiple savings and loan holding companies. ACB proposes that the Home Owners' Loan Act be amended to permit a savings and loan holding company to charter a credit card savings association and still maintain its exempt status. Under this proposal, a company could take advantage of the efficiencies of having its regulator be the same as the credit card institution's regulator.

PROTECTION OF INFORMATION PROVIDED TO BANKING AGENCIES (MATRIX NO. 100)

Court decisions have created ambiguity about the privileged status of information provided by depository institutions to bank supervisors. ACB recommends the adoption of legislation that makes clear that when a depository institution submits information to a bank regulator as part of the supervisory process, the depository institution has not waived any privilege it may claim with respect to that information. Such legislation would facilitate the free flow of information between banking regulators and depository institutions that is needed to maintain the safety and soundness of our banking system.

TECHNICAL AMENDMENTS

ACB supports two additional technical amendments to Federal banking laws. The first would give Federal savings associations the same authority as national banks to invest in corporate debt securities that are the equivalent of commercial loans. The second would afford a Federal savings association the same treatment that a national bank has with regard to the execution of State and local court judgments against the association.

Conclusion

I wish to again express ACB's appreciation for your invitation to testify on the importance of reducing regulatory burdens and costs for community banks. We strongly support the Committee's efforts in providing regulatory relief, and look forward to working with you and your staff in crafting legislation to accomplish this goal.

PREPARED STATEMENT OF H. GREG McCLELLAN

PRESIDENT AND CEO, MAX FEDERAL CREDIT UNION

ON BEHALF OF

THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

MARCH 1, 2006

Introduction

The National Association of Federal Credit Unions (NAFCU) and the entire credit union community appreciate this opportunity to participate in this discussion regarding regulatory relief for America's financial institutions. We would like to thank Chairman Shelby, Ranking Member Sarbanes, Senator Crapo, and Members of the Committee for having us here today. NAFCU is the only national organization exclusively representing the interests of the Nation's federally chartered credit unions. NAFCU is comprised of over 800 Federal credit unions—member owned financial institutions across the Nation—representing over 27 million individual credit union members. NAFCU-member credit unions collectively account for approximately two-thirds of the assets of all Federal credit unions in the United States.

I am Greg McClellan and I currently serve as the President and CEO of MAX Federal Credit Union headquartered in Montgomery, Alabama. Prior to taking over as CEO, I spent over 20 years as the Executive Vice President and Chief Operations Officer at the credit union. MAX FCU is a community credit union with over 106,000 members and more than $650 million in assets. I have been involved in the credit union movement for more than 20 years, and I have more than 30 years experience in the financial services industry.

I am a member of the Millbrook Chamber of Commerce and a board member of the Boys & Girls Club of South Central Alabama. I currently serve as the President of the Montgomery Chapter of the Alabama Credit Union League, Vice Chair of the Alabama Credit Union Executive Society Council and Vice Chair of the Credit Union Coalition of Alabama, in addition to serving on NAFCU's NAFCU/PAC Committee.

Historically, credit unions have served a unique function in the delivery of necessary financial services to all Americans. Established by an act of Congress in 1934, the Federal credit union system was created and has been recognized as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to necessary financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 87 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 U.S.C. 1752(1)). While over 70 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The Nation's 8,695 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. In the 8 years since Congress passed the *Credit Union Membership Access Act* (CUMAA—P.L. 105–219) Federal credit unions have added over 1,400 underserved areas, resulting in low-cost financial services being made available to over 100 million Americans. As owners of cooperative financial institutions, united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, Federal credit union directors serve without remuneration—a fact epitomizing the true “volunteer spirit” permeating the credit union community. In fact, while the average bank director is paid approximately $14,000 per year, the average credit union board member is paid $0.

Credit unions have an unparalleled safety and soundness record. Unlike banks and thrifts, credit unions have never cost the American taxpayer a single dime. While the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loans Insurance Corporation (FSLIC) were both started with seed money from the U.S. Treasury, every dollar that has gone into the National Credit Union Share Insurance Fund (NCUSIF) has come from the credit unions it insures. Furthermore, unlike the thrift insurance fund that unfortunately cost hundreds of billions of dollars, credit unions have never needed a Federal bailout.

Looking Beyond CUMAA

Credit unions have been the target of criticism by some in the banking industry for more than two decades. Over the past few years, the banker attacks have intensified. The Supreme Court’s decision in 1998 in the AT&T Family Federal Credit Union field of membership case followed by Congress’ prompt passage of CUMAA in the summer of 1998, which was seen by many as a significant victory for credit unions, brought the issue to the forefront. CUMAA overturned in 8 short months a decision that had encompassed 8 years of costly litigation initiated by the banks.

CUMAA was an important and necessary piece of legislation for credit unions at the time of its enactment because it codified a number of fundamental credit union concepts embraced by both Federal and State-chartered credit unions. These include:

- The multiple-group policy that NCUA initiated in 1984;
- The “once a member, always a member” principle followed by virtually every credit union in the country; and
- The “family member” concept followed by many credit unions.

Yet CUMAA came with some provisions that were added and not widely supported by the credit union community. These include:

- Arbitrary limitations on member business loans;
- Imposition of a bank-like Prompt Corrective Action (PCA) requirement that, given the structure of credit unions, serves in many respects as an overly restrictive constraint on growth; and
- Various other artificial and arbitrary limitations on growth.

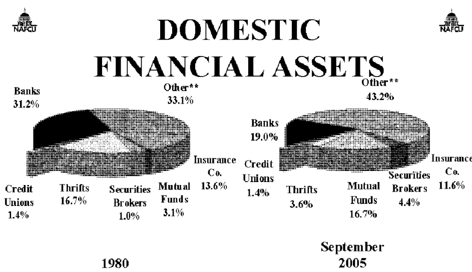
In the wake of CUMAA, NAFCU and its membership concluded the following:

- NCUA should work to eliminate unnecessary regulations and work with Congress to repeal laws which are only serving to drive small financial institutions out of business.
- Mergers seem to be a practical and necessary way of creating financially viable credit unions that can survive in today’s financial services marketplace.
- It is important that the regulatory environment allow for credit union growth and not impair the ability of credit unions to remain competitive.

As a result of these meetings, it became clear that both regulatory and legislative action was needed in the post-CUMAA environment.

The Current Situation

NAFCU is pleased to report to the Committee that credit unions today are vibrant and healthy. Membership in credit unions continues to grow with credit unions serving over 87 million Americans—more than at any time in history. At the same time, it is important to note that over the past 25 years, the credit union market share, as a percentage of financial assets, has not changed and, as a consequence, credit unions provide little competitive threat to other financial institutions. According to data obtained from the Federal Reserve Board, during the 25 year period from 1980 to September 2005, the percentage of total financial assets held by credit unions remained constant at only 1.4 percent.

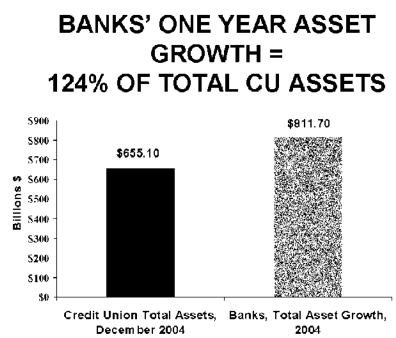


**Other includes items such as private pension funds, mortgages, asset-backed securities, finance companies, and investments in bank personal trusts.

Source: Flow of Funds Accounts of the United States, FRB

The above chart only tells part of the story. Credit unions remain small financial institutions. As of last September, the average credit union has $78 million in assets, while the "average" bank and thrift has over $1.2 billion in assets.

Furthermore, a number of individual banks have total assets greater than the entire credit union community combined. As shown in the chart below, the annual asset growth of the commercial bank sector for the last full year available (2004) exceeded the size of the entire credit union community, that is total assets—with banks growing in just 1 year by a magnitude that it took credit unions nearly a century to achieve.



Source: NCUA; FDIC

As is the case with the banks and thrifts, there has been consolidation within the credit union community in recent years. The number of credit unions has declined by more than 63 percent over the course of the past 36 years, from an all-time high of 23,866 in 1969 to 8,880 this past December. Similar to the experience of all credit unions, the number of Federal credit unions has declined by just about 58 percent over that same period, from a high of 12,921 in 1969 to 5,393 today.

NAFCU Efforts to Enhance the Federal Charter

Over the past 5 years NAFCU has been working closely with former NCUA Board Chairman Dennis Dollar, current NCUA Board Chairman JoAnn Johnson, Board Vice Chairman Rodney Hood, and Board Member Gigi Hyland, along with other Board Members and their respective staffs in an effort to improve the regulatory environment for Federal credit unions. We are pleased to see that these efforts have been productive in several respects.

On the legislative front, NAFCU has been meeting with legislators on both sides of the aisle to compile a package of initiatives to help credit unions better serve their members in today's sophisticated financial marketplace. An important part of that effort has involved identifying areas in which we believe Congress should provide what is now overdue regulatory relief. NAFCU has suggested a series of recommendations designed to enhance the Federal charter, several of which were contained either in whole or in part, in previous regulatory relief measures passed by the House. Credit unions exist in a dynamic environment where the laws and regulations dealing with credit union issues are currently in need of review and refinement in order to ensure credit unions can continue to respond to changing market conditions.

NAFCU has been pleased to work with Senator Crapo and the Members of the Committee in crafting the Matrix of Regulatory Relief Proposals and we applaud the Senator and his staff for their efforts. We look forward to regulatory relief legislation being introduced and hope that the Committee will turn to the next step of marking-up legislation.

The House Bill—A Good First Step

NAFCU urges the Committee, when drafting a regulatory relief bill, to start with the credit union proposals found of Title III of the House bill, The *Financial Services Regulatory Relief Act* (H.R. 3505) and included in the Matrix as outlined below:

Leases of Land on Federal Facilities for Credit Unions (Matrix #16)

NAFCU supports the effort to give credit unions the opportunity to negotiate land leases on Federal property under the same terms and conditions as credit unions now able to lease space in Federal buildings under the *Federal Credit Union Act* (FCUA). The credit unions that will be impacted by this change are predominantly defense (military) credit unions that have tried to expand their service to our men and women in uniform by building (and paying for) their own member service centers on military facilities. Many credit unions that have expanded their services by building their own facilities to serve military personnel have had their leases go from a nominal fee (for example $1.00 a year) to a "fair market value" rate of over $2,000 a month. For not-for-profit cooperative credit unions, this increase in leasing costs will inevitably lead to higher fees and/or fewer services for their members—the men and women that serve our country.

Investments in Securities by Federal Credit Unions (Matrix #12)

NAFCU supports this effort to increase investment options for Federal credit unions by allowing certain limited investments in securities. The current limitations in the Federal Credit Union Act unduly restrict Federal credit unions in today's dynamic financial marketplace and have the potential of adversely impacting both safety and soundness. The track record of safe and sound performance by credit unions warrants expanded investment authority in accordance with regulations promulgated by the NCUA Board.

Increase in General 12-Year Limitation of Term of Federal Credit Union Loans (Matrix #10)

NAFCU supports this provision that would increase the general 12-year limit on Federal credit union loans to 15 years or longer as permitted by the NCUA Board. The current 12-year limit is outdated and does not conform to maturities that are commonly accepted in the market today. It is also important that the NCUA Board have the discretionary authority to extend this limitation beyond 15 years when necessary in order to appropriately address marketplace conditions.

Increase in 1 Percent Investment Limit in Credit Union Service Organizations (Matrix #11, #131)

NAFCU supports this provision to increase the 1 percent investment limit in credit union service organizations (CUSO's). However, in lieu of just raising the limit to 3 percent, as found in the last version of regulatory relief passed by the House, NAFCU recommends that Congress give the NCUA Board authority to establish an appropriate investment limit recognizing that as time goes on, that limit may warrant further adjustment.

Member Business Loan Exclusion for Loans to Nonprofit Religious Organizations (Matrix #17)

NAFCU supports this effort to exclude loans or loan participations by federally insured credit unions to nonprofit religious organizations from the member business loan limit.

Check-Cashing and Money-Transfer Services Offered to Those Within the Credit Union's Field of Membership (Matrix #9)

NAFCU supports efforts to allow Federal credit unions to offer check-cashing and money-transfer services to anyone within the credit union's field of membership. We believe this new authority, which would be discretionary and not mandatory, will allow credit unions to help combat abuses by nontraditional financial institutions that prey on our Nation's immigrants and others who live and work in underserved communities. The House passed stand-alone legislation to this effect (H.R. 749) on April 26, 2005.

Voluntary Mergers Involving Certain Credit Unions (Matrix #13)

NAFCU supports this clarifying amendment since there is no sound reason for imposing a numerical limitation of 3,000 on the size of a group that can go forward with a credit union merger before considering spinning off the group and requiring it to form a separate credit union. In addition, the retroactive effective date of August 7, 1998 (the date of enactment of CUMAA), is an important part of this section and must be maintained.

Conversion of Certain Credit Unions to Community Charter (Matrix #18)

NAFCU supports efforts that give NCUA the authority to allow credit unions to continue to serve and add members from their select employee groups (SEG's) after a credit union converts to a community charter. In addition, a credit union that converts to (or merges into) a community charter should be allowed to retain all employee groups in its field of membership at the time of conversion. Current law does not allow this, penalizing not only the credit union, but also those in its field of membership. We urge that the language from Section 307 of the *Credit Union Regulatory Improvements Act* (CURIA), H.R. 2317, be included for this section.

Credit Union Governance (Matrix #19, #132)

The *Federal Credit Union Act* contains many antiquated "governance" provisions that, while perhaps appropriate in 1934, are outdated, unnecessary, and inappropriate restrictions on the day-to-day operations of modern Federal credit unions. We support changes that would remove many of these provisions from the *Federal Credit Union Act* and instead allow the NCUA to use its regulatory authority to oversee these governance issues. For example, one antiquated provision prohibits credit unions from expelling disruptive or threatening members without a two-thirds vote of the membership; we believe the regulator and the credit union board should have some discretion in such cases. Additionally, NAFCU supports the following credit union governance proposals which would:

- Allow credit unions to reimburse volunteers on the board of directors for wages they would otherwise forfeit by participating in credit union-related activities;
- Allow the NCUA Board to set the amount at which the credit union board of directors must approve a loan to, or guaranteed by, a director or member of the credit union supervisory committee (currently set by statute at $20,000); and,
- Allow the NCUA Board to determine policies for review of approved pending applications for membership to the credit union (currently required monthly).

Provide NCUA with Greater Flexibility in Responding to Market Conditions (Matrix #20)

NAFCU supports the proposal to give NCUA the authority to adjust interest rates depending on market conditions. Under current law, Federal credit unions are the only type of insured institution subject to Federal usury limits on consumer loans. This provision would still keep that limit, but give NCUA greater flexibility to make adjustments based on market conditions.

Exemption from Premerger Notification Requirement of the Clayton Act (Matrix #21)

NAFCU supports the inclusion of this language which would exempt credit unions, just as banks and thrifts are already exempt, from the premerger notification requirements of the *Hart-Scott-Rodino Act.* Credit unions, like other depository institutions, are already exempt from the other provisions of the Act. The extensive review of the merger process by NCUA, makes this an extraneous burden faced by credit unions that other financial depository institutions do not share.

Treatment of Credit Unions as Depository Institutions under Securities Laws (Matrix #14)

Gramm-Leach-Bliley provided banks with registration relief from certain enumerated activities. NAFCU supports providing credit unions regulatory relief along those same lines, eliminating the requirement that credit unions register with the Securities and Exchange Commission (SEC) as broker/dealers when engaging in certain activities.

Modify the Statutory Definition of "Net Worth" to Include the Retained Earnings from other Institutions that have Merged with the Surviving Credit Union (Matrix #167)

Currently, credit union mergers are accounted for by using the "pooling method," meaning that the net worth of each merging credit union is combined to form the net worth of the surviving credit union: $2M (net worth of credit union A) + $2M (net worth of credit union B) = $4M (net worth of credit union AB). However, the

Financial Accounting Standards Board (FASB) has proposed eliminating pooling and imposing the "purchase method" of accounting on credit union mergers. Using this method and the current definition of net worth which is "retained earnings" as required by PCA, the net worth of the surviving credit union is only $2M ($2M [net worth of credit union A] + $2M [net worth of credit union B] = $2M [net worth of credit union AB]). Therefore, under the purchase method of accounting, only the surviving credit union's retained earnings count as net worth for PCA purposes. Consequently, the surviving credit union may have trouble meeting PCA requirements, unless credit union net worth is redefined.

It is important to note that this amendment does not legislate accounting practices; credit unions will be required to use the "purchase method" of accounting for mergers in order to receive a clean audit. This amendment does not grant credit unions that currently lack the authority to offer alternative capital accounts the authority to do so, nor does it confer upon NCUA the regulatory authority or discretion to authorize such accounts now or in the future. This amendment is intended to address a narrow and technical accounting issue and in the process simply maintain the status quo so that, in the case of merging credit unions, 2 + 2 can continue to equal 4. The House has also passed this NAFCU-supported language as stand-alone legislation, H.R. 1042, to address this same issue.

At a House Subcommittee on Financial Institutions and Consumer Credit hearing on H.R. 1042 last April, the Subcommittee heard support for the legislation from NCUA and the National Association of State Credit Union Supervisors (NASCUS). Additionally, Mr. Robert Herz, the Chairman of FASB, testified at the hearing that the legislation does not pose an issue to FASB's standard setting activities. The House passed H.R. 1042 under suspension of the rules on June 13, 2005. We would urge the Committee to include the language from H.R. 1042 in any regulatory relief bill.

Additional Regulatory Relief Proposals

Additionally, NAFCU supports including items #1 and #2 from the Matrix—the language from *The Business Checking Freedom Act,* H.R. 1224, which was passed by the House on May 24, 2005 by a vote of 424–1. Among other things, this language would allow the Federal Reserve to pay interest on balances held by depository institutions, including credit unions, at a Federal Reserve Bank.

There are additional provisions in House's *Credit Union Regulatory Improvements Act* (CURIA), H.R. 2317, which are not presently included in the *Financial Services Regulatory Relief Act,* H.R. 3505, that we believe should be included in any regulatory relief bill that the Senate Banking Committee may act on. NAFCU encourages the Committee to review CURIA, which includes updated legislative language on these proposals and include the following provisions:

Risk-Based Capital/PCA Reform (Matrix #8)

NAFCU supports this effort to modernize credit union capital requirements by redefining the net worth ratio to include risk assets. This would result in a new, more appropriate measurement to determine the relative risk of a credit union's assets and improve the safety and soundness of credit unions and the NCUSIF. It simply does not make sense that the current capital system treats a new 1 year unsecured $10,000 loan the same as a 30-year mortgage that is on its last year of repayment. We urge inclusion of the proposal put forth by the NCUA and included as Title I of the House CURIA bill in any regulatory relief legislation.

The American Bankers Association (ABA) expressed three concerns regarding risk-based capital in a letter to NCUA dated November 18, 2004. We believe that these concerns have been addressed in the actual proposal transmitted to Capitol Hill and incorporated into Title I of CURIA. Specifically, the ABA said that:

- CU's need a meaningful leverage ratio;
- There should be no substantive difference between bank and CU leverage ratio standards; and,
- Secondary capital would undermine the unique character of credit unions.

Neither the NCUA proposal nor Title I of CURIA would expand the authority for NCUA to authorize secondary capital accounts. As far as leverage ratios are concerned, NCUA's proposal:

- Advocates a system involving complementary leverage and risk-based standards working in tandem;
- For the leverage requirement, NCUA advocates a reduction in the standard net worth (that is, leverage) ratio requirements for credit unions *to a level comparable to what is required of FDIC-insured institutions.* In order to achieve comparability

between the Federal insurance funds, it is necessary to factor in the NCUSIF's mutual deposit-based funding mechanism; and,

- The risk-based proposal tailors the risk-asset categories and weights of BASEL II, as well as related aspects of the FDIC's PCA system, to the operation of credit unions. This approach is consistent with BASEL II and the FDIC's PCA system, addressing credit and operational risks under the risk-based requirement and acknowledging other forms of risk, such as interest rate risk.

The ABA's letter of November 18, 2004, also reiterates the recommendation contained in its April 18, 2000, comment letter to NCUA that said:

> NCUA should adopt a more bank-like risk-weighted capital system and then work with the banking agencies within the umbrella of the Federal Financial Institutions Examination Council to improve the current risk-based capital adequacy standard to better recognize credit quality and the use of internal risk models to manage financial institution risk.

What NCUA has transmitted to policymakers on Capitol Hill (which is included in Title I of CURIA), in fact, closely resembles the bank-like risk-weighted capital system and was developed with ample input from the Treasury Department. One difference, however, is that NCUA's proposal does not consider any credit union "internal risk models." While NCUA may in the future make that part of the risk mitigation credit, we have no assurance that this will be the case, so one could objectively conclude that the proposed risk-based capital system for credit unions is, in fact, more stringent than that currently applicable to banks and thrifts.

As you may recall, during the Senate Banking Committee's 2004 hearing on regulatory relief, the panel of industry witnesses discussed the issue of risk-based capital for credit unions and at the conclusion of that discussion a bank witness noted his understanding that the credit union industry "would like to see the leverage ratio eliminated and have only risk-based capital. . . . [while banks] have several capital ratios that we have to comply with, three to be certain, and that includes a leverage ratio. So if they [credit unions] want equality that does not amount to eliminating the leverage ratio. They can have the risk-based capital ratio too, I suppose, and that might be wise, but we are not eliminating the other ratio." To which NAFCU witness Bill Cheney responded: ". . . we are not asking to eliminate it." (Hearing Transcript at page 151). NAFCU continues to support the complimentary leverage and risk-based standards proposed by the NCUA.

Limits on Member Business Loans (Matrix #74, #84, #85, #86)

NAFCU supports revision of the current asset limit on member business loans. The current limit restricts member business lending at a credit union from the lesser of 1.75 times actual net worth or 1.75 times net worth required for a well-capitalized credit union. We support the language found in Title II of the House CURIA bill and the Matrix that would revise this restriction, replacing the formula with a flat rate of 20 percent of the total assets of a credit union, as proposed in Title II of the House CURIA bill. NAFCU believes this provision would facilitate member business lending without jeopardizing the safety and soundness of participating credit unions. While the current cap was first imposed on credit unions as part of CUMAA in 1998, the law also directed the Treasury Department to study the need for such a cap. In 2001, the Treasury Department released its study entitled "Credit Union Member Business Lending" in which it concluded that "credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions." We would urge the Committee to review this study and give it the weight it deserves when considering these provisions. NAFCU also supports revising the current definition of a member business loan by giving the NCUA the authority to exclude loans of $100,000 or less as de minimus, rather than preserving the current threshold of $50,000.

Leasing Space in Buildings with Credit Union Offices in Underserved Areas (Matrix #121)

NAFCU supports the provision in CURIA that enhances the ability of credit unions to assist distressed communities with economic revitalization efforts. This provision would allow a credit union to lease space in a building or on property in an underserved area in which it maintains a physical presence to other parties on a more permanent basis. It would permit a Federal credit union to acquire, construct, or refurbish a building in an underserved community, and lease out excess space in that building.

Credit Union Conversion Voting Requirements (Matrix #83)

NAFCU does not object to a credit union's right to convert to a mutual savings bank charter, however, we believe transparency and disclosure are paramount in the conversion process, and that the decision to convert should require the approval of a larger percentage of members than is currently the case. With that in mind, NAFCU supports language to require that a minimum of 20 percent of a credit union's members eligible to vote should cast a ballot in the vote taken to convert and a majority of those credit union members must vote in favor of the conversion.

In addition to the above provisions from the House CURIA bill, NAFCU also supports the inclusion of Matrix Items #168 (Eliminate or Modify the Limitation on Credit Union Experience for NCUA Board Members) and #176 (Seasoned Customer CTR Exemption—Provided that this would be made to apply to credit unions as well).

Furthermore, we support granting the NCUA parity in the following Matrix items:

- (#157) Elimination of Criminal Indictments Against Receiverships;
- (#160) Recordkeeping Amendment; and,
- (#161) Preservation of Records by Optical Imaging and Other Means.

We should note that we do not support inclusion in any regulatory relief bill of provisions #25 (NCUA Vendor Examinations) and #168(b) (NASCUS—NCUA Board Member have State regulatory experience).

Conclusion

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, there is a clear need for easing the regulatory burden on credit unions as we move forward into the 21st century financial services marketplace. Providing credit unions some relief from the regulatory burdens that they face will allow credit unions to better serve their members and meet their needs in a dynamic marketplace. We urge the Committee to consider the important provisions we outlined in this testimony for inclusion in any Senate regulatory relief bill. We understand that this legislation is a work in progress and we urge you to undertake careful examination of any other measures that fall within the scope of this legislation. We would like to once again thank Chairman Shelby, Ranking Member Sarbanes, Senator Crapo, and the Members of the Senate Banking Committee for this opportunity to testify before you today. We look forward to working with you on this important matter and would welcome your comments or questions.

PREPARED STATEMENT OF STEVE BARTLETT

PRESIDENT AND CHIEF EXECUTIVE OFFICER,
FINANCIAL SERVICES ROUNDTABLE

MARCH 1, 2006

Introduction

Good morning, Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee. My name is Steve Bartlett and I am President & CEO of The Financial Services Roundtable.

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $40.7 trillion in managed assets, $960 billion in revenue, and 2.3 million jobs.

The Roundtable appreciates the opportunity to share its views on the topic of regulatory relief for financial services firms. We strongly support efforts to eliminate outdated regulations and streamline the regulatory compliance process. Useless laws and regulations impose significant, and unnecessary, burdens on financial services firms, which make our firms less efficient.

We often discuss regulatory reduction in the context of costs to big business, but the real burden is placed on small businesses and consumers through an increase in costs of financial services products. Many of the issues before us today have been under consideration for nearly 6 years and 2006 is a good time to address these concerns facing institutions of all sizes. I also want to take this time to mention the important issue of an optional Federal charter for insurers and producers. While a regulatory relief bill might not be the appropriate vehicle, the Senate Banking Committee is the right place to address this issue through oversight hearings, legislation, and a mark-up. I strongly believe that an optional Federal charter will bring advantages to insurers, producers, and most importantly consumers—and I look forward to continuing this dialogue with your Committee.

I fully appreciate to some extent that I am "preaching to the choir" when I cite the burdens of regulation on financial services firms. Your Committee in particular, Mr. Chairman and Senator Crapo has led the effort to eliminate unnecessary and overly burdensome laws and regulations applicable to financial services firms. The Roundtable appreciates these efforts, and hopes that they will be fully realized with the enactment of a regulatory burden relief bill in this Congress.

For over a year now, the Roundtable has undertaken its own initiative aimed at regulatory burden relief. We are engaged in an ongoing dialogue with the appropriate Federal financial regulatory agencies about several problems, and, in some instances, have recommended specific remedies. Based on direction from our senior executives, there are four major regulatory problems in need of reform. I will begin by addressing these four key issues. I also have highlighted a number of other regulatory reforms sought by the Roundtable, many of which were incorporated in H.R. 3505, "the Financial Services Regulatory Relief Act of 2005", which was approved by the House Financial Services Committee last year. Please find attached to my testimony an addendum of additional regulatory relief proposals offered for consideration by The Financial Services Roundtable.*

The Roundtable's Regulatory Oversight Coalition

The Roundtable continues its own effort to reduce excessive regulation. This effort is focused on four regulatory problem areas:

- Suspicious Activity Report (SAR) filing requirements;
- SEC enforcement policies and practices;
- Attorney Client Privilege (the confidentiality of information that is shared with Federal financial regulators); and
- Compliance with Section 404 of the Sarbanes-Oxley Act.

SAR's

Roundtable member companies strongly support the government's efforts to combat money laundering and terrorist financing. However, we believe that the current system of reporting suspicious activities is not working properly. The best evidence of this is the dramatic increase in SAR filings in recent years. For example, since 1996, national SAR reporting has increased 453 percent. Similarly, FinCEN reported 81,197 filings in 1997 versus 288,343 filings in 2003. In 2004, depository institutions had filed a total of 689, 419 SAR's, and the total number of SAR filings is projected to be around 900,000 for 2005.

There are several reasons for this dramatic increase in SAR filings. First, the failure to file SAR's has become a criminal issue. The U.S. Justice Department has aggressively pursued actions against financial institutions for failing to file SAR's. This criminalization of the filing process has created a huge reputational risk for financial institutions, and has caused institutions to file an increasing number of SAR's in order to avoid any potential for prosecution. Second, there are no clear standards for when SAR's should be filed. Although guidelines are in place, examiners neither clearly nor consistently apply them. In addition, financial institutions do not receive feedback from law enforcement on the type of information that should be included in the SAR. Third, Roundtable member companies have encountered a "zero tolerance" policy among the Federal financial regulatory agencies. Under this policy, institutions are held accountable for every single transaction.

Finally, there is a lack of coordination among the various agencies and examiners responsible for SAR filings. This lack of coordination often results in duplicate requests and multiple filings.

To address these problems, The Roundtable has urged the Federal financial regulatory agencies to take the following actions:

- Amend existing SAR regulations to incorporate the good faith guidance recently issued, but without the exception for "significant" nonfilings;
- Draft regulations and/or guidelines that focus on an institution's anti-money laundering program and policies, not individual transactions;
- Coordinate with each other on all examination procedures, and provide consistent interpretations of the Bank Secrecy Act;

* Held in Committee files.

- Consider raising the Currency Transaction Report (CTR) threshold above the current $10,000.00 level; and
- Provide additional guidance on Customer Identification Programs, including tailoring the regulations to individual businesses versus a one-size-fits-all approach.

SEC Enforcement

Roundtable member companies are increasingly concerned about the enforcement policies and practices of the Securities and Exchange Commission (SEC). Just as the Roundtable supports compliance with Federal anti-money laundering laws and regulations, the Roundtable supports compliance with our Nation's securities laws. Moreover, we continue to work in a collaborative fashion with the SEC. That said, we believe that compliance is being hindered by certain SEC enforcement policies and practices.

Specifically, the Roundtable believes that the Office of Compliance, Inspection, and Examination (OCIE) should be returned back to the operating divisions. This would align the SEC's examination and inspection procedures with the policy making functions at the SEC. The Roundtable believes that with OCIE folded back into the operating divisions institutions would have a chance to more freely discuss compliance issues and other practices outside of a potential enforcement context. This is the model that has been successfully followed by the Federal banking agencies, and we believe that it would enhance, not reduce, compliance with securities laws.

Second, we believe that the SEC should provide a notice to institutions when an investigation is complete. Currently, no such notices are provided, and this practice can have an unnecessary chilling effect on business operations.

Third, we believe that there should be Commission approval prior to sweep examinations, and there should be written notification to the Commission prior to inspections. Moreover, the Roundtable supports legislation, such as H.R. 4618, sponsored by Congressman Vito Fossella.

Fourth, as discussed further below, we believe the SEC should drop its policy of "forcing" companies to waive attorney-client privilege in the course of an investigation. This policy is impairing the attorney-client privilege, and it threatens to undermine internal discussion and investigations. We note with interest that the SEC in recent days reversed course and halted its subpoenas of journalists' notes. The SEC should show similar restraint in the attorney-client privilege arena and drop its policy of seeking waivers of the privilege." Finally, we believe the SEC should give financial institutions adequate time to respond to broad document requests.

The SEC has said that it will not tolerate unreasonable delays in response to inquiries. The Roundtable does not endorse unreasonable delays, but has found that the SEC's definition of what constitutes an unreasonable delay is often very limited. This has created problems for institutions that are trying to determine what information is relevant and what is protected by the attorney-client privilege.

Confidentiality of Information Shared with Regulators

Financial institutions are required to share an increasing amount of information with Federal financial regulators. Reporting and filing requirements imposed by Federal law and regulators are a major source of this burden. For example, since the enactment of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, Federal banking and thrift regulators have promulgated over 801 final rules, most of which impose various types of reporting and filing requirements. Additionally, financial institutions are asked to provide a wide-range of documents and information to regulators in the course of examinations and investigations.

Unfortunately, this information sharing is threatened by two developments. First, there is the potential for confidential information that is shared with a Federal financial regulator to become accessible by third parties. Needless to say, this potential can have significant chilling effects on the nature and type of information an institution is willing to share with its regulator.

Second, the Justice Department, the SEC, and the other Federal financial regulators have adopted policies that effectively undermine the attorney-client privilege. Under these policies, the wavier of the attorney-client privilege is a condition for being deemed "cooperative" with the agency, and the failure to waive the privilege can adversely affect the nature of the charges that may be brought in an enforcement case or the size of any civil money penalty that may be assessed against an institution. Such policies can have significant unintended consequences:

- They have a chilling effect on the communications between management, boards of directors, and their attorneys because of the uncertainty over what conversations and work-product is protected:
- They discourage internal investigations. The current regulatory environment, including reforms brought about by the Sarbanes-Oxley Act, encourages companies

to conduct thorough internal investigations and, to the extent necessary, communicate the results of those investigations to the appropriate Federal regulators. Yet, the likelihood that such communications will result in a waiver of the attorney-client privilege creates a disincentive to conducting investigations. Thus, the current waiver policy is directly counter to the goals of Sarbanes-Oxley and similar regulatory reforms.

- Furthermore, the policies place employees in a difficult position during the course of investigations. If employees cooperate in an investigation, their statements may have to be provided to the investigation agency. If an employee decided not to cooperate and withholds information, the employee risks termination or other action against them.

To protect the confidentiality of information given to a Federal financial regulator, the Roundtable urges the enactment of legislation similar to The Financial Services Antifraud Network Act of 2001 (also known as the Bank Examination Report Privilege Act or BERPA), which was proposed in the 107th Congress,[1] and the Securities Fraud Deterrence and Investor Restitution Act, which was proposed in the 108th Congress.[2] These proposals would protect the integrity and effectiveness of the information shared with Federal financial regulators. For example, BERPA would clarify that information voluntarily disclosed to an examining agency continues to be protected by the institution's own privileges. BERPA also would codify and strengthen the bank supervisory privilege by defining confidential supervisory information, affirming that such information is the property of the agency that created or requested it, and protecting this information from unwarranted disclosure to third parties. Furthermore, BERPA would reaffirm the agencies' powers to establish procedures governing the production of confidential supervisory information to third parties.

The Roundtable also recommends that such legislation be expanded to cover information shared with an institution's auditors. The Sarbanes-Oxley Act protects privileged documents provided to the Public Company Accounting Oversight Board (PCAOB) in connection with the inspections and investigations of registered audit firms.

This protection, however, does not extend to information obtained by the auditors themselves. Ensuring that information shared with auditors can remain subject to confidentiality will help to ensure the flow of information between an institution and its auditors.

With respect to the governmental policies that have the effect of undermining the attorney-client privilege, The Roundtable recommends that Congress make it clear to the Justice Department and the Federal financial regulators that the waiver of the privilege should not be a matter of policy in all investigations.

Section 404 of the Sarbanes-Oxley Act

Section 404 of the Sarbanes-Oxley Act requires SEC-reporting firms to conduct annual assessments of the effectiveness of their internal controls, and to have their auditors independently attest to and report on this assessment. The Roundtable supports the goals of this section. Strong corporate governance and transparency of management structure and internal controls are important. Nonetheless, the Roundtable has identified a certain substantial concern with the implementation of Section 404.

Most notably, Section 404 has changed the role of auditors. It has made auditors hesitant to provide advice to clients, caused auditors to impose excessive testing and documentation requirements on clients, and significantly increased the cost of outside audits.

Additionally, Section 404 has imposed significant initial and on-going costs on companies. A recent survey by Financial Executives International found that the total cost of compliance per company is approximately $4.36 million. These costs include large increases in external costs for consulting, software and other vendors, additional personnel, and, as noted above, additional fees by external auditors.

Furthermore, Roundtable members have encountered confusion over the standards in Section 404. For example, we find a need for clarity on the meaning of terms such as "material weakness" and "significant controls."

[1] H.R. 1408, Financial Services Antifraud Network Act of 2001, U.S. House of Representatives, 107th Congress (November 7, 2001).

[2] H.R. 2179, Securities Fraud Deterrence and Investor Restitution Act, U.S. House of Representatives, 108th Congress (May 21, 2003).

Other Needed Regulatory Reforms

There are a number of other needed regulatory reforms that the Roundtable urges the Committee to consider as it crafts regulatory relief legislation. I will start by highlighting provisions from H.R. 3505, and then list some other recommended changes to Federal law.

Interstate Banking

Over 10 years ago, Congress enacted the landmark Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. Since then, the public benefits anticipated by that Act have been realized.

The creation of new bank branches has helped to maintain the competitiveness of our financial services industry, and has improved access to financial products in otherwise underserved markets. Branch entry into new markets has enhanced competition in many markets, and this, in turn, has resulted not only in a better array of financial products and services for households and small businesses, but also in competitive prices for such products and services. There is, however, one remaining legal barrier to interstate branching, which should be eliminated.

Under the Riegle-Neal Act, a bank cannot establish a new or so-called "de novo" interstate branch without the affirmative approval of a host State. Since 1994, only 17 States have given that approval; 33 States have not. The time has come to remove this barrier to interstate branching. The Roundtable urges the Committee to do so by incorporating Section 401 from H.R. 3505 in its version of regulatory relief legislation.

Section 401 eliminates the provision in the Riegle-Neal Act that requires State approval for de novo branching. In other words, the enactment of Section 401 would allow a bank to establish new branches in any State, without limitations.

Section 401 is supported by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Conference of State Bank Supervisors. These Federal and State regulators recognize the public benefits associated with expanding access to banking offices. They also realize that current law has created some competitive disparities between different types of institutions.

Section 401 also makes other useful modifications to interstate operations. It removes a minimum requirement on the age of a bank that is acquired by an out-of-State bank. It allows State bank supervisors to permit State banks to engage in interstate trust activities similar to the trust activities permissible for national banks. It facilitates mergers and consolidations between insured banks and uninsured banks with different home States. All of these changes facilitate the provision of banking products and services to consumers.

Coordination of State Exams

A second provision related to interstate banking that we would urge the Committee to incorporate in its version of regulatory relief legislation is Section 619 of H.R. 3505. Section 619 of H.R. 3505 clarifies the authority of State banking supervisors over interstate branches of State-chartered banks. It provides that the banking supervisor of the State in which a bank is chartered (a "home" State supervisor) is responsible for the examination and supervision of branches located in other States, and that only a home State supervisor may impose supervisory fees on interstate branches. Section 619 also encourages State banking supervisors to enter into cooperative supervisory agreements related to the examination and supervision of State banks with interstate operations. Such an agreement could provide for joint examinations, and even the assessment of joint supervisory fees. Furthermore, Section 619 acknowledges the authority of a "host" State banking supervisor to examine the interstate branches of State banks for compliance with host State law.

The addition of this provision will help to avoid needless confusion, and potential conflict, over the examination and supervision of the interstate branches of State banks.

Regulation of Thrift Institutions

While the Roundtable supports all of the thrift provisions in H.R.3505, I would highlight four of those provisions, which are particularly important to our members.

Diversity Jurisdiction

Under the law, citizens of two different States may avail themselves of the Federal courts if certain jurisdictional thresholds are met. Every corporation is deemed to be a citizen of two States: (1) the State of incorporation; and (2) the State in which it has its principal place of business, if different. Thus a company with offices in every State will still be able to use the Federal courts, as long as the other party is not a citizen of the company's "home" State.

Federal savings associations are treated differently. For Federal savings associations, there is no provision governing their citizenship, and this issue has been litigated over and over.

We urge the Committee to amend the law to clarify that a Federal savings association is a citizen of the State in which the institution's main or home office is located. This would put Federal thrift associations under the same rules that apply to every other corporation in America.

Parity for Thrifts Under the Federal Securities Laws

Section 201 of H.R. 3505 would establish regulatory parity between the securities activities of banks and thrifts. For years, the brokerage and investment activities of commercial banks have enjoyed exemptions under Federal securities laws.[3] As a result, the securities activities of banks have been subject to regulation by banking regulators, not the Securities and Exchange Commission. Thrift institutions, on the other hand, have not enjoyed similar exemptions under the Exchange Act or the Investment Advisers Act, even though Congress has, over time, permitted thrifts to engage in the same brokerage and investment activities as commercial banks.[4] As a result, the securities activities of thrifts have been subject to regulation by both the Securities and Exchange Commission (SEC) and the Office of Thrift Supervision (OTS).

Using its rulemaking powers, the SEC has attempted to address this regulatory disparity, first by granting thrifts a regulatory exemption under the Exchange Act, and, most recently, by proposing a limited exemption for thrifts under the Investment Advisers Act. Unfortunately, those actions by the SEC do not fully resolve the disparity between the regulation of banks and thrifts. Therefore, we urge the Committee to include Section 201 in its version of regulatory relief legislation.

Section 201 would establish an explicit exemption for thrifts in the Exchange Act that is comparable to the exemption for commercial banks. This statutory change would remove any doubt about the permanence of the existing regulatory exemption adopted by the SEC.

Section 201 also would make the exemption for thrifts under the Investment Advisers Act parallel to the current exemption for banks. The regulation recently proposed by the SEC grants thrifts an exemption from SEC regulation only when they are engaged in investment advisory activities in connection with trust activities. It would not apply to other investment advisory services, such as retail planning services. Section 201 draws no such distinction. It would give thrifts the same exemption as commercial banks.

The OTS examines the securities-related activities of thrifts, just as the OCC and other banking agencies examine the securities-related activities of commercial banks. Thus, the exemptions proposed in Section 201 do not leave a regulatory void. They simply place thrifts on regulatory par with commercial banks, by eliminating the costs associated with registration with the SEC.

Auto Loans

The Roundtable urges the Committee to incorporate Section 208 of H.R. 3505 in its version of regulatory relief legislation. Current law limits the amount of automobile loans by a thrift to no more than 35 percent of the institution's assets. Section 208 would remove this ceiling. Congress has previously determined that credit card loans and education loans by thrifts should not be subject to any asset limitation. Automobile loans should be placed in this same category. Doing so will allow thrifts to further diversify their portfolios and enhance their balance sheets. Also, this provision would increase competition in the auto loan business, to the benefit of consumers.

Dividends

The Roundtable supports Section 204 of H.R. 3505. Section 204 would replace a mandatory dividend notice requirement for thrifts owned by savings and loan holding companies with an optional requirement under the control of the Director of OTS. The existing mandatory requirement is no longer necessary. Other existing Federal statutes and regulations give the OTS the authority to ensure that thrifts held by holding companies pay dividends only in appropriate circumstances. Moreover, the current mandatory requirement applies only to thrifts owned by savings and loan holding companies, not to those owned by other companies or banks. Thus, Section 204 removes a regulatory disparity that need not exist.

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[3] The scope of this exemption was narrowed in the Gramm-Leach-Bliley Act.

[4] In 1999, Congress did amend the Investment Company Act to treat thrifts the same as banks.

Cross Marketing

Presently, an insurance affiliate of a financial holding company may engage in cross-marketing with a company in which the insurance affiliate has made an investment if (1) the cross-marketing takes place only through statement inserts and Internet websites; (2) the cross-marketing activity is conducted in accordance with the antitying restrictions of the Bank Holding Company Act (BHCA); and (3) the Board determines that the proposed arrangement is in the public interest, does not undermine the separation of banking and commerce, and is consistent with the safety and soundness of depository institutions. Under current law, however, a merchant banking affiliate of a financial holding company may not engage in such limited cross-marketing activities with the companies in which it makes investments. The Roundtable urges the Committee to amend the BHCA and establish parity of treatment between financial holding companies that own insurance affiliates and those that own merchant banking affiliates.

We also urge the Committee to permit a depository institution subsidiary of a financial holding company to engage in cross-marketing activities with a nonfinancial company held by a merchant banking affiliate if the nonfinancial company is not controlled by the financial holding company. When a financial holding company does not control a portfolio company, cross-marketing activities are unlikely to materially undermine the separation between banking and commerce.

In these noncontrol situations, the separation of banking and commerce is maintained by the other restrictions contained in the BHCA that limit the holding period of the investment and restrictions that limit the financial holding company's ability to manage and operate the portfolio company.

These proposed modifications to the BHCA were incorporated in Section 501 of H.R. 3505.

SEC Regulation of Broker-Dealers

Sections 201 and 202 of the Gramm-Leach-Bliley Act were intended to provide for SEC regulation of certain new securities activities, but permit banks to continue to engage directly in traditional trust and accommodation activities, that have long been regulated by the banking agencies. The Gramm-Leach-Bliley Act never envisioned that banks would be forced to "push out" traditional trust activities into SEC regulated companies. Despite this clear Congressional intent, the SEC has issued proposed regulations that would do exactly that—it would force banks to divest historic business lines and push them out to registered broker-dealers. The Federal Reserve and the OCC have objected to these proposed regulations, and their comment letter to the SEC emphasizes the importance of issuing a regulation that conforms to Congressional intent.

Nevertheless, the SEC appears adamant in going forward with a far-reaching regulation that would effectively require banks to cease engaging in many traditional banking activities. The Committee should amend the Gramm-Leach-Bliley Act to strike Sections 201 and 202 to ensure that banks may continue to engage in traditional banking functions without the threat of having to push these activities out into a nonbanking company.

Anti-Tying

We urge the Committee to repeal the price variance feature of the existing antitying rule so that a banking institution can give a price break to commercial customers if that commercial customer decides to purchase other products and services from the institution. Banks should have the ability to offer a commercial customer a price break on a product or service if the commercial customer decides to buy another product or service. This change would not encourage antitrust activities. Unlike the classic tying case, the customer could not be forced into buying a product. If the customer thinks the price break is good enough, he or she can buy the product. If the customer does not think the price break is good enough, he or she is under no obligation to buy the product. Furthermore, our proposed change would apply only to commercial customers, not individuals or small businesses.

Simplified Privacy Notice

Like many consumers, the Roundtable member companies have found that the privacy notice required by the GLBA is overly confusing, and largely ignored by many consumers.

Accordingly, we recommend that the Committee use this opportunity to simplify the form of the notice required by GLBA.

There is extensive research in support of simple notices. That research indicates that consumers have difficulty processing notices that contain more than seven elements and require the reader to translate vocabulary used in the notice into concepts they understand. Consumer surveys also indicate that over 60 percent of consumers would prefer a shorter notice than the lengthy privacy policy mandated by GLBA.

Recognizing the problem created by the existing GLBA privacy notice, the Federal banking agencies, the FTC, NCUA, CFTC, and SEC recently requested comment on alternative notices that would be more readable and useful to consumers. These Federal agencies, however, lack the authority to make a simplified notice truly consumer-friendly because they cannot address conflicting and overlapping State privacy laws. Section 507 of GLBA permits individual States to adopt privacy protections that are "greater" than those established by GLBA. This provision allows States to adopt their own privacy notices, and this simply adds to consumer confusion and frustration.

We strongly recommend that the Committee include a provision in its version of regulatory relief legislation that directs the relevant Federal agencies to finalize a simplified privacy notice for purposes of GLBA, and provides that such a notice supersede State privacy notices. As the research has indicated, consumers will be better served if they are given a simple, uniform explanation of an institution's privacy policy and their privacy rights.

Real Estate Brokerage

The Financial Services Roundtable strongly supports the authorization of financial services holding companies to engage in real estate brokerage activities. We believe that the Gramm-Leach-Bliley Act of 1999 clearly contemplated that this would be a permissible "financial activity" for financial services holding companies, and thus can be authorized by a joint rulemaking of the Treasury Department and the Federal Reserve Board. We also strongly support legislation, such as H.R. 2660 sponsored by Chairman Oxley and Ranking Member Frank in the House, that would define this activity as "financial" without the need for a rulemaking proceeding.

Conclusion

In conclusion, the Roundtable appreciates the efforts of the Committee to eliminate laws and regulations that impose significant, and unnecessary, burdens on financial services firms and the American consumer. The costs savings that will result from this regulatory relief legislation will benefit the consumers of financial products and services. We look forward to working with the Committee on this important legislation.

PREPARED STATEMENT OF JOE McGEE

PRESIDENT & CEO, LEGACY COMMUNITY FEDERAL CREDIT UNION
BIRMINGHAM, AL ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION

MARCH 1, 2006

Chairman Shelby, Ranking Member Sarbanes, Senator Crapo, and other Members of the Committee, I am Joe McGee, President and CEO of the Legacy Community Federal Credit Union in Birmingham, Alabama. I appreciate the opportunity to represent the Credit Union National Association (CUNA) at this hearing to address legislation to help alleviate the regulatory burden under which all federally insured depository institutions operate today. CUNA is the largest credit union advocacy organization, representing over 90 percent of our Nation's approximately 8,800 State and Federal credit unions and their 87 million members.

Legacy Community Federal Credit Union, originally University FCU serving UAB, has recently converted to a community charter, serving 7 counties in Alabama. At Legacy Community Federal Credit Union, our motto is "Your Life, Your Legacy." We aim to treat all of our members with respect and dignity and we offer honest, fair deals to all members at all times. We deliver a wide range of low cost products and services to the diverse economic and social make-up of our members and potential members and always look out for better ways to reach out to the under served within our field of membership.

At Legacy, we put forth every effort to enable our members to become financially self-sufficient and successful. We place a high priority on consumer education and the teaching of financial thrift as demonstrated through our homebuyer and financial planning seminars, free financial planning services, website, consumer education library, consumer credit counseling programs as well as programs in which we advocate for the elderly, such as our Gate Keeper Program. Our multilingual staff work with our members to provide free checking accounts, experienced-based lending, a special educational loan program to promote continued learning, as well as a student loan program with reduced payments and interest rates.

I am extremely proud to speak on behalf of the Nation's credit unions today because credit unions benefit America. We are the only financial institutions that are run solely for the benefit of the people who use their services—not for the benefit of stockholders, or the board of directors, or the institution itself. We operate without paying a dime to most of our boards of directors, and without providing stock options to our senior management. We do this because of the devoted efforts of tens of thousands of selfless volunteers for whom credit unions are not just a business, but a cause. We do this "not for charity, not for profit, but for service." That attitude makes us unique. Now we are asking for Congress's help in continuing the not-for-profit, people-oriented, cooperative work we do.

Credit Unions are Unique Depository Institutions

CUNA is pleased that the Senate Banking Committee is moving forward with this initiative to provide America's financial institutions with well needed regulatory relief of costly and outdated burdens. Some might mistakenly believe that the Credit Union Membership Access of 1998 (CUMAA, Pub. L. No. 105–219)) was the credit union version of regulatory relief. While that law did provide relief from an onerous 1998 U.S. Supreme Court decision severely restricting fields of membership of Federal credit unions, it also imposed several new, stringent regulations on credit unions, which are most severely regulated group of all insured financial institutions.

Congress in CUMAA directed the U.S. Department of the Treasury to evaluate the differences between credit unions and other types of Federally insured financial institutions, including any differences in the regulation of credit unions and banks. The 2001 Treasury study, "Comparing Credit Unions with Other Depository Institutions," found that while "credit unions have certain characteristics in common with banks and thrifts, (for example, the intermediation function), they are clearly distinguishable from these other depository institutions in their structure and operational characteristics."

When Congress amended the Federal Credit Union Act with the passage of CUMAA in 1998, it included a preamble which enumerated the characteristics that differentiate credit unions from other depository institutions and from the foundation on which the Federal tax exemption for credit unions rests. The preamble states:

> "Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are:

- member-owned,
- democratically operated,
- not-for profit organizations,
- generally managed by volunteer boards of directors, and
- because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means."

Other 1998 Congressional findings in CUMAA also emphasize the unique nature of credit unions:

(1) "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means."

(2) "Credit unions continue to fulfill this public purpose and current members and membership groups should not face divestiture from the financial services institution of their choice as a result of recent court action."

Recognition and appreciation of these fundamental attributes are critical to understanding credit unions. As Treasury stated in its study, "Many banks or thrifts exhibit one or more of . . . (these) characteristics, but only credit unions exhibit all five together."

As unique institutions, credit unions today stand distinctly in need of regulatory relief.

Credit Unions' Regulatory Burden is Real and Relief is Imperative

Regulatory burden is an issue for all financial institutions in general, and for credit unions in particular. Indeed, *credit unions are the most heavily regulated of all financial institutions.* Credit unions are, for instance, subject to the same consumer protection laws as other financial institutions (such as Truth-Lending, Equal Credit Opportunity, Fair Credit Reporting Act, Home Mortgage Disclosure, Real Estate Settlement Procedures Act, Truth-in-Savings, and the Expedited Funds Availability Act), the ever-increasing requirements of the Bank Secrecy Act, and a broad array of safety and soundness rules. In addition, credit unions have an extensive list of unique operating restrictions, including the following:

- Credit unions are the only type of financial institution that have field of membership restrictions on whom they may serve.
- Credit unions may not raise capital in the marketplace but must rely on retained earnings to build equity.
- Credit unions are the only group of financial institutions that must meet *statutory* net worth requirements under the prompt corrective action (PCA) provisions.
- Credit unions face severe limitations on member business lending.
- Federal credit unions have a Federal usury ceiling, limitations on loan maturities, and stringent limitations on their investment options.
- Federal credit unions' governance practices are inflexible because many aspects are fixed in statute.

As discussed in detail below, there are two major areas of concern that CUNA asks be addressed by this Committee in regulatory relief legislation: The prompt corrective action (PCA) provisions in Section 216 of the Federal Credit Union Act (12 U.S.C. § 1790d); and the member business loan cap in Section 107A (12 U.S.C. § 1757a) of the Act. These provisions were added to the law in 1998 as part of the CUMAA legislation.

The unnecessarily inflexible PCA requirements were imposed on federally insured credit unions in 1998, not because of any problems with credit unions, but simply because PCA had been imposed on banks and thrift institutions several years earlier and some in Congress and the Treasury Department felt credit unions and its regulator should be subject to similar standards. However, as formulated in 1998, the credit union PCA standards are not, in fact and application, similar. The statutory net worth requirements direct federally insured credit unions to maintain a minimum of 6 percent net worth to total assets in order to meet the definition of an adequately capitalized credit union. Well-capitalized credit unions must meet a 7 percent net worth ratio. "[T]his exceeds the 4 percent Tier 1 level ratio applicable for banks and thrifts (and is statutory as opposed to regulatory)," Treasury noted in its 2001 study. "Complex" credit unions have additional net worth requirements.

The member business loan cap imposed in 1998 is also unnecessarily restrictive and arbitrary in nature. Treasury's 2001 analysis pointed to the fact that "Federal credit unions have more limited powers than national banks and Federal saving associations. Most notably, Federal credit unions face stricter limitations on their (member business) . . . lending and securities activities."

A federally insured credit union's member business loan (MBL) aggregate portfolio may not exceed the lesser of 1.75 times its net worth or 12.25 percent of total assets, unless the credit union is chartered to make such loans, has a history of making such loans or has been designated as a community development credit union. By comparison, banks have no specific limits on commercial lending, and thrifts may place up to 20 percent of their assets in a combination of small business loans and other commercial loans. There are other limitations on credit unions' member business lending that do not apply to commercial banks. For instance, a Federal credit union's member business loan is generally limited to a 12-year maturity and can only be made to members.

Unlike banks, credit unions have not received new statutory powers for many years. In 2003, the Filene Research Institute published a study by Professor William E. Jackson III of the University of North Carolina at Chapel Hill, which looked at the efforts of Congress over the last two decades to provide regulatory relief for traditional depository institutions and whether more relief for credit unions is reasonable and appropriate.

The study reviewed sources of funding, investments, and the ownership structure of banks, thrifts, and credit unions and found that the operational differences among these types of institutions are "distinctive." It observed that since 1980, Congress has enacted a number of statutory provisions that have noticeably changed the regulatory environment in which banks and thrifts conduct business, such as by deregulating liabilities, removing restrictions on interstate branching, and expanding the list of activities permissible for financial holding companies.

Most recently, the Gramm-Leach-Bliley Act of 1999 expanded the statutory definition of the kinds of products and services in which banks may engage. Under the Act, banking institutions may engage in activities that are merely "financial in nature" as opposed to those that are "closely related to banking." The bank regulators have the authority to determine what is permissible as "financial in nature." Credit unions were not included in any sweeping, statutory expansion of powers, but they were included in the substantial requirements under the Act regarding privacy, including requirements to communicate their member privacy protection policies to members on an annual basis.

The credit union study noted, "Credit unions face stricter limitations on their lending and investing activities" than other institutions bear. "In general, *credit unions have received less deregulation than either banks or thrifts,"* the study concluded.

CUNA endorsed the regulatory relief legislation that was passed by the House of Representatives in 2004, and supports H.R. 3505, the Financial Services Regulatory Relief Act, which has been approved by both the House Financial Services Committee and the House Judiciary Committee. This bill contains a number of amendments to the Federal Credit Union Act advocated by CUNA. However, the legislation does not include two key provisions that we urge this Committee to make a high priority for inclusion in its regulatory relief bill, provisions found in H.R. 2317, the Credit Union Regulatory Improvements Act (CURIA), which has garnered notable bi-partisan support in the House.

Prompt Corrective Action Reform

CUNA strongly supports amending the system of prompt corrective action for credit unions by establishing a dual ratio requirement: A pure leverage ratio and a net worth to risk-asset ratio. The resulting system would be comparable to the system of PCA in effect for FDIC-insured institutions while taking into account the unique operating characteristics of cooperative credit unions.

History of the PCA Provisions

Net worth requirements were not the original purpose of the CUMAA. The genesis of the 1998 Act was the Supreme Court's field of membership decision that prohibited NCUA from approving Federal credit union fields of membership comprising more than one group. Since its adoption 8 years ago, NCUA and credit unions have had sufficient time to experience PCA requirements. Therefore, it is not surprising that there should be a need for some modifications to PCA now that the NCUA and the credit union movement have been operating under PCA for several years.

The PCA section of CUMAA established for the first time "capital" or "net worth" requirements for credit unions. Prior to that time, credit unions were subject to a requirement to add to their regular reserves, depending on the ratio of those reserves to "risk-assets" (then defined as loans and long-term investments). The purpose of PCA section of the Act (Section 1790d) is "to resolve the problems of insured credit unions at the least possible long-term loss to the Fund." The CUMAA instructs the NCUA to implement regulations that establish a system of PCA for credit unions that is consistent with the PCA regime for banks and thrifts under the 1991 Federal Deposit Insurance Corporation Improvement Act (FDICIA) but that takes into account the unique cooperative nature of credit unions.

There are, however, a number of ways that credit union PCA under CUMAA differs from PCA as it applies to banks and thrifts under FDICIA. Key differences are:

- The net worth levels that determine a credit union's net worth classification are specified in the Act rather than being established by regulation as is the case for banks and thrifts.
- The levels of the net worth ratio for a credit union to be classified "well" or "adequately" capitalized are 2 percentage points (200 basis points) above those currently in place for banks and thrifts, even though credit unions' activities are far more circumscribed than those of banks.
- The system of risk-based net worth requirements for credit unions is structured very differently from the Basel-based system in place for banks and thrifts. For example, the Basel system is credit-risk based while credit union risk-based net worth requirements explicitly account for the difficult-to-quantify interest rate risk. In PCA as implemented under FDICIA, interest rate risk at banks and thrifts is instead dealt with through examination and supervision.

The Need for PCA Reform

There are two basic problems with the current credit union PCA system:

- *There are unnecessarily high basic credit union capital requirements.* Credit unions have significantly higher capital requirements than do banks, even though the National Credit Union Share Insurance Fund (NCUSIF) has an enviable record compared to other Federal deposit insurance funds. Indeed, because credit unions' cooperative structure creates a systemic incentive against excessive risk taking, it has been argued that credit unions actually require less capital to meet potential losses than do other depository institutions.
- *The current risk-based PCA system is imprecise.* The current system of risk-based net worth requirements for credit unions provides an imprecise treatment of risk.

It is only when a portfolio reaches a relatively high concentration of assets that it signals greater risk and the need for additional net worth. This system weakens the measurement of the NCUSIF's exposure to risk, and provides blurred incentives to credit unions on how to manage their balance sheets so as to minimize risk. A Basel-type method of applying different weights to different types of assets based on the asset's risk profile would permit a more precise accounting for risk than does the current credit union PCA system, thus improving the flow of actionable information regarding net worth adequacy to both regulators and credit unions.

Taken together, these problems have created an unnecessary constraint on healthy, well-managed credit unions. Credit unions agree that any credit union with a net worth ratio well below those required to be adequately capitalized should be subject to prompt and stringent corrective action. There is no desire to shield such credit unions from PCA—they are indeed the appropriate targets of PCA. Because credit unions themselves fund the NCUSIF, they are keenly aware that they are the ones that pay when a credit union fails. Therefore, *CUNA strongly supports a rigorous safety and soundness regulatory regime for credit unions that is anchored by meaningful and appropriate net worth requirements which drive the credit union system's PCA requirements.*

Under the current system of PCA, however, there are many credit unions that have more than enough capital to operate in a safe and sound manner but feel constrained in serving their members because potential reductions in their net worth category can result from growth in member deposits, even when not induced by the credit union. The current law stipulates that a credit union with a 6 percent net worth ratio is "adequately" capitalized. Considering the risk exposure of the vast majority of credit unions and the history of their Federal share insurance fund, 6 percent is more than adequate net worth.

As a result of the effect of potential growth on a credit union's net worth ratio under the present system of PCA, a very well run, very healthy, very safe and sound credit union feels regulatory constraints operating with a 6 percent net worth ratio. Without access to external capital markets, credit unions may only rely on retained earnings to build net worth. Thus, a spurt of growth brought on by members' desire to save more at their credit union can quickly lower a credit union's net worth ratio, even if the credit union maintains a healthy net income rate.

Any credit union can be hit with sharp and unexpected increases in member deposits, which are the primary source of asset growth for credit unions. This can happen whenever credit union members face rising concerns either about their own economic or employment outlook (as in a recession) or about the safety of other financial investments they may hold (as when the stock market falls). A recent example is the influx of funds by members of certain Gulf Coast credit unions who deposited insurance payments as a result of Hurricane Katrina. The resulting deposit building translates into large swings in deposit inflows without any additional effort by the credit union to attract deposits. As an example, total credit union savings growth rose from 6 percent in 2000 to over 15 percent in 2001 despite the fact that credit unions lowered their savings dividend rates sharply throughout the year. The year 2001 produced both a recession and falling stock market, and was topped off with the consumer confidence weakening effects of the September terrorist attacks.

Credit union concern about the impact of growth triggered by external factors on net worth ratios goes far beyond those credit unions that are close to the 6 percent cutoff for being considered adequately capitalized. Because of the conservative management style that is the product of their cooperative, volunteer-run structure, most credit unions seek always to be classified as "well" rather than "adequately" capitalized. In order to do that, they must maintain a significant cushion above the 7 percent level required to be "well" capitalized so as not to fall below 7 percent after a period of rapid growth. A typical target is to have a 200 basis point cushion above the 7 percent standard. Thus, in effect, the PCA regulation, which was intended to ensure that credit unions maintain a 6 percent adequately capitalized ratio, has created powerful incentives to induce credit unions to hold net worth ratios roughly 50 percent higher than that level, far in excess of the risk in their portfolios. The PCA regulation in its present form thus drives credit unions to operate at "overcapitalized" levels, reducing their ability to provide benefits to their members, and forcing them instead to earn unnecessarily high levels of net income to build and maintain net worth.

There are two ways to resolve the problems with the current system of PCA. One would be to permit credit unions to issue some form of secondary capital in a way that both provides additional protection to the NCUSIF and does not upset the unique cooperative ownership structure of credit unions. Although CUNA believes that credit unions should have greater access to such secondary capital, this is not something CUNA is advocating as part of regulatory relief legislation.

The preferable solution is to amend the PCA requirements. PCA reform should have two primary goals. First, CUNA believes any reform should preserve the requirement that regulators must take prompt and forceful supervisory actions against credit unions that become seriously undercapitalized, maintaining the very strong incentives for credit unions to avoid becoming undercapitalized. This is essential to achieving the purpose of minimizing losses to the NCUSIF. Second, PCA requirements should not force well-capitalized credit unions to feel the need to establish a large buffer over minimum net worth requirements so that they become overcapitalized.

CUNA advocates reforming PCA in a manner consistent with these two requirements by transforming the system into one with net worth requirements comparable to those in effect for FDIC-insured institutions, and that is much more explicitly based on risk measurement by incorporating a Basel-type risk structure.

Specific PCA Amendments

CUNA strongly urges amendments to the Federal Credit Union Act so that a credit union's PCA capitalization classification would be determined on the basis of two ratios: The net worth ratio and the ratio of net worth to risk assets. The net worth ratio would be defined as net worth less the credit union's deposit in the NCUSIF, divided by total assets less the NCUSIF deposit. The ratio of net worth to risk assets would be defined as net worth minus the NCUSIF deposit divided by risk assets, where risk assets would be designed in a manner comparable to the Basel system in effect for banks of similar size to credit unions.

Specifically, CUNA urges the Committee to include in regulatory relief legislation provisions to change the PCA requirements for credit unions (Section 216 of the Federal Credit Union Act, 12 U.S.C. § 1790d) as follows:

1. Amend the net worth categories: The Federal Credit Union Act specifies net worth ratios that, along with a risk-based net worth requirement, determine a credit union's net worth category. The Act should continue to specify net worth requirements, but at levels more appropriate for credit unions and comparable to those currently in effect for banks and thrift institutions. See the chart below for the proposed categories for net worth ratios.

2. Amend the risk-based net worth categories: Currently, federally insured credit unions that are considered "complex" must meet a risk-based net worth requirement. The Act should require all credit unions to meet a risk-based net worth requirement and should direct the NCUA Board to design the risk-based requirement appropriate to credit unions in a manner more comparable to risk standards for FDIC-insured institutions. The right column in the chart below provides information on appropriate ratios of net worth to risk assets.

3. Provide NCUA with the flexibility to address other risk criteria: Current risk-based net worth requirements for credit unions incorporate measures of interest-rate risk as well as credit risk. The comparable standards for risk-based capital requirements for FDIC-insured institutions deal only with credit risk. The NCUA Board should have the authority to delegate to NCUA's regional directors the authority to lower by one level a credit union's net worth category for reasons of interest rate risk only that is not captured in the risk-based ratios.

4. Amend the definitions relating to net worth: Net worth, for purposes of PCA, is currently defined as a credit union's retained earnings balance under generally accepted accounting principles. The Financial Accounting Standards Board (FASB) is finalizing guidance, expected to be effective in 2007, on the accounting treatment of mergers of cooperatives that would create a new component of net worth, in addition to retained earnings, after a credit union merger. The unintended effect of the FASB rule will be to no longer permit a continuing credit union to include the merging credit union's net worth in its PCA calculations. FASB's application of its proposal to credit unions will mean that a credit union's PCA net worth would typically be understated by the amount of the fair value of the merging credit union's retained earnings, that is, part of GAAP net worth would be excluded from regulatory net worth. This anomaly must be addressed by including a definition of net worth for purposes of PCA to include the new component for post-merger credit unions.

Without an amendment to the PCA definition, the FASB pronouncement will have the unintended consequence of discouraging, if not eliminating, voluntary mergers that, absent FASB's policy, would be advantageous to credit union members involved. In addition, FASB's application of its proposal to credit unions will mean that a credit union's net worth would typically be understated by the amount of the fair value of the merging credit union's retained earnings. This result is not in the public interest. That is why CUNA, along with the NCUA and others, supports a technical correction that would amend the Federal Credit Union Act to make it clear that net worth equity, including acquired earnings of a merged credit union as determined under GAAP, and as authorized by the NCUA Board, would be acceptable for calculating PCA ratios.

Senior legal staff at FASB has indicated support for a legislative approach, and we urge the Committee to address this problem, well in advance of the effective date, so credit unions will have certainty regarding the accounting treatment of mergers. The House of Representatives approved by voice vote on June 13, 2005 a bill specifically solving this problem, H.R. 1042, the "Net Worth Amendment of Credit Unions Act."

Several other changes in the PCA-related definitions are needed. The definition of secondary capital for low-income credit unions needs to address certain limitations on its use by those credit unions. The definition of the net worth ratio also needs to be modified to exclude a credit union's National Credit Union Share Insurance Fund (NCUSIF) deposit from the numerator and denominator of the ratio; the ratio of net worth to risk-assets must also exclude a credit union's NCUSIF deposit from the numerator.

5. Amend the net worth restoration plan requirements: The NCUA Board should have the authority to permit a marginally undercapitalized credit union to operate without a net worth restoration plan if the Board determines that the situation is growth-related and likely to be short term. The law should also authorize the Board to issue an order to a critically undercapitalized credit union and possibly shorten the timing of the period before appointment of a liquidating agent. CUNA would also like to see an amendment clarifying the coordination requirement with State officials in the case of State-chartered credit unions.

How the PCA Amendments Would Work

The table below shows the ratio cutoff points for the various net worth classifications CUNA advocates. A credit union would have to meet both ratio classifications, and if different, the lower of the two classifications would apply. For example, a credit union classified as "well-capitalized" by its net worth ratio, but "undercapitalized" by its ratio of net worth to risk assets, would be considered undercapitalized.

Net Worth Categories	**Net Worth Ratio**	**Ratio of Net Worth to Risk Assets**
Well Capitalized	5% or greater	8% or greater
Adequately Capitalized	4% to < 5%	8% or greater
Undercapitalized	3% to < 4%	6% to 8%
Significantly Undercapitalized	2% to < 3%	< 6%
Critically Undercapitalized	<2%	NA

The proposed net worth cutoff points are substantially similar to those currently in effect for FDIC-insured institutions. Nevertheless, the ratios would have the effect of being more stringent on credit unions for two reasons. First, not all of an individual credit union's net worth would be included in the numerator of the ratio—the NCUSIF deposit would first be subtracted. Second, a portion of banks' net worth can be met by secondary or Tier II capital. All but low-income credit unions have no access to secondary capital, so all credit union net worth is equivalent to banks' Tier I capital, which has more characteristics of pure capital than does Tier II.

In the PCA reforms CUNA envisions, NCUA would have to design a risk-based net worth requirement based on comparable standards applied to FDIC-insured institutions. The outlook for those standards as they will apply to banks is currently under review by the Federal banking regulators. Federal banking regulators have indicated that if Basel II takes affect for the very largest U.S. banks (approximately 25 banks and thrifts), some modifications to Basel I for all other U.S. banks will be implemented.

The exact nature of the changes to Basel I for the vast bulk of U.S. banks and thrifts is as yet unclear, although U.S. banking regulators have stated they do not intend to permit smaller U.S. banks to be disadvantaged compared to the largest banks if Basel II lowers net worth requirements for the very large institutions. Thus, it is likely that any modified version of Basel I in place for smaller banks would be the standard under which NCUA would construct a risk-weighting system for credit unions. Since it would be Basel-based, it would focus on credit risk, leaving the treatment of interest rate risk to the supervisory process (our third recommendation). This kind of reformed credit union risk-based system would provide a much more precise measure of balance sheet risk than the current risk-based net worth requirement.

The PCA reform plan will improve the risk-based components of PCA and place greater emphasis on the risk-based measures, while lowering to the same level in effect for banks the pure net worth ratio requirements for a credit union to be classified as adequately capitalized. CUNA believes that in addition to relying on improved risk measurements, a reduction of the pure net worth levels to be classified as well- or adequately capitalized is justified for the following reasons:

- *We proposed subtracting out the 1 percent NCUSIF deposit in calculating the net worth ratio.* One of the original justifications for higher credit union PCA net worth requirements (higher than for banks) was the 1 percent NCUSIF deposit. While FASB and NCUA have both affirmed that the 1 percent NCUSIF deposit is an asset and thus part of net worth, as a result of the unique credit union funding mechanism of the NCUSIF, the 1 percent deposit appears on the books of both the NCUSIF and insured credit unions. We propose to address this issue by defining the net worth ratio as "net worth less the 1 percent NCUSIF deposit divided by assets less the 1 percent deposit." Thus, to be adequately capitalized, a credit union must hold net worth equal to about 5.7 percent (on average) of its assets to meet the 5 percent net worth requirement. This means that the discretionary and mandatory supervisory actions of PCA will be applied when a credit union is at higher level of individual capital than for a similarly situated bank or thrift.
- *Although credit unions cannot access capital markets, banks experiencing problems are unlikely to have ready access to capital markets.* Another reason given for credit unions' higher-than-banks net worth requirements is their lack of access to capital markets. Credit unions' only source of building net worth is through the retention of earnings, which is a time-consuming process. Since credit unions cannot access capital markets, drafters of the PCA requirements thought credit unions should hold more capital to begin with so that they have it available in time of need. There is some merit to this notion, but a problem with this logic is that is suggests that a poorly capitalized bank can easily access the capital markets. However, if a bank's capital ratio falls substantially due to losses, investors are likely to be wary of providing additional capital to it. Other institutions similarly have limited access to capital markets when they have experienced substantial losses. Thus, the lack of effective access to outside capital in times of financial stress might not really distinguish credit unions from banks or other depository institutions as much as it might appear.
- *Credit unions have some control over growth by the dividends paid on savings.* A credit union's net worth ratio might fall due to rapid asset growth, but this should not require higher net worth requirements for credit unions. Asset growth, which comes from savings deposits, can often be substantially influenced by a credit union's dividend policies. Under the current PCA system, lowering dividend rates creates the dual effects of retarding growth and boosting net income, both of which raise net worth ratios. Our plan would permit a credit union to protect a reasonable net worth ratio with appropriate dividend rate cutting rather than being required to hold additional net worth.
- *There is substantial evidence that credit unions actually require less net worth than do for-profit financial institutions in order to provide protection to the deposit insurance system.* Credit unions, because of their very cooperative nature, take on less risk than do for-profit financial institutions. Because credit union boards and management are not enticed to act by stock ownership and options, the moral hazard problem of deposit insurance has much less room for play in credit unions than in other insured depository institutions. Evidence of the effects of this conservative financial management by credit unions is found in the fact that average credit union ratios for net worth, net income, and credit quality have shown dramatically less volatility over that past two decades than comparable statistics for banks and thrifts. Similarly, the equity ratio of the NCUSIF has been remarkably stable, between 1.2 percent and 1.3 percent, of insured shares while other Federal deposit funds have seen huge swings, and even insolvency. This is hardly evidence supporting the need of more capital in credit unions than in banks and thrifts.

Reforming PCA as outlined by our testimony would preserve and strengthen the essential share-insurance fund protection of PCA and would more closely tie a credit union's net worth requirements to its exposure to risk—the reason for holding net worth in the first place. It would also permit adequately and well-capitalized credit unions to operate in a manner devoted more to member service and less to the unnecessary accumulation of net worth.

Changes in Member Business Loan Statutory Requirements

Some mistakenly believe that credit unions first obtained authority to lend to businesses with the passage of the Credit Union Membership Access Act in 1998. On the contrary, CUMAA imposed statutory limits on credit union member business lending for the first time; until then, NCUA addressed business lending activities of credit unions through supervision and regulation. The CUMAA-imposed limits are expressed as a 1.75 multiple of net worth, but only net worth up to the amount required to be classified as well capitalized (that is, 7 percent) can be counted. Therefore, the limit is (1.75 x 7) or 12.25 percent of assets for most federally insured credit unions.

Credit unions are not major players in business lending, although there are some credit unions which feel they have a field of membership and expertise that would allow them to provide more businesses with more competitive options that currently permitted by the Federal Credit Union Act. At mid-year 2005, the dollar amount of credit union member business loans was less than 1 percent of the total commercial loans held by all U.S. depository institutions. Credit union MBL's represent just 3.8 percent of the total of credit union loans outstanding, and only one in five U.S. credit unions offer MBL's. The average size of credit union MBL's granted in the first 6 months of 2005 was $166,506.

Looking at Alabama credit union statistics, 34 credit unions out of a total of 159 in Alabama offer MBL's to their members. The average size of an Alabama MBL is $144,283. The total amount of business lending by credit unions in Alabama is $105.3 million, while banking institutions in Alabama make $76.3 billion in business loans. In Alabama, credit unions represent 0.14 percent of the market share for business lending, while banking institutions represent 99.86 percent; and, while credit union business loans represent only 0.98 percent of credit union assets, banking institutions' business loans represent 35.52 percent of bank assets.

Need for Reform of Credit Union Member Business Loan (MBL) Limits

Small businesses are the engine of economic growth, accounting for about one-half of private nonfarm economic activity in the United States annually. Their ability to access capital is paramount. Their access is seriously constrained by the double-whammy of banking industry consolidation and the CUMAA-imposed limitations on credit union MBL's. FDIC statistics show that the largest 100 banking institutions now control over 70 percent of banking industry assets nationally—in 1992, the 100 largest banks held about 45 percent of total banking industry assets.

Recent research published by the Small Business Administration reveals that small businesses receive less credit on average in regions with a large share of deposits are held by the largest banks. The findings reveal "credit access has been significantly reduced by banking consolidation . . . we believe this suggests that small businesses, especially those to which relationship lending is important, have a lower likelihood of using banks as a source of credit." CUMAA's member business restrictions on credit unions severely restrict small business access to credit outside the banking industry at a time when small firms are finding it increasingly difficult to obtain credit from the banking industry.

Basic problems with the current MBL limit include the following:

- *The limit is arbitrary and unnecessarily restrictive.* Insured commercial banks have no comparable business lending portfolio concentration limitations. Thrift institutions have portfolio concentration limitations, but those limitations are substantially less restrictive than the limits placed on credit unions in CUMAA. There is no safety and soundness reason that net worth above 7 percent cannot also support business lending. If all net worth could be counted, the actual limit would average between 18 percent and 19 percent of total assets rather than 12.25 percent of total assets.
- *The 12.25 percent cap discourages credit unions from entering into business lending.* Even though very few credit unions are approaching the 12.25 percent ceiling, the very existence of that limitation discourages credit unions from opening business lending departments. Credit unions must meet strict regulatory requirements before implementing an MBL program, including the addition of experienced staff. Many are concerned that the costs of meeting these requirements cannot be recovered with a limit of only 12.25 percent of assets. For example, in today's market, a typical experienced mid-level commercial loan officer would receive total compensation of approximately $100,000. The substantial costs associated with hiring an experienced lender, combined with funding costs and overhead and startup costs such as a data processing system to support this type of lending,

present a serious barrier at most credit unions given the current 12.25 percent limitation.

- *The MBL threshold definition creates a disincentive that hurts small businesses.* The current $50,000 threshold for defining an MBL is too low and creates a disincentive for credit unions to make loans to smaller businesses. Permitting the threshold to rise to $100,000 would open up a significant source of credit to small businesses. The NCUA Board was on the verge of revising its regulations to move the threshold to $100,000 when Congress incorporated the then $50,000 regulatory definition into the 1998 law. Even business purpose loans up to $100,000 are so small as to be unattractive to many larger commercial lenders. A simple inflation adjustment of the $50,000 threshold, which was initially established by regulation in 1993, would result in a threshold figure of $65,000.

Since their inception, credit unions have offered business-related loans to their members. Moreover, credit union member business lending shows a record of safety. According to a 2001 U.S. Treasury Department study entitled "Credit Union Member Business Lending," credit union business lending is more regulated than commercial lending at other financial institutions. In addition, in comparing delinquencies on business loans, Treasury found credit union delinquencies (business loans more than 60 days past due) were lower than those of banks and thrifts (business loans more than 90 days past due). Not surprisingly, the Treasury also concluded that member business lending "does not pose material risk" to the National Credit Union Share Insurance Fund. The trends continue today, and MBL's have even lower loss rates than other types of credit union lending, which themselves have relatively low loss experience.

CUNA's Regulatory Relief Recommendations for Economic Growth

In reforming credit union MBL limits in Section 107A of the Federal Credit Union Act (12 U.S.C. § 1757a), Congress will help to ensure a greater number of available sources of credit to small businesses throughout the country. This will make it easier for small businesses to secure credit at lower prices, in turn making it easier for them to survive and thrive.

CUNA urges that the following provisions be included in the Committee's regulatory relief bill:

1. Increase the limit on member business loans: Congress should eliminate the current asset limit on MBL's at a credit union (the lesser of 1.75 times actual net worth or 1.75 times net worth required for a well-capitalized credit union, or 12.25 percent) and replaces it with a flat rate of 20 percent of the total assets of a credit union. This provision would facilitate member business lending without jeopardizing safety and soundness at participating credit unions.

2. Increase the threshold of which business purpose loans are defined as member business loans: Congress should amend the current definition of a MBL to give NCUA the authority to exclude loans of $100,000 or less as de minimus, rather than the current limit of $50,000. Loans below the threshold do not apply against the cap, but more importantly, credit unions that are not in a position to open business lending departments that have to comply with NCUA's extensive MBL regulations can still help small businesses with smaller dollar loans.

3. Provide NCUA with the authority to address member business lending by undercapitalized credit unions: The Federal Credit Union Act currently prohibits a credit union from making any new MBL's if its net worth falls below 6 percent. NCUA should have the authority to determine how to address business lending by any undercapitalized credit union.

4. Exclude from the definition of member business loans to nonprofit religious organizations: The law currently provides exceptions to the MBL caps for credit unions with a history of primarily making such loans. Credit unions serving religious organizations were instrumental in persuading Congress to include this exception in the 1998 law. We believe that, when passing CUMAA, Congress simply overlooked the situation that other credit unions purchase parts of these loans (participate in them). We propose that the Act be amended to exclude from the MBL limit loans to or loan participations involving nonprofit religious organizations. While these types of loans would not be subject to the limit, such loans would still be subject to other regulatory requirements, such as those relating to safety and soundness.

5. Authorize Federal credit unions to lease space in credit union offices located in underserved areas: While not directly related to business lending, CUNA also supports an amendment to Section 107 of the Federal Credit Union Act (12 U.S.C. § 1757), but adding new authority which would enhance the ability of credit unions to assist distressed communities with their economic revitalization efforts. A Federal credit union maintaining a presence in an underserved area should be allowed to lease space in its building or on its property to third parties on a more permanent basis. This change would allow a Federal credit union to acquire, construct, or refurbish a building in an underserved community, then lease out excess space in that building which should assist in community development.

CUNA urges the Committee to include amendments to the member business lending provisions in the Federal Credit Union Act in its regulatory relief bill.

Other Amendments to the Federal Credit Unions Act

In addition to seeking amendments to the Federal Credit Union Act relating to prompt corrective action and member business loans, there are a number of other amendments to the Act that CUNA urges the Committee to include in its regulatory relief legislation. These are:

Leases of Land on Federal Facilities for Credit Unions

We support an amendment to Section 124 of the Federal Credit Union Act (12 U.S.C. § 70) which would permit military and civilian authorities responsible for buildings on Federal property the discretion to extend real estate leases at minimal charge to credit unions that finance the construction of credit union facilities on Federal land. Credit unions provide important financial benefits to military and civilian personnel, including those who live or work on Federal property. This amendment would authorize an affected credit union, with the approval of the appropriate authorities, to structure low cost lease arrangements which would enable the credit union to channel more funds into lending programs and favorable savings rates for its members.

Investments in Securities by Federal Credit Unions

The Federal Credit Union Act's limitations on the investment authority of Federal credit unions are anachronistic. CUNA supports an amendment to Section 107 of the Federal Credit Union Act (12 U.S.C. § 57) to provide additional investment authority for credit unions to purchase for their own accounts certain investment securities. The NCUA Board should have the authority to define appropriate investments under this provision, thus ensuring that new investment vehicles would meet high standards of safety and soundness and be consistent with credit union activities. The total amount of the investment securities of any one obligor or maker should not exceed 10 percent of the credit union's unimpaired capital and surplus

Increase in the General 12-Year Maturity Limit Applicable to Federal Credit Union Loans

Currently, Federal credit unions are authorized to make loans to members, to other credit unions, and to credit union service organizations. The Federal Credit Union Act imposes various restrictions on these authorities, including a 12-year maturity limit that is subject to exceptions for certain types of loans, such as mortgage loans. The Federal Credit Union Act (Section 107(5), 12 U.S.C. § 1757(5)) should allow loan maturities up to 15 years, or longer terms as permitted by the NCUA Board. While we would prefer that loan maturities be completely removed from the statute, leaving NCUA with the authority to determine the maturity on loans consistent with safety and soundness, a 15-year maturity is preferable to the current limit. Such an increase in the loan limit would help lower monthly payments for credit union borrowers.

Increase in the 1 Percent Investment Limit in Credit Union Service Organizations

The Federal Credit Union Act authorizes Federal credit unions to invest in organizations providing services to credit unions and credit union members. An individual Federal credit union, however, may invest in the aggregate no more than 1 percent of its total paid-in and unimpaired capital and surplus in these organizations, commonly known as credit union service organizations (CUSO's). CUNA asks the Committee to include an amendment to raise the limit in Section 107(7)(I) (12 U.S.C. § 1757(7)(I)) to 3 percent.

CUSO's provide a range of services to credit unions and their members. Some services directly support credit union operations such as data processing, record retention and debt collection. Other services directly benefit members such as financial planning, retirement planning and shared branching. Utilizing services provided through a CUSO reduces risk to a credit union and allows it to take advantage of economies of scale and other efficiencies that help contain costs to the credit union's members. Further, a Federal credit union's participation in CUSO's is regulated by NCUA, and the agency has access to the books and records of the CUSO.

The current limit on CUSO investments by Federal credit unions is out-dated and limits the ability of credit unions to support CUSO's to meet the range of members' needs for financial services. This limit results in Federal credit unions having to either forego certain opportunities that would benefit members or use outside vendors in which the credit union has no ownership stake. While CUNA would prefer to see the 1 percent limit eliminated or set by NCUA through the regulatory process, an increase to 3 percent in the statute would provide credit unions more options to investment in CUSO's to enhance their ability to serve their members.

CUNA also would support raising the 1 percent borrowing limitation (Section 107(5)(D), 12 U.S.C. § 1757(5)(D)) that currently restricts loans from credit unions to CUSO's. We believe the limit should be on par with the investment limit, which we hope the Committee will support raising to 3 percent.

Check-Cashing and Money-Transfer Services Offered Within the Field of Membership

Federal credit unions are currently authorized to provide check-cashing services only to members and have very limited authority to provide wire transfer services to individuals in the field of membership under certain conditions. CUNA urges the Committee to support an amendment to Section 107(12) of the Federal Credit Union Act (12 U.S.C. § 1757(12)) to allow a Federal credit union to provide check-cashing services and money transfer services to anyone eligible to become a member of the credit union. Such services would include the authority to sell travelers checks and money orders, and send and receive international and domestic funds transfers.

This proposed amendment is fully consistent with the initiatives of President Bush and Congress to reach out to underserved communities in this country. Many of these individuals live from pay check to pay check and do not have established accounts for a variety of reasons, including the fact that they do not have extra money to keep on deposit. We know of members who join 1 day, deposit their necessary share balance and come in the very next day and withdraw because they need the money. This is not financial mismanagement on their part. They just do not have another source of funds.

If Federal credit unions are permitted to cash checks, sell negotiable checks, and facilitate transfers of funds, we could accomplish two things: Save our staff time and effort opening new accounts for short term cash purposes which are soon closed; and gain the loyalty and respect of potential members so that when they are financially capable of establishing an account, they will look to the credit union, which can also provide financial education and other support services.

Legislation that includes similar provisions is pending in both the House and Senate on this issue: The International Consumer Protection Act, introduced in the House (H.R. 928) by Representative Gutierrez and in the Senate (S. 31) by Senator Sarbanes. Additionally, the Expanded Access to Financial Services Act (H.R. 749), introduced by Representatives Gerlach and Sherman, contains identical language to this provision, and passed the House of Representatives on April 26, 2005 by voice vote. CUNA strongly supports all legislative efforts to enact this provision and is grateful to Ranking Member Sarbanes for the introduction of his bill.

Voluntary Mergers Involving Multiple Common Bond Credit Unions

In voluntary mergers of multiple bond credit unions, NCUA has determined that the Federal Credit Union Act requires it to consider whether any employee group of over 3,000 in the merging credit union could sustain a separate credit union. This provision is unreasonable and could occasionally limit the ability of two healthy multiple common bond Federal credit unions from efficiently combining their financial resources to serve their members better. CUNA urges that Section 109(d)(2) of the Federal Credit Union Act (12 U.S.C. § 1759(d)(2)) be amended to eliminate this requirement for voluntary mergers.

Conversions Involving Common Bond Credit Unions

CUNA supports an amendment to Section 109(g) of the Federal Credit Union Act (12 U.S.C. § 1959(g)) to allow a multiple common bond Federal credit union converting to or merging with a community Federal credit union to retain all groups in its membership field prior to becoming a community credit union. Currently, when a multiple group credit union converts to or merges with a community charter, a limited number of groups previously served may be outside of the boundaries set for the community credit union. Thus, new members within those groups would be ineligible for service from that Federal credit union. The amendment would allow the community credit union to provide service to all members of groups previously served by the multiple group credit unions.

Credit Union Governance

CUNA strongly believes that credit union boards should have more authority in making their own decisions. We are proposing three specific amendments for the Committee's consideration for inclusion in its regulatory relief bill. First, Federal credit union boards must be given flexibility to expel a member who is disruptive to the operations of the credit union, including harassing personnel and creating safety concerns, without the need for a two-thirds vote of the membership present at a special meeting as required by current law (Section 118(b) of the Act, 12 U.S.C. § 1764(b)). Second, Federal credit unions should have the ability in their by laws to limit the length of service of individual members of their boards of directors (amending Section 111(a) of the Act, 12 U.S.C. § 1761(a)). Third, Federal credit unions should have the ability, if they choose to do so, to reimburse volunteers for wages they would otherwise forfeit by participating in credit union affairs (Section 111(c) of the Act, 12 U.S.C. § 1761(c)).

Some Federal credit unions have occasionally faced situations where there was a need to expeditiously expel a member for just cause, particularly for instances of harassing or threatening—credit union staff. The boards of these credit unions should have the ability to quickly act, without having to call a special membership meeting.

Federal credit unions should have the right to limit the length of service of their boards of directors, which should help to assure broader representation from the membership. This would be a permissive, not mandatory, authority. Providing credit unions with this right does not raise supervisory concerns and should not, therefore, be determined by the Federal Government.

Credit unions are directed by committed volunteers. Given the pressures of today's economy on many workers and the legal liability when holding governing positions at credit unions, it is increasingly difficult to attract and maintain such individuals. Rather than needlessly discouraging volunteer participation through artificial constraints, the Federal Credit Union Act should encourage such involvement by allowing volunteers serving on the Federal credit union's board or any of its committees to recoup wages they would otherwise forfeit by participating in credit union affairs. The decision on whether to reimburse for lost wages should be left to individual credit unions, not a mandatory requirement.

Providing NCUA with Greater Flexibility in Responding to Market Conditions

Section 107(5)(A)(vi) of the Federal Credit Union Act (12 U.S.C. § 1757(5)(A)(vi)) provides the authority for the NCUA Board to establish a Federal usury ceiling above 15 percent under certain circumstances up a period not to exceed 18 months. CUNA feels that it is important that NCUA be given greater flexibility in evaluating the marketplace by looking at interest rates in the preceding 6 months or (rather than the current "and") whether prevailing interest rate levels threaten the safety and soundness of individual credit unions.

Exemption from the Premerger Notification Requirement of the Clayton Act

CUNA believes that it is very important to give federally insured credit unions the same exemption that banks and thrift institutions already have from premerger notification requirements and fees of the Federal Trade Commission. Therefore we request that the Committee include in its regulatory relief bill an amendment to Section 7A(c)(7) of the Clayton Act (15 U.S.C. § 18a(c)(7)).

Treatment of Credit Unions as Depository Institutions under Securities Laws

CUNA requests that Section 3(a)(6) of the Securities and Exchange Act of 1934 (15 U.S.C. § 78c(a)(6)) and Section 202(a)(2) of the Investment Advisers Act of 1940 (12 U.S.C. § 80b–2(a)(2)) be amended to give federally insured credit unions exceptions, similar to those provided to banks, from broker-dealer and investment adviser registration requirements.

Privately Insured Credit Unions Authorized to become FHLB Members

Currently, only federally insured credit unions may become members of the Federal Home Loan Bank System. A privately insured credit union should be permitted to apply to become a member of a Federal Home Loan Bank. The State regulator of a privately insured credit union applying for membership could certify that the credit union meets the eligibility requirements for Federal deposit insurance in order to qualify for membership in the Federal Home Loan Bank system.

Eliminate the Requirement that only one NCUA Board Member can have Credit Union Experience

CUMAA added a provision to the Federal Credit Union Act (Section 102(b)(2)(B), 12 U.S.C. § 1752a(b)(2)(B)) stating that only one member of the NCUA Board may have recent credit union experience. A similar experience limit does not apply to any other Federal regulatory agency. And the restriction denies the NCUA Board and credit unions the expertise that can greatly enhance their regulatory and supervisory systems. This restriction should be stricken from the stature. The law should be changed to State at least one person on the NCUA Board should have recent credit union experience.

Amendments to Other Federal Laws that CUNA Urges the Committee Include in Regulatory Relief Legislation

The "Matrix of Financial Services Regulatory Relief Proposals" prepared by Senator Crapo's staff is certainly a comprehensive listing of regulatory relief provisions across a broad array of banking and consumer disclosure regulations. CUNA's support for a number of amendments to laws other than the Federal Credit Union Act is noted in the Matrix. We would like to highlight several provisions that we urge the Committee to include in its regulatory relief bill. Where appropriate, we note by number where the proposal is found in the Matrix.

- *Monetary reserve requirements:* CUNA hopes that any regulatory relief passed by Congress includes authority for the Federal Reserve Board to pay interest on the reserves that credit unions have to maintain in compliance with the Fed's Regulation D (#1). While we support the provision recommended by the Fed (#2 of the Matrix), which would give the Fed greater flexibility to set the transaction account reserve level as low as 0 percent, we think that it is important that the Committee make the basic inquiry to the Fed on whether monetary reserves are even needed in 2006 for carrying out the Nation's monetary policy.

  The current six transfers a month restrictions on savings accounts is a tremendous regulatory burden on depository institutions. The requirement is impossible to logically explain to consumers, is challenging to support by data processing systems, and we really question if monetary reserves help the Fed carrying out it monetary policy today. The banking industry seeks (#113) to expand the number of permissible transfers from savings deposits from 6 to 24 per months, which would maintain a line, albeit a thin line, between savings and transaction accounts. We support #113 if this is the only change possible, but we urge the Committee to review the need for monetary reserves in this modern electronic age. We certainly want the Committee to understand that there is a major operational burden in having to count transfers per month and warn consumers about the consequences of exceeding the arbitrary number of transfers.
- *Annual privacy notices:* CUNA supports the elimination of the annual privacy notice provision in the Gramm-Leach-Bliley Act (#63 and others). Financial institutions that do not share personal financial information or have not changed their policy should not have to send out these notices every year. A credit union should be required to give new members its privacy notice, provide all members with a revised privacy notice when its privacy policy has changed, post its privacy notice on its website if it maintains a website, and make a copy of its privacy notice available upon request. This approach would be more useful to consumers than annually sending out another piece of paper that goes unread.
- *Bank Secrecy Act and the requirements of the Office of Foreign Assets Control (OFAC):* Compliance with the Bank Secrecy Act is taking up a tremendous amount of time and resources for credit unions as well as banks and thrift institutions right now, as the agencies and regulated financial institutions work through new compliance expectations. Any further guidance on suspicious activity monitoring would be especially welcomed, as suggested in #180. We certainly support the ideas offered by the Independent Community Bankers of America in #106 about reviewing the currency transaction reporting thresholds, and reporting, retention and exemption procedures.

  We saw nowhere mentioned in the Matrix a related burden, the various OFAC compliance requirements. Simply put, OFAC has certain requirements, with potentially high penalties, that are impossible to comply with—unless we want to bring the Nation's payments system to a screeching halt. We ask the Committee will help identify the appropriate place to review the regulatory burdens and concerns created by certain OFAC requirements.

Conclusion

In summary, Mr. Chairman, we are grateful to the Committee for holding this hearing. Credit unions' ability to continue serving the financial needs of our current members and our potential members who need access to our services in Alabama and across the country will be significantly reduced without the regulatory relief this Committee is addressing. We strongly urge the Committee to act on this very important issue this year. And, we strongly urge the Committee to include the many amendments we have suggested to the Federal Credit Union Act, particularly on prompt corrective action reform and member business lending restrictions, and the provisions we cite in other Federal laws that are unnecessarily burdensome.

I thank you for the opportunity to present these proposals on behalf of CUNA, and I look forward to your questions.

PREPARED STATEMENT OF TERRY JORDE

PRESIDENT/CEO, COUNTRYBANK USA, CANDO, ND
AND CHAIRMAN-ELECT
INDEPENDENT COMMUNITY BANKERS OF AMERICA, WASHINGTON, DC

MARCH 1, 2006

Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee, my name is Terry Jorde, President and CEO of CountryBank USA. I am also Chairman-Elect of the Independent Community Bankers of America.[1] My bank is located in Cando, North Dakota, a town of 1,300 people where the motto is, "You Can Do Better in Cando." CountryBank has 29 full time employees and $39 million in assets. We are a small, but diversified organization with 10 of my employees working in our insurance agency, two employees devoted to retail sales of nondeposit investment products, and the remaining 16 devoted to traditional banking products and services. I split my time between two locations.

ICBA appreciates the opportunity to testify on the need to reduce the regulatory burden on banks, thrifts and credit unions, a topic this Committee has been studying for some time. Community banks hope that Congress will complete action this year on legislation that will truly lift some of the extraordinary burden. We commend Senator Mike Crapo for taking the leadership role on this issue, working closely with Chairman Shelby. We have appreciated the opportunity to work with him on the many proposals that we and others have asked to be included in regulatory relief legislation.

Before discussing the topic of today's hearing, I want to take a moment to thank all the Members of this Committee for including deposit insurance reform in the recently enacted budget reconciliation bill. I want to extend special thanks to Senators Tim Johnson, Wayne Allard, Michael Enzi, and Chuck Hagel for their years of hard work in pushing deposit insurance reform in the Senate as well as to Chairman Shelby and Ranking Member Sarbanes for moving this bill to enactment this year. This new law is tremendously important in making FDIC insurance a more stable and fair system for community banks and for consumers. Importantly, the legislation will encourage depositors to keep their money in local banks where it can be lent out to build and support local communities.

Community Bankers Need Regulatory Relief

Last year, ICBA testified before this Committee about community banks' need for relief from the severe regulatory burden that we face.[2] *Our testimony detailed the loss of market share suffered by community banks and pointed to a study by two economists at the Federal Reserve Bank of Dallas that concluded that the competitive position and future viability of small banks is questionable in large part due to the crushing regulatory burden we face.*[3]

While larger banks have hundreds or thousands of employees to throw into the regulatory breach, a community bank with $100 million in assets typically has just 30 full time employees, a $200 million bank about 60 employees. If my bank is faced with a new regulation, we must train one or more of our current employees, and complying with the new regulation will take time away from customer service. My compliance officer not only has responsibility for overseeing our compliance program, but she also originates around 60 real estate loans per year for sale on the secondary market, she sits on our audit and technology committee, she regularly teaches homebuyer education courses at our community college, and she baby sits

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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.*

[2] Testimony of David Hayes, President/CEO, Security Bank, Dyersburg, TN, and Chairman of the Independent Community Bankers of America, June 21, 2005.

[3] Gunther and Moore, "Small Banks' Competitors Loom Large," Southwest Economy, Federal Reserve Bank of Dallas, Jan./Feb. 2004.

my son at times like this when I am begging for relief. Unlike larger institutions, we cannot just add a new person and pass the costs on to our customers.

This disproportionate regulatory impact makes it difficult for community bankers to fulfill their central mission, to finance and support their local communities. Community bankers provide tremendous leadership in their communities, which is critical to economic development and community revitalization.

For example, in a typical week I may spend six hours in a hospital board meeting, four hours in an economic development corporation meeting, and another four hours working with other local community bankers to develop a financial incentive package for a potential new business in our community. You could argue that this is not an efficient and cost-effective way to spend my time, but like most community banks, the very survival of my bank and the economic vitality of my community depend on these activities. I have a very real incentive to work to assure the success of Cando. Branches of large megabanks do not provide this same commitment to the local community.

Legislation is Necessary

ICBA strongly supports the bank regulatory reduction project mandated by the Economic Growth and Paperwork Reduction Act of 1996 (EGRPRA). We commend the interagency EGRPRA task force, spearheaded by now-Office of Thrift Supervision Director John Reich, for the excellent job it has done to identify those banking regulations that are outdated, unnecessary, or unduly burdensome. *While the bank regulators have been working hard to identify burdens they can reduce on their own, they report to us that there are severe limits on what they can do without help from Congress. Many burdensome and outdated regulatory requirements are hardwired into Federal statute.*

Communities First Act Provides Regulatory Relief

Senator Brownback's Communities First Act (S. 1568) grew out of that realization. *Many of the provisions of the Communities First Act build on the concept of a tiered regulatory and supervision system recommended by Director Reich by targeting relief to institutions based on their size. Other CFA provisions would apply to all banks, regardless of size.* All would go a long way toward improving community banks' ability to compete and serve local communities.

It is our commitment to our communities that led ICBA to work with Senator Brownback on the Communities First Act. That bill is cosponsored by a Member of this Committee, Senator Chuck Hagel, as well Senators Roberts, Inhofe, and Coburn. It has put into legislative language proposals that ICBA made in our 2004 testimony before this Committee.[4] These proposals are also included in Senator Crapo's comprehensive matrix of relief proposals.[5]

I can tell you from my meetings with community bankers throughout the country that they are very excited by the Communities First Act. *A total of 46 State banking trade associations have also endorsed CFA.* (List of endorsing associations attached.) It is a positive agenda for our members and their communities. We also recognize it is an ambitious agenda that will not be enacted all at once. Indeed, we are pleased that six of the fifteen provisions from the House companion bill (H.R. 2061) are included in the House's broad regulatory relief bill (H.R. 3505).

ICBA urges this Committee to include as many provisions from the Communities First Act as possible in any new bill it drafts.

The following provisions from CFA are included in the House bill:

- Streamlining Call Reports (H.R. 3505, Sec. 606; CFA, Sec. 204). Calls on the agencies to reduce or eliminate the information required for reports of condition if the information is "no longer necessary or appropriate."
- *Flexible Exam Schedule for Community Banks* (H.R. 3505, Sec. 607; CFA, Sec. 107). Expands the eligibility for the 18-month exam cycle from banks under $250 million in assets to banks up to $1 billion.
- *Short Form for Call Reports* (H.R. 3505, Sec. 608; CFA, Sec. 102). Permits highly rated, well-capitalized banks with assets of $1 billion or less to file a short form quarterly Call Report in two of every four quarters.

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[4] Testimony of Dale Leighty, President and Chairman, First National Bank of Las Animas, Las Animas, CO, and Chairman of the Independent Community Bankers of America, June 22, 2004.

[5] In response to a request from the FDIC for Senator Crapo, who is working on a regulatory relief bill in the Senate, several bank industry trade associations including ICBA identified a list of 78 recommendations—made by various witnesses in testimony to the Senate Banking Committee—that the associations all support. While individual associations may also support additional recommendations not on this consensus list, virtually all of the regulatory provisions of the Communities First Act are on the list (items 101–120).

- *Changes to Small BHC Policy Statement* (H.R. 3505, Sec. 616; CFA, Sec. 104). Requires the Federal Reserve to revise the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors so that the policy applies to BHC's with assets of less than $1 billion that are not engaged in any nonbanking activities involving significant leverage and do not have a significant amount of outstanding debt. (The current policy applies to BHC's with assets under $150 million. Subsequent to introduction of CFA, the Federal Reserve proposed to increase the level to $500 million.)
- *Exception to Annual Privacy Notice* (H.R. 3505, Sec. 617; CFA, Sec. 203). Exempts a bank from the annual privacy notice requirement if the bank does not share customer information other than as permitted by one of the exceptions in the Gramm-Leach-Bliley Act, does not share information with affiliates under the Fair Credit Reporting Act, and has not changed its policies.
- *Management Interlocks* (H.R. 3505, Sec. 404; CFA, Sec. 105): Increases the size of the small depository institution exception under the Depository Institution Management Interlocks Act. (H.R. 3505, $100 million; CFA, $500 million).

The following section explains these provisions and the other bank regulatory provisions of the Communities First Act in more detail.

Reports of Condition (Call Reports) & BHC Policy Statement

Section 102 of the Communities First Act would permit highly rated, well-capitalized banks with assets of $1 billion or less to file a short quarterly call report form in two quarters of each year. This would reduce the reporting burden for these banks, while still providing the banking agencies with the data they need.

Section 204 would benefit all banks by directing the agencies to reduce or eliminate filings that are not outweighed by the benefits to safety and soundness or the ability of the FDIC and other regulators to accurately determine the financial condition and operations of the reporting institutions. ICBA believes that this Congressional directive would help reverse the repeated increases in the reporting burden imposed when agency economists and financial analysts seek to add "just one or two more" items to the call reports. While many of these items provide interesting information, we question whether private companies—banks—should have to provide nonessential information under threat of government sanction.

The current call report instructions and schedules consist of 458 pages. While extensive and time consuming to produce, the detail required in the quarterly filings by community banks are not essential to the agencies. The fact is that in most community banks, the world just does not change that dramatically between March 31 and June 30 of each year. The FDIC will not lose track of us if every other time we file a short-form call report instead of the extensive report. And, the Federal Reserve will still be able to conduct monetary policy without our real time data. On the other hand, this would significantly reduce the reporting burden for banks like mine, while still providing the banking agencies with the data they need.

Section 104 of the Communities First Act would direct the Federal Reserve to make bank holding companies with assets up to $1 billion eligible for the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors. To qualify, the holding company must also (1) not be engaged in any nonbanking activities involving significant leverage, and (2) not have a significant amount of outstanding debt that is held by the general public. This change would reduce the paperwork burden on these small, noncomplex, holding companies, while maintaining the Federal Reserve's ability to obtain holding company information for larger institutions. (As indicated above, the Federal Reserve could soon increase this level to $500 million.)

The banking industry has included each of these recommendations as consensus items on the list for Senator Crapo.

EXAMINATION SCHEDULES

Section 107 of the Communities First Act would give Federal regulators flexibility to determine the examination interval for well-rated, well-capitalized banks with up to $1 billion in assets. This would replace the current 18-month exam schedule for banks with less than $250 million in assets. The banking industry supported this as a consensus recommendation.

Section 110 would increase CRA examination intervals for banks up to $1 billion.[6]

[6] It is important to note that this examination interval is a separate issue from the question of examination procedures for banks under $1 billion in assets. The regulatory agencies have already adopted, or have proposed adopting those streamlined procedures.

Both of these changes would help strong, well-run community banks focus on service to their communities rather than responding to unnecessarily frequent examinations.

Let me explain how this would bring about regulatory relief for a typical community bank. In the past, the burden of a bank examination consisted primarily of bank examiners being in the bank for 2–3 weeks asking bank employees questions throughout the day and sifting through credit files. However, most bankers will tell you that the burden begins long before the examiners come on site. When I first started in banking, examiners would just show up 1 day unannounced. Today, most banks receive notice of a bank examination at least 2 months in advance of the examiner walking through the door. This is because of the massive amount of information and documentation that they want mailed to them before the exam.

In my bank it takes five or six of us nearly a month to prepare and send the information to the examiners. That means that a bank on a 12-month exam cycle is spending 40 weeks in a 10-year period just getting ready for the exam and another 20–30 weeks in the actual examination. If we could extend the exam interval just 6 months for a well-capitalized bank, that would literally save the typical bank 23 weeks every 10 years. If you multiply that by the 8,500 banks in our country, we are talking about 195,500 weeks! The cost savings and economic implications are enormous.

Privacy Notices

One of the most wasteful provisions of the Gramm-Leach-Bliley Act has been the requirement that financial institutions send annual privacy notices to their customers. The law requires them to be written in impossible-to-understand legalese. The industry and agencies have been working on ways to simplify this language, but the task is daunting. However, *Section 203 of the Communities First Act offers a measure that would greatly reduce the number of these notices that must be mailed. It simply says that if an institution does not share information (except for narrow purposes, such as providing information to an outside data processing firm) and has not changed its policies, it need not send out the annual notices.* While any size institution could take advantage of this provision, community bankers are especially interested in having this option. I can tell you that my customers and their trash collectors would also be grateful.

Like virtually all of the regulatory provisions of the Communities First Act, this section is a banking industry consensus item.

DIRECTOR INTERLOCKS AND LOANS TO OFFICERS

Section 105 of the Communities First Act increases the size of banks eligible for an exemption from interlocking director prohibitions from $20 million to $500 million. It has always been a challenge for the smallest institutions to find qualified directors. Now that directors' responsibilities have increased under the Sarbanes-Oxley Act and other requirements, this has become a challenge even for larger community banks.

Section 108 of the Communities First Act allows banks with less than $1 billion in total assets to make loans to executive officers, in the aggregate, up to two times capital. The current asset size limit is $100 million in deposits. This is not a tenfold increase, because a bank with $1 billion in assets could have considerably less than that in deposit liabilities.

Section 205 would help all banks by increasing the special regulatory lending limit on loans to executive officers for loans other than those for housing, education, and certain secured loans to $250,000.[7] This limit has not been adjusted in over a decade, so this amendment simply makes an appropriate adjustment for inflation.

These adjustments are all included in the banking industry's consensus recommendations to Senator Crapo.

Protection for Community Banks under SIPC

The Securities Investor Protection Act does not provide immediate protection to community banks that suffer losses when a securities firm fails. Current law exempts commercial banks from SIPC coverage and assumes that all commercial banks are in a position to fend for themselves in such cases. This may be true for large commercial banks, but it is less so for community banks.

Section 106 of the Communities First Act would provide banks with assets up to $5 billion the same protection afforded other investors and other depository institu-

[7] Executive officers would remain subject to the same limit on directors and principal shareholders, the loans-to-one-borrower limit, and to the requirement that loans to insiders not be on preferential terms.

tions (thrift institutions and credit unions) for their brokerage account assets under the SIPA.

This is included in the banking industry's consensus recommendations to Senator Crapo.

Impact of New Regulations on Community Banks

Neither we—nor you—can anticipate all of the potential new burdens that future laws and regulations may impose on community banks. Therefore, *Section 109 of the Communities First Act directs the banking agencies to take into account the effect any new regulation, requirement, or guideline would have on community banks.* This sends a clear message from Congress to the agencies that the public policy of the United States is firmly committed to maintaining a strong, vibrant, community bank sector for our economy.

Sarbanes-Oxley Act, Section 404

Section 404 of Sarbanes-Oxley imposes tremendous unexpected costs on virtually all companies. A recent ICBA survey showed that—including outside audit fees, consulting fees, software costs, and vendor costs—the average community bank will spend more than $200,000 and devote over 2,000 internal staff hours to comply with the internal control attestation requirements of Section 404.

Section 103 of the Communities First Act recognizes that these added costs are unnecessary for community banks. First, unlike other companies, banks have been under similar requirements for years, though with an exemption for community banks.[8] Congress imposed these requirements on banks after the crises of the 1980's. So, Section 404 is redundant when imposed on the banking sector. Second, unlike other companies, *banks are closely supervised and examined by Federal officials on a regular basis. The adequacy of their internal controls is assessed by bank examiners as part of the safety and soundness exams.* Companies like Enron and WorldCom were not regulated the same way. Not only is this burden redundant and unnecessary for community banks, but it is also a key factor in undermining their ability to remain independent.

The banking industry has also agreed that this proposal is a consensus item on the list for Senator Crapo.

Truth in Lending Right of Rescission

Section 201 of the Communities First Act calls for several changes that would expedite consumers' access to their funds without undermining the protection that the 3-day right of rescission provides. They would apply without regard to the size of the institution involved.

Subsection (a) directs the Federal Reserve to provide exemptions when the lender is a federally insured depository institution. The right of rescission was imposed to protect consumers against high-pressure loan sellers often connected with illicit home improvement operations or similar schemes. The loan programs of federally insured institutions are, obviously, run on a far different basis and are subject to regular scrutiny by banking regulators. Our customers know exactly what they have applied for and are receiving. They are frequently puzzled and annoyed when they hear they have to wait an additional 3 days for their funds.

Subsection (b) addresses another source of annoyance for consumers, the fact that borrowers have to wait 3 days to get the benefit of a refinancing transaction even if they are not taking any cash out of the deal. It makes no sense to insist that a consumer wait to begin taking advantage of a lower interest rate or different term, which are the typical purposes of these kinds of transactions.

Finally, subsection (c) eliminates the right of rescission when a borrower is opening up an open-ended line of credit. The very design of the product grants consumers a perpetual right of rescission if that is what they want. The consumer can simply refrain from drawing on the account for 3 days or longer. On the other hand, consumers who need immediate access to their line of credit should have it.

The banking industry has included the provisions of Section 201 in its consensus recommendations.

Home Mortgage Disclosure Act

The Communities First Act would make several changes to the Home Mortgage Disclosure Act. *Section 101 would increase two reporting exemption levels from $30 million and $34 million*[9] *in assets to $250 million.* While this may appear to be a

[8] The FDIC recently increased the exemption level from $500 million to $1 billion to reduce the regulatory burden.

[9] The $34 million began as a $10 million exemption, but has been increased by statute and by the Federal Reserve using an inflation-based index.

substantial increase, the vast majority of industry assets would remain covered. In fact, the FDIC reports that as of March 31, 2004, banks and thrifts with $250 million or less in assets held only 6.7 percent of industry assets. The amendment would index the $250 million level using the existing procedure in HMDA.

Title II of H.R. 2061 makes several additional changes in HMDA that could apply to a bank of any size, depending on its activity or location. *Section 202 would exempt banks with fewer than 100 reportable loan applications per year per category. This would lift the burden from banks for which mortgage lending is not a major business line.*

Banks that operate outside Metropolitan Statistical Areas are exempt from HMDA. Section 202 would also allow the Federal Reserve to develop a definition of Metropolitan Statistical Area for HMDA purposes, instead of using Census Bureau definition created for entirely different reasons. Current law requires the use of the Census Bureau definition, so certain areas that are truly rural are often included in metropolitan statistical areas. This may serve the purposes of the Census Bureau, but the Federal Reserve should have the flexibility to modify these definitions when determining which areas must be covered by HMDA. This would avoid unnecessarily covering certain rural banks that are relatively close to metropolitan areas.

Finally, *Section 202 would benefit all banks that must continue to report HMDA data by requiring the Federal Reserve to review and streamline the data collection and reporting requirements every 5 years.*

It is important to note that the banking industry has included each of these HMDA provisions on its list of consensus items for inclusion in a regulatory relief bill in its response to Senator Crapo.

Bank Secrecy Act Compliance

The Nation's community banks are committed to supporting the Federal Government's efforts to prevent our institutions from being used for money laundering, terrorist financing, and other fraudulent activities. However, ICBA also believes that it is critical that resources be focused where the risks are greatest. Over the years, there has been a tendency to require reports that have little value for law enforcement but that clog the system and obscure the truly suspicious activities. In addition, bankers across the country continue to identify the Bank Secrecy Act as one of the most burdensome areas of compliance.

ICBA appreciates the efforts by Congress to bring greater focus to the many reports required under the Bank Secrecy Act. Elements of Title VII of H.R. 3505 are a helpful step in the right direction and we look forward to continuing to work with Congress, the Treasury, and the banking agencies to achieve an effective compliance regime that directs resources of banks, regulators, and law enforcement agencies where it can do the most good.

ICBA supports Section 701 of H.R. 3505 that would allow banks to exempt seasoned customers from currency transaction reports without being required to renew the exemption annually. Past efforts to increase the use of the current exemption process have not succeeded, despite years of efforts by interested parties, including industry representatives, regulators, and law enforcement. In fact, ICBA is represented on a Treasury committee that has been seeking solutions to this problem. Therefore, ICBA supports Congress taking this step since it has the potential to eliminate many unnecessary reports. However, for this provision to succeed, it will be important that Treasury establish an appropriate definition for qualified customers, and ICBA looks forward to working with Treasury on this definition.

Fundamentally, ICBA believes that a simple across-the-board increase in the dollar threshold for currency transaction reports—a level that has not changed since the Bank Secrecy Act was first adopted over 35 years ago—would be easier to apply. However, we also recognize that law enforcement agencies are concerned that such a change might eliminate valuable information for detecting and prosecuting criminal activities. However, it would be helpful if banks and other financial institutions had better information from law enforcement. Under Section 314 of the USA PATRIOT Act, Congress adopted a provision designed to encourage law enforcement agencies to enhance their communications efforts with financial institutions to help them focus resources on those risks that present the greatest threats of money laundering and terrorist financing. ICBA encourages Congress to continue to take steps to ensure that this information is provided by law enforcement agencies. If law enforcement agencies provide regular reports to the industry, it will help us focus resources where they are most appropriate.

ICBA supports several other provisions in H.R. 3505 that would help alleviate the regulatory burden facing community banks. Section 702 would require the banking agencies and Treasury to develop uniform BSA regulations and examination requirements. In the fall of 2004, the banking agencies and Treasury entered into a Memorandum of Understanding that was, in part, designed to achieve such a goal. Last June, after unprecedented interagency cooperation, the agencies issued a single Bank Secrecy Act/Anti-Money Laundering Examination Manual. ICBA strongly applauds these efforts, and appreciates the opportunity to have played a part. Section 702 would codify the steps that have already been taken and therefore ICBA supports it. Section 702 would also require the development of "a clear policy statement on appropriate processes for resolving examiner-institution disagreements." Again, this is a step that ICBA strongly supports.

Inconsistencies between agencies or differing interpretations about the same regulatory requirement increase regulatory burden. Section 702 would require the Secretary of the Treasury to assess potential inconsistencies or redundancies among the various BSA regulations. Since eliminating these inconsistencies can help reduce regulatory burden, ICBA also supports this provision.

In recent years, there has been confusion about what and how much information should be reported to bank boards of directors about the suspicious activity reports that banks file with the Federal Government. Section 703 would require the Treasury to review these requirements and make appropriate recommendations. ICBA has been working closely with a subcommittee of Treasury's Bank Secrecy Act Advisory Group on this issue and ICBA believes this provision would enhance its work.

ICBA also supports provisions in H.R. 3505 that would require Treasury to assess and eliminate unnecessary customer identification requirements for the purchase of monetary instruments, assess ways to eliminate recurring suspicious activity reports, and improve the current system for electronic filing of BSA reports. ICBA also supports language that would express the sense of Congress that encourage banks to provide financial services to money services businesses and require Treasury to provide banks with information about money laundering and terrorist financing in other markets. ICBA encourages Congress to continue to monitor progress in all these areas.

In closing, ICBA wants to congratulate the former Director of Treasury's Financial Crimes Enforcement Network, Bill Fox, for his excellent outreach efforts to the banking industry, especially the Nation's community banks. Bill's tireless efforts helped bring about many improvements in the current BSA compliance regime. We look forward to working with the new Director of FinCEN, Bob Werner, to continue the successful collaboration between community banks, banking regulators, and law enforcement to develop an effective and efficient BSA system.

ICBA OPPOSES EXPANSION OF ACTIVITIES FOR INDUSTRIAL LOAN COMPANIES AND CREDIT UNIONS

ICBA strongly believes that "regulatory relief" legislation must not become a vehicle to expand new activities for industrial loan companies and credit unions. We urge that the Committee reject proposals that would provide broad interstate branching powers and new business checking powers for ILC's. We also urge you to reject proposals to increase the tax-exempt credit unions' business lending powers and reduce their capital requirements.

Both ILC's and credit unions already have unfair regulatory and tax advantages over community banks. Commercial companies may own ILC's and ILC holding companies are not subject to consolidated supervision by the Federal Reserve. Credit union profits are exempt from taxation and credit unions are not subject to the Community Reinvestment Act.

In addition, ILC's pose unique safety and soundness risks, as well as conflicts of interest by mixing banking with commerce. Both Federal Reserve Chairmen Greenspan and Bernanke have highlighted these risks and have urged Congress to close the ILC loophole.

In a particularly strange twist, credit union groups in California and Utah have applied to acquire or establish ILC's. These combinations would allow credit unions to expand their reach beyond any conceivable common bond restriction.

Congress should promptly redress these imbalances in the Nation's financial system. In the context of regulatory burden relief legislation, we urge you to—at a minimum—refrain from exacerbating them.

Banks Not Positioned to Prevent Internet Gambling

At the same time that this Committee is carefully considering proposals to reduce unnecessary regulatory burden, some in Congress are seriously considering ones to *increase* that burden. These are bills that would make illegal some forms of gambling on the Internet. As a key enforcement mechanism, they would require banks and others to attempt to prevent payments to gambling companies on behalf of bank customers. *While we share concerns about Internet gambling, it is highly doubtful that such legislation, if passed, would have any meaningful effect on the amount of* *gambling on the Internet.* Credit card issuers have already raised substantial roadblocks that prevent payments directly to gambling sites. In response, these sites have devised effective ways to get around these roadblocks. In most cases a gambler will establish an account with a nonbank payment company, which will make payments to gambling companies on behalf of the gambler. In such cases, the gambler may actually provide funds to the payment company from his checking or credit card account *before* doing any gambling at all.

So, while the pending legislation would likely be ineffective, it would impose an additional burden on community banks. They would have to adopt formal procedures to attempt to comply with the new requirements. Even if they actually failed to block any transactions, community banks would have to bear training and monitoring costs. These banks already bear a considerable burden in complying with attempts to prevent money laundering and terrorist financing. These efforts should not be diverted by ineffectual attempts to block gambling.

ICBA urges Congress to reject proposals to use the banking system to restrict Internet gambling unless they have some reasonable chance of being effective and will not add to the tremendous burden on community banks. The proposals that we have seen so far do not come close to meeting this test. Congress should not pass legislation that claims to "do good" without effectively (and efficiently) restricting bad behavior or encouraging positive action.

Conclusion

ICBA appreciates this Committee's commitment to moving legislation that would reduce the regulatory burden on community banks. I believe that the tremendous weight of over-regulation is crushing the banking system and is rapidly driving the consolidation of our industry.

Most regulations probably had a well thought out purpose when they were originated, but it's been said, "no single raindrop feels it is responsible for the resulting flood." Community banks in particular face a disproportionate impact and we need substantial relief before we are washed away. On behalf of my community bank and the nearly 5,000 members of the Independent Community Bankers of America that I represent today, I ask you to remember this as you consider legislation and regulatory relief for our industry. Thank you.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SANTORUM FROM JOHN M. REICH

Q.1. Under current regulations of mutual holding companies, public shareholders have a right to approve the compensation package of executives and provide direction to a foundation, which might be created by the Initial Public Offering (IPO). Should they also have a say in determining the Board? Why or why not?

A.1. Typically, minority public shareholders of a depository institution in a mutual holding company (MHC) structure have dual interests in the MHC structure—as mutual members of the MHC and as shareholders of the institution. As minority public shareholders of the depository institution in a MHC structure, they have the same rights as any public shareholder to nominate directors and to vote in the election of directors of the underlying stock depository institution.

It is important to clarify that under current regulations, while minority shareholders of stock subsidiaries of MHC's have the right to vote on the establishment of management stock benefit plans, minority shareholders do not have the ability to vote on the compensation package of executives. Similarly, while minority shareholders have the ability to vote regarding the establishment of a foundation, they do not have the ability to provide direction to a charitable foundation established by the MHC. Minority shareholders are informed of these rights and restrictions via offering materials provided to them prior to their purchase of stock in the subsidiary stock institution.

While minority public shareholders do not typically have preferential voting rights vis-á-vis a majority and controlling shareholder (such as a MHC), OTS established certain separate voting rights for minority shareholders in the MHC context. Specifically, minority shareholders have separate voting rights in connection with stock benefit plans and foundations because both types of transactions may dilute the percentage of stock held by existing minority shareholders. That is, in the case of both the implementation of employee plans and the establishment of charitable foundations, the company may issue additional stock. Such issuances of stock would have a direct dilutive effect on minority interests, thus, separate voting rights are extended to minority shareholders to protect their existing percentage interest in an institution subsidiary of a MHC. Other corporate actions, including the election of members of the board of directors, do not dilute the minority stockholders' interest, and therefore do not merit the extension of separate voting rights to minority stockholders.

Again, while minority shareholders are unable to control the election of directors to the institution's board of directors, minority shareholders do have a role in determining the board. Like a minority shareholder of any publicly traded company, minority shareholders in a MHC structure have the right to nominate directors and the right to vote in the ejection of directors.

Q.2. Because shareholders are prohibited from challenging the Board slate, it is my understanding that they are therefore effectively blocked from firing the management of an under-performing mutual holding company. Could this structure increase the risk that OTS may have more troubled mutual holding companies?

A.2. Rather than increasing the risks to the institution, there is considerable factual and anecdotal evidence suggesting that mutuality insulates a depository institution from the types of shareholder and market pressures than can sometimes cause a stock institution to take unsound business risks.

In any MHC structure, the top-tier entity is a MHC that has no shareholders. The subsidiary savings association's depositors are the voting members of the MHC. The corporate governance provisions for Federal MHC's are similar to the corporate governance provisions regarding Federal mutual savings associations. OTS has found the mutual form of organization to be at least as conducive to safe and sound operations as the stock form of organization for savings associations. Similarly, OTS examinations of MHC's suggest that such entities are less likely to be troubled than stock holding companies.

Q.3. In a recent speech to the Exchequer Club in mid-February, you noted that OTS has petitioned Congress for a number of statutory changes for the thrift charter including "parity for savings banks" on the issues of investor adviser and broker-dealer activities, saying there should be "equal footing." It is my understanding that while asking for these changes to put thrifts on "equal footing" in these areas, OTS staff maintains that shareholdings in mutual savings banks and mutual holding companies should not have the same rights on governance and operations issues as do shareholders in other financial institutions. Could you explain these two seemingly divergent positions?

A.3. Minority shareholders in MHC structures already have the same rights as minority shareholders in other stock corporations. They may present issues for shareholder votes, nominate directors, and vote on all appropriate matters. As with any minority shareholder in a corporation where a single shareholder controls the majority of the voting shares, minority shareholders in a MHC structure cannot control the outcome of the vote unless they are able to convince the MHC majority shareholder that their recommendation should be adopted.

It is also important to note that the interests of depositors in a MHC or mutual thrift are not comparable to the interests of stockholders in a stock form depository institution or holding company. Due to the confidentiality of the deposit relationship and the privacy rights of member depositors, depositor lists cannot be provided in the same manner that stock institutions can provide shareholder lists. MHC's and stock form depository institutions or holding companies are different forms of ownership. Based on the differences in mutual and stock form of organization, it follows that their corporate governance structures will be different. However, the form of ownership should not be confused with the separate and unrelated issue of providing for a fair and competitive marketplace among financial institutions in the offering of investment, advisory, and broker dealer services to consumers.

Q.4. Recently, in a response to a letter from a Member of this Committee, OTS responded that it believes increasing shareholders' rights would "significantly disadvantage the rights and interests of the depositors of a mutual savings bank that reorganizes into a mutual holding company structure." OTS further stated that minority shareholders in a mutual holding company structure are aware of the lack of corporate governance at the outset and to try to give these members "greater rights" than the majority would undermine the "basic principles of sound corporate governance and corporate ownership rights." Do you agree with this opinion? If so, please explain why.

A.4. It is important to correct a mischaracterization of OTS' response suggested by the question. OTS made no statement in the letter referenced in the question regarding a "lack of corporate governance" with respect to minority shareholders in a MHC structure or otherwise; nor has the agency suggested in any other context that there is a lack of corporate governance with MHC structures. The point that was made in the letter was that providing minority shareholders with the ability to control a depository institution in a MHC structure would undermine basic principles of sound corporate governance and corporate ownership rights. Sound corporate governance requires that shareholders' interests and rights be reflective of the interpretative ownership interests and rights.

The letter stated that investors in minority stock in a MHC structure are aware at the outset that minority shareholders receive a minority interest. They should also understand that the MHC, as the majority shareholder, controls the institution and makes the business decisions regarding it. Corporate governance principles regarding any stock entity enable the majority shareholder (in the case of MHC structures, the MHC) to control the operations of the entity.

We maintain that the proposal to which OTS's previous letter responded would significantly disadvantage the rights and interests of the depositors of a mutual savings bank that reorganizes into a MHC structure. That letter proposed to provide the minority shareholders with the sole voting rights in the depository institution controlled by the MHC. In our view, this proposal would cause the mutual accountholders of the MHC to lose their rights in the underlying institution, without the protections provided under the OTS mutual-to-stock conversion regulations. Such an action would also provide an inappropriate windfall to minority shareholders, given that they would have control in excess of the amount of their capital contribution to the subsidiary depository institution.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM JOHN M. REICH

Q.1. The agencies have devoted considerable time and resources to developing the matrix and have sought input from consumer groups as well as industry representatives. As regulators you bring a unique perspective to the process. Based on that perspective, why do you feel regulatory relief is necessary now?

A.1. The Federal banking agencies have promulgated more than 850 regulations and modifications since the passage in 1989 of the Financial Institutions Reform, Recovery, and Enforcement Act. While regulatory requirements add up, little is done to eliminate outdated, no longer necessary, or unduly onerous provisions.

The vast majority of existing laws and regulations are appropriate and beneficial to a strong and effective Federal regulatory oversight system, but over time some provisions lose their utility. Five Federal agencies (including the NCUA) have reviewed the 187 regulatory-relief proposals and determined that the vast majority of the provisions no longer serve a useful purpose or can be modified to be less burdensome.

When Congress passed the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) in 1996, Federal banking regulators were given a mandate to review their regulations to reduce the regulatory burden imposed on financial institutions. We have taken this mandate seriously. Over the past 3 years, the agencies have opened more than 125 regulations for comment, received more than 1,000 comment letters, and held 16 banker and consumer group outreach meetings around the country.

All institutions bear regulatory burden, but the impact on smaller ones is disproportionate. The future of many of our Nation's smaller community banks, and the thousands of communities they serve, depends on Congress enacting meaningful regulatory relief legislation. This is the best opportunity we have had in many years to achieve this goal.

Q.2. We have received several proposals designed to give regulators additional flexibility in conducting examinations (#42, 68, 112, and 169). Do these types of proposals pose a safety and soundness concern?

A.2. Current law requires the Federal banking agencies (FBA's) to conduct a full-scope, on-site examination for the depository institutions under their jurisdiction at least every 12 months. There is an exception for small institutions that are well-capitalized and managed and have total assets of less than $250 million, and meet other criteria. Examinations of these small institutions are required at least every 18 months.

When originally enacted in 1991, the small institution examination exception was available to institutions with assets less than $100 million (assuming the other statutory criteria were satisfied). This statutory threshold was raised to $250 million in 1994 for institutions in outstanding condition and meeting the other statutory criteria. In 1996, the FBA's were authorized to extend the $250 million threshold to institutions in good condition. Given the fact that the current threshold has been in place for almost 10 years, OTS believes it is appropriate to consider whether the $250 million cap should be raised. OTS supports increasing the small institution threshold to $1 billion for well-capitalized, well-managed institutions. We believe this provision would reduce regulatory burden on low-risk, small institutions and permit the FBA's to more effectively focus their resources on the highest risk institutions.

With respect to matrix number 112, OTS is unable to take a position on this proposal without reviewing the legislative language.

Q.3. Prior to the Gramm-Leach-Bliley Act, banks engaging in traditional banking services such as trust and fiduciary activities were exempt from the definitions of broker and dealer under the Securities Exchange Act of 1934. What protections were in place prior to the Gramm-Leach-Bliley Act to ensure that these activities were conducted in an appropriate manner? Is there any evidence that banks were abusing this exemption or that these activities posed a risk to the system? The SEC has attempted to implement the amendments made to the definitions of broker and dealer by issuing its Regulation B. What is the status of Regulation B?

A.3. While it is true that banks engaging in traditional banking services prior to the enactment of the Gramm-Leach-Bliley Act (GLB Act) were exempt from the definitions of broker and dealer under the Securities Exchange Act of 1934 (Exchange Act)—savings associations do not now, and have never had, a similar statutory exemption.

The Exchange Act requires any broker or dealer to register with the Securities and Exchange Commission (SEC) if it uses the mail or any instrumentality of interstate commerce to effect transactions in, or induce the purchase or sale of, any security (Section 15(a)(1)). Section 201 and 202 of the GLB Act amended Section 3(a)(4)(B) and 3(a)(5)(C) of the Exchange Act to conditionally exempt banks from registration as a broker or dealer if they engaged in certain banking activities. The definition of "bank" in the Exchange Act (Section 3(a)(6)) has been interpreted by the SEC to include State-chartered banks and national banks, but never savings associations. The GLB Act did not change the definition of bank in the Exchange Act. The SEC, utilizing its broad exemptive authority in Section 36 of the Exchange Act, has provided a temporary exemption from the definitions of "broker" for savings associations on the same terms and under the same conditions that banks are excepted (17 CFR 242.733). This exemption is in effect until September 30, 2006.

The legislative history of the Exchange Act indicates that banks were excluded from the definition of "broker" and "dealer" because Congress recognized at that time (1934) that banks engaging in securities transactions were already subject to the scrutiny of bank regulators. Banks have provided securities services for many years, largely through their trust departments, with few problems. Trust department services are subject to strict and well-developed mandates of State trust and fiduciary law. Trust services also receive strict scrutiny by bank supervisors and examiners that specialize in these activities.

Savings associations engage in the same securities transactions, largely through their trust departments. The authority for savings associations to engage in trust activities has been in place since 1980. Since then, savings associations have been providing the same trust department services to their customers as banks. Savings associations engaging in securities transactions through their trust department are subject to the same State trust and fiduciary laws as banks and receive similar Federal regulatory oversight by trained supervisors and examiners.

Other securities services have long been provided by banks and savings associations as an integral part of their normal banking functions without generating any significant securities-related concerns. Custodial and safekeeping activities, which may involve certain securities transactions, are core banking functions. These activities are provided as an accommodation to customers or offered to particular customers such as employee benefit 401(k) plans or bank-offered custodial IRA's. Other "broker" or "dealer" securities transactions that occur in the course of providing customers common bank and savings association products and services, such as networking (depository institution customers purchasing securities products through a third party brokerage arrangement) or sweeps of deposit funds into certain money market funds, are common banking practices.

The history of banks and savings associations engaging in these activities without any significant concerns is true of all of the securities transactions detailed in Section 201 and 202 of the GLB Act. All of these activities receive constant scrutiny by bank supervisors and examiners. These protections were in place prior to the enactment of the GLB Act and will remain in place in the future. The exceptions provided to banks in the GLB Act, and to savings associations through the SEC's temporary exemption, meet the exemption test in Sections 15 and 36 of the Exchange Act in that they are in the interest of the public and consistent with the protection of investors.

The SEC issued interim final broker-dealer rules on May 11, 2001 to implement Sections 201 and 202 of the GLB Act. As part of these rules, the Commission exercised its authority to include savings associations within the bank exceptions. This treated savings associations the same as banks for the first time for purposes of broker-dealer registration. In the interim broker-dealer rule, the SEC recognized it would be wrong to continue disparate, anomalous treatment between savings associations and banks. The SEC postponed the effective date of the interim rule several times. On June 30, 2004, the SEC published in the *Federal Register* a new proposed broker rule (Regulation B). Unlike the interim final rules, savings associations are not treated the same as banks in all respects.

Savings associations are treated the same as banks for the 11 statutory activities they may engage in without registering as a broker with the SEC, as provided by the GLB Act. However, three nonstatutory exemptions provided banks would not be extended to savings associations. The SEC describes the three nonstatutory exemptions as targeted exemptions that recognize the existing business practices of some banks. We understand that the SEC does not believe savings associations are engaged in the exempted securities activities and will only extend relief for savings associations to the securities activities they are currently performing. A separate analysis conducted by OTS indicates that savings associations engage in all of the securities activities covered by the three additional exemptions. Pursuant to its request, this information was forwarded to the SEC in October 2004.

Since the publication of the proposed Regulation B rules, OTS met with several SEC Commissioners, filed a comment letter on September 1, 2004 objecting to the unequal treatment of savings associations, and held conversations with staff from the Division of Market Regulation. The SEC has not indicated that it is willing to reverse its position with regard to the inequitable treatment of savings associations. A temporary exemption for savings associations from having to register as a broker is in place until September 30, 2006.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM DONALD L. KOHN

Q.1. The agencies have devoted considerable time and resources to developing the matrix and have sought input from consumer groups as well as industry representatives. As regulators, you bring a unique perspective to the process. Based on that perspective, why do you feel regulatory relief is necessary now?

A.1. The number of regulatory requirements imposed on banking organizations has increased substantially over time. Some of these regulatory requirements, however, may no longer provide public benefits commensurate with their costs. For example, changes in the marketplace, technology, supervisory or risk management practices, or the Federal banking laws themselves may well have reduced the need for certain regulatory requirements or restrictions adopted in the past.

Unnecessary regulatory burdens hinder the ability of large and small banking organizations to meet the needs of their customers, operate profitably, innovate, and compete with other financial services providers. Compliance can weigh especially heavily on community banks because of the smaller scale of their operations over which to spread the costs.

For these reasons, the Board strives to review each of its regulations at least once every 5 years to identify those provisions that are out of date or no longer warranted. The Board also has been an active participant in the ongoing regulatory review process being conducted by the Federal banking agencies pursuant to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA).

Many proposals to reduce regulatory burden, however, require Congressional action to implement. For this reason, the Board has proposed or supported a variety of legislative proposals that we believe would provide meaningful relief to banking organizations supervised by the Federal Reserve. These proposals are highlighted and discussed in my written testimony. The Board strongly supports the Committee's efforts to develop a regulatory relief bill that is consistent with the Nation's public policy objectives, and the Board and its staff look forward to working with the Committee and its staff as the regulatory relief process moves forward.

Q.2. We have received several proposals designed to give regulators additional flexibility in conducting examinations (#42, 68, 112, and 169). Do these types of proposals pose a safety and soundness concern?

A.2. Of the four examination-related amendments you mention, the Board supports only proposal No. 68. We believe this amendment would provide meaningful relief to small insured depository institutions without adversely affecting safety and soundness.

Federal law currently requires that the appropriate Federal banking agency conduct a full scope, on-site safety and soundness examination of each insured depository institution at least once every 12 months. The statute, however, permits institutions that have less than $250 million in assets to be examined on an 18-month cycle if the institution is well-capitalized, well-managed, and meets certain other criteria.[1] The $250 million asset cutoff for an institution to qualify for an 18-month examination cycle has not been adjusted since 1994.

The Board supports an amendment (proposal No. 68) that would raise this asset threshold from $250 million to $500 million. Doing so would potentially allow approximately an additional 1,200 insured depository institutions to qualify for an 18-month examination cycle. Importantly, this change would not exempt any insured depository institution from routine safety and soundness examinations, nor would it lengthen the examination cycle for institutions experiencing financial or managerial difficulties.

The Board does not support proposals No. 112 and No. 169, which would raise the asset threshold for an 18-month examination cycle to $1 billion. Institutions that have assets approaching $1 billion tend to have more complex risk profiles and are more likely to operate business lines on a regional or national basis than institutions with assets of less than $500 million. For these reasons, the Board believes that institutions with assets of $500 million or more should continue to be subject to a 12-month safety and soundness exam cycle. We also believe it would be preferable to gain experience with a $500 million cutoff before deciding whether it would be appropriate to raise the threshold further.

The Board also does not support proposal No. 42. This amendment would allow a Federal banking agency to extend the 12 or 18-month safety and soundness examination cycle for an institution of *any* size, and for a potentially indefinite period of time, in order to allocate and conserve the agency's examination resources. Despite advances in off-site monitoring, the Board continues to believe that regular on-site examinations play a critical role in helping bank supervisors detect and correct asset, risk-management, or internal control problems at an institution before these problems result in claims on the deposit insurance funds. These lessons were learned during the thrift and banking crises of the 1980's and were the reason Congress established the mandatory exam cycles in 1991. These mandatory on-site examination cycles impose important discipline on the Federal banking agencies, ensure that insured depository institutions do not go unexamined for extended periods, and have contributed significantly to the safety and soundness of insured depository institutions. If an agency is experiencing shortages in its examination resources, we believe it would be better to address these constraints through the supplementation of the agency's resources, rather than by extending the mandated frequency of safety and soundness examinations.

Q.3.a. Prior to the Gramm-Leach-Bliley Act, banks engaging in traditional banking services such as trust and fiduciary activities were exempt from the definitions of broker and dealer under the Securities Exchange Act of 1934. What protections were in place prior to the Gramm-Leach-Bliley Act to ensure that these activities were conducted in an appropriate manner?

[1] *See* 12 U.S.C. § 1820(d). The Board and the Federal Deposit Insurance Corporation (FDIC) may alternate responsibility for conducting the required examinations of State-chartered banks with the bank's appropriate State supervisor if the Board or FDIC determines that the State examination fulfills the purposes of the Federal mandate.

A.3.a. Banks have provided their customers a wide range of securities transaction services for many years as an integral part of their trust, fiduciary, custodial, and other normal bank functions. Banks have provided these securities-related services under the effective and comprehensive supervision and regulation of the Board, the Office of the Comptroller of the Currency (OCC), and the FDIC (the Banking Agencies). We believe this framework of supervision and regulation has provided, and continues to provide, sufficient protections to consumers that obtain securities-related services from a bank.

In the trust and fiduciary area, for example, bank customers are protected by well-established and comprehensive trust and fiduciary laws and principles that arise from a variety of Federal, State, and common law sources separate and apart from the Federal securities laws.[2] The Banking Agencies regularly examine the trust and fiduciary activities of banks to help ensure that banks comply with their fiduciary obligations to customers. As part of these examinations, our examiners review, among other things, the discretionary investments made by banks on behalf of their trust and fiduciary accounts to ensure that the investments are prudent and consistent with applicable law and the underlying account documents; the bank's trading activities for trust and fiduciary customers to ensure best execution on securities transactions and the fair and equitable allocation of securities purchases and sales among accounts; the effectiveness of the bank's policies for preventing self-dealing and conflicts of interest; and the fees received by the bank to ensure that they are consistent with the bank's fiduciary obligations and properly disclosed to the customer.

Likewise, the Banking Agencies' supervision and examination process provides important protections to customers that obtain custodial services (including related securities order-taking services) from a bank. As part of the examination of a bank's custodial activities, bank examiners review the banks' account acceptance process, settlement of custodial securities transactions handled by the bank, and safekeeping of customers' securities; the experience, training, and qualifications of staff engaged in custodial activities; and the policies and procedures that banks have in place to help ensure that beneficial owners of securities are provided proxy material and other corporate communications in a timely manner in accordance with applicable shareholder communication rules.

The Banking Agencies also adopted guidelines governing the referral of retail customers to affiliated or unaffiliated broker-dealers. These guidelines provide that bank employees should receive only a "nominal" one-time fee for the referral of a retail customer, and provide that the payment of any referral fee should not depend on whether the referral results in a securities transaction. In addition, these guidelines provide for banks to make certain disclosures concerning the nature of nondeposit investment products to protect retail customers from confusion about the risks of these investments.

The Banking Agencies also have adopted regulations that require banks to maintain adequate records and issue customer confirma-

[2] *See, e.g.,* Uniform Trust Code (2000); Uniform Prudent Investor Act (1994); Employee Retirement Income Security Act of 1974, Section 401 *et.seq.* (29 U.S.C. §§1101 *et. seq.*); 12 CFR Part 9 (OCC fiduciary regulations); Restatement (Second) of Trusts §§169 to 185 (1959).

tions for all securities transactions and establish policies and procedures governing the supervision of securities transactions and the reporting of personal transactions by bank employees.[3] Moreover, despite their exceptions from the definitions of "broker" and "dealer," banks always have been subject to the antifraud provisions of the Federal securities law, including Section 10(b) of the Securities Exchange Act of 1934 (1934 Act). In examining a bank's compliance with these and other applicable laws, regulations, guidance, and principles, Banking Agency examiners are guided by extensive and detailed training and examination manuals, as well as supplemental advisory or supervisory letters, bulletins, and other examiner guidance.[4]

In light of these strong existing protections, and the lack of any significant securities-related concerns arising from the securities activities conducted by banks, Congress drafted the exceptions for bank activities in Title II of the Gramm-Leach-Bliley Act (GLB Act) broadly in order to allow banks to continue to provide securities services in connection with their normal bank functions without disruption.

Q.3.b. Is there any evidence that banks were abusing this exemption or that these activities posed a risk to the system?

A.3.b. The Board is not aware of any evidence indicating that banks abused their exceptions from the definitions of "broker" and "dealer" prior to the GLB Act. As discussed above, banks have provided securities transaction services for many years as an integral part of their traditional bank functions. These activities were conducted under the effective supervision and regulation of the Banking Agencies and did not generate significant securities-related concerns or create undue risks to the safety and soundness of banks. Congress recognized this fact when it adopted the GLB Act[5] and, for this reason, crafted the new exceptions in Title II in a broad way so that they would cover the securities activities that banks had been providing for many years in connection with their normal bank functions. We note, moreover, that numerous banking organizations have operated and continue to operate separate, nonbank registered broker-dealer affiliates to conduct general retail brokerage activities or other securities activities, such as underwriting corporate debt or equity securities, that are outside the normal and traditional functions protected by Title II.

Q.3.c. The SEC has attempted to implement the amendments made to the definitions of broker and dealer by issuing its Regulation B. What is the status of Regulation B?

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[3] *See* 12 CFR Part 12 (OCC); Part 208 (Board); and Part 344 (FDIC).

[4] *See, e.g.,* Board, Commercial Bank Examination Manual; OCC, Comptroller's Handbooks for Asset Management, Conflicts of Interest, Investment Management Services, Personal Fiduciary Services and Custody Services; FDIC, Trust Examination Manual and Risk Management Manual of Examination Policies.

[5] *See* S. Rep. No. 106–44 at 10 (1999) ("Banks have historically provided securities services largely through their trust departments, or as an accommodation to certain customers. Banks are uniquely qualified to provide these services and have done so without any problems for years. Banks provided trust services under the strict mandates of State trust and fiduciary law without problems long before Glass-Steagall was enacted; there is no compelling policy reason for changing Federal regulation of bank trust departments, solely because Glass-Steagall is being modified.")

A.3.c. In June 2004, the Securities and Exchange Commission (SEC) requested comment on proposed Regulation B, which would implement the "broker" exceptions for banks adopted by Congress in Title II of the GLB Act. These exceptions include the important statutory exceptions designed to allow banks to continue to effect securities transactions as part of their trust, fiduciary, custodial, and networking activities. In September 2005, the SEC announced that it was continuing to review the comments submitted on Regulation B and adopted an order extending the blanket exemption that banks have from the definition of "broker" under the 1934 Act until September 30, 2006. This process continues and the SEC has not yet finalized proposed Regulation B.

In October 2004, the Board, OCC, and FDIC submitted a joint comment letter to the SEC on proposed Regulation B that sets forth in detail the Banking Agencies' concerns with the proposed regulation. The comment letter notes that, if Regulation B as proposed were to be adopted in final, it would significantly disrupt the normal functions and customer relationships of banks that the GLB Act was intended to protect and preserve. The proposed regulation also would impose substantial and unnecessary costs on banks and their customers and limit customer choice by preventing or discouraging banks from providing traditional services to customers. The Board believes these results would not occur if the statutory "broker" exceptions for banks in the GLB Act are implemented in a manner consistent with the statute's language and purpose.

Since filing this comment letter, Board members and staff have been discussing the Banking Agencies' concerns with the SEC and its staff.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM DOUGLAS H. JONES

Q.1. The agencies have devoted considerable time and resources to developing the matrix and have sought input from consumer groups as well as industry representatives. As regulators you bring a unique perspective to the process. Based on that perspective, why do you feel regulatory relief is necessary now?

A.1. Over the years, Congress has enacted many laws and the banking agencies have adopted many regulations that have protected consumers, strengthened financial institution safety and soundness, and improved crime detection. Individually, few of these laws impose a significant burden on financial institutions; however, cumulatively, they have created a complex regulatory framework that raises costs for banks and savings institutions. The FDIC is committed to relieving regulatory burden while maintaining the benefits and protections established for consumers and financial institutions.

It is a good idea for agencies to systematically review their regulations, written policies, and underlying statutes to improve efficiency, reduce unnecessary costs, and eliminate inconsistencies and outmoded and duplicative requirements. As you know, the latest attempt at reviewing our regulations and statutes is in accordance with the requirements of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. This is not the first time, however, and will not be the last. The Federal regulatory agencies have become more sensitive to regulatory costs, especially those incurred by small community institutions, and will continue to strive toward more efficient regulation and procedures and also continue to keep Congress informed of statutory changes that we believe will help us toward this goal. At this point, the agencies have endeavored over the past several years to work with the industry, consumer groups, and Congress to come up with worthwhile provisions in the law that could use updating. Now would be a good time for Congress to consider these suggestions, especially since it has been almost 10 years since burden reduction legislation has been adopted.

Q.2. We have received several proposals designed to give regulators additional flexibility in conducting examinations (#42, 68, 112, and 169). Do these types of proposals pose a safety and soundness concern?

A.2. Section 10(d) of the Federal Deposit Insurance Act requires Federal banking agencies to conduct full-scope, on-site examinations of insured depository institutions within their jurisdiction at least every 12 months. Small institutions (currently defined as institutions with total assets of less than $250 million) that are well-capitalized, well-managed, and meet certain other criteria are required to be examined at least every 18 months. Nearly 60 percent of insured institutions currently qualify for the 18-month examination cycle based on their size, capitalization level, and examination rating.

Proposals to increase flexibility in conducting examinations do not necessarily pose safety and soundness concerns unless examination intervals are unduly lengthened or regulatory discretion is given without set criteria or parameters. The FDIC's analysis of the banking crisis of the 1980's and early 1990's indicates that safety and soundness concerns arise when the examination frequency extends beyond 2 years. Off-site monitoring tools based on Call Report data become more unreliable after such an extended period. The examination cycle should not be extended without set criteria or parameters designed to prevent situations that exacerbated the last banking crisis. Proposal 42 may pose safety and soundness risks because it eliminates the specific examination frequency requirements from Section 10(d).

The examination frequency intervals set forth in Section 10(d) have been very effective in promoting the safety and soundness of the banking industry by requiring the Federal banking agencies to give appropriate and timely attention to *all* of the institutions they supervise. However, the FDIC agrees that the $250 million small bank threshold, which has been in effect for a decade, could be raised without compromising safety and soundness. Of the various proposals on examination flexibility, the FDIC prefers Proposal 68, which increases the small bank threshold to $500 million, but leaves the maximum interval between examinations at 18 months. It is estimated that an additional 1,000 insured institutions would be eligible for the 18-month examination cycle if this proposal were to be adopted. For these institutions, the extra 6 months between full-scope examinations would represent a significant reduction in regulatory burden with little additional risk to the Deposit Insurance Fund.

Q.3.a. Prior to the Gramm-Leach-Bliley Act, banks engaging in traditional banking services such as trust and fiduciary activities were exempt from the definition of broker and dealer under the Securities Exchange Act of 1934. What protections were in place prior to the Gramm-Leach-Bliley Act to ensure that these activities were conducted in an appropriate manner?

A.3.a. Prior to the enactment of the Gramm-Leach-Bliley Act (GLBA) customers of banks engaged in securities-related activities were protected by:

- Federal banking regulations governing recordkeeping and confirmation requirements for securities transactions (for example the FDIC's regulations at 12 CFR Part 344 and substantially identical regulations promulgated by the other Federal bank regulatory agencies),
- an interagency statement of policy governing retail sales by banks of nondeposit investment products (NDIP SOP), and
- periodic examinations by the Federal regulatory agencies of the trust and fiduciary services activities conducted by banks.

Each of these protections remains in place and continues to be in effect.

The FDIC's recordkeeping and confirmation regulations at 12 CFR Part 344 require that banks maintain detailed customer and account records of their customers for whom the banks effect securities transactions. In addition, these regulations require customer confirmations by banks for securities transactions and specify the content and timing of such confirmations. In particular, banks are required to disclose details concerning the amount and the source of remuneration received by the bank for effecting a securities transaction, as well as the remuneration received by other parties to the transaction. These regulations also require the settlement of securities transactions and mandate the development and implementation of securities trading policies and procedures, including the fair and equitable allocation of securities and prices to customer accounts and the crossing of buy and sell orders on a fair and equitable basis. Further, these regulations require the reporting of personal securities trading by bank officers and employees. Compliance with these recordkeeping and confirmation requirements is reviewed at each trust examination for those banks that execute securities transactions for customers.

The NDIP SOP was adopted by the Federal banking agencies on February 15, 1994, in response to the increased involvement of banks in the sale of retail nondeposit investment products to bank customers. The NDIP SOP is designed to ensure bank customers are clearly and fully informed of the character and risks associated with nondeposit investment products. The NDIP SOP requires banks to implement policies and procedures governing compliance with applicable laws and regulations, the supervision of personnel selling nondeposit investment products, the types of investment products sold, the permissible use of customer information, appropriate and inappropriate referral activities, and a description of the training requirements and compensation arrangements for personnel involved in selling nondeposit investment products. The NDIP SOP contains guidelines for the securities activities of banks, including disclosures and advertising, qualifications and training of personnel, suitability and sales practices, compensation, and compliance with applicable laws, regulations, and internal policies. Compliance with the NDIP SOP is reviewed at each trust examination for those banks engaged in the sale of nondeposit investment products.

Banks that conduct securities activities in conjunction with the provision of trust and fiduciary services are subject to regular examinations by the appropriate Federal banking agency of their trust and fiduciary services activities. These trust examinations are designed to evaluate the institution's performance as a trustee, fiduciary, or custodian for the benefit of bank customers and account beneficiaries. Under these trust examination procedures, individual ratings are assigned to the trust department's: (1) management; (2) the adequacy of its operations, internal controls, and auditing programs; (3) the department's earnings; (4) the institution's policies, procedures, and performance under the applicable Federal and State laws and regulations, general fiduciary standards and practices, written account documents and agreements, and internal bank policies and procedures; and (5) the policies, procedures, and performance of the bank's asset management functions. Based on these five individual factors, an overall rating, based on a scale of 1 to 5, is assigned to the bank's trust and fiduciary services departments. Banks rated "3 or lower" are considered unsatisfactory in one or more areas and are subject to more frequent and extensive examinations until the underlying deficiencies are corrected.

As part of the evaluation of a bank's trust or fiduciary services department, trust examiners review the following trading and brokerage activities conducted in the trust or fiduciary services department:

- efforts to obtain "best execution" on securities trades;
- suitability of investments in agency accounts when the bank exercises investment discretion;
- appropriate due diligence for brokers placed on approved list, broker allocation guidelines, and the establishment of trading limits;
- satisfactory maintenance of all trading-related records, including order tickets, confirmations, etc.;
- fair allocation of securities and prices when securities are bought or sold in blocks, or when buy and sell orders are crossed between accounts;
- timely resolution of failed trades and customer complaints;
- prohibitions or limitations on personal trading by bank personnel, including procedures designed to prevent or detect inappropriate trading practices such as front running fiduciary account trades;
- appropriate separation of trading activity from back room functions; and appropriate audit coverage of trading activities conducted in fiduciary accounts.

In addition, other activities, such as securities lending and the operation of common and collective investment funds are reviewed at each examination. At each examination, examiners identify actual and potential conflicts of interest and evaluate the bank's management of such conflicts. Actual and potential conflicts involving the sale or use of proprietary products and services, such as proprietary mutual funds or affiliated brokerage firms, are subject to close scrutiny at each examination. Other specialized lines of business, such as employee benefit plan services or corporate trust services are subject to review based on both compliance with general fiduciary standards and with Federal and State laws and regulations governing those activities.

Each Federal banking agency maintains groups of trained examination specialists in their regional offices dedicated to conducting reviews of trust and fiduciary services. In addition, each agency also maintains an examination policy manual to provide specific subject matter guidance to examiners.

Q.3.b. Is there any evidence that banks were abusing this exemption or that these activities posed a risk to the system?

A.3.b. The FDIC's trust examination experience indicates that the securities related activities conducted by banks, including activities carried out within the trust or fiduciary services departments, do not pose a significant risk to bank customers or to the system as a whole. To date, examinations do not indicate any systematic abuse of the exemption on the part of banks. Noncompliance by banks with Federal and State trust laws, regulations, and fiduciary standards have been minor and sporadic in nature.

Q.3.c. The SEC has attempted to implement the amendments made to the definitions of broker and dealer by issuing its Regulation B. What is the status of Regulation B?

A.3.c. The SEC has extended the temporary exemption of banks from its interpretation of the definition of "broker" under the Securities Exchange Act of 1934, as amended by GLBA, until September 30, 2006. (Exchange Act Release No. 34–52405 (September 9, 2005)) In this order, the SEC stated that the "Commission believes that extending the exemption from the definition of "broker" until September 30, 2006, will prevent banks and other financial institutions from unnecessarily incurring costs to comply with the statutory scheme based on the current Interim Rules . . . ." (*id.* at 3) The SEC is considering the many comments it received from the banking industry, banking regulators, and Members of Congress in response to its Regulation B Proposal prior to any action on a final rule. In the interim, Federal banking agency principals and staff continue to discuss the issues with the SEC and its staff.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM JULIE L. WILLIAMS

Q.1. The agencies have devoted considerable time and resources to developing the matrix and have sought input from consumer groups as well as industry representatives. As regulators you bring a unique perspective to the process. Based on that perspective, why do you feel regulatory relief is necessary now?

A.1. Unnecessary regulatory burdens increase bank costs. Bank customers feel the impact of these increased costs in the form of higher prices. In addition, bank customers may, in certain cases, feel the impact of unnecessary regulatory burdens in other ways, such as diminished product choices. Unnecessary burdens also can become an issue of competitive viability, particularly for our Nation's community banks, and can lead to the inefficient use of banks' resources.

My testimony highlighted a number of legislative changes for Congress to consider to reduce unnecessary burdens on our Nation's depository institutions. Congressional action is necessary now so that the impact of these unnecessary burdens can be eased for banks and their customers as expeditiously as possible. The more quickly Congress acts, the more quickly the banks and their customers can realize the benefits of eliminating unnecessary burdens.

Q.2. We have received several proposals designed to give regulators additional flexibility in conducting examinations (#42, 68, 112, and 169). Do these types of proposals pose a safety and soundness concern?

A.2. The matrix items that you have listed approach this issue in different ways. The OCC supports matrix #169 that would amend the Federal Deposit Insurance Act to increase the small bank threshold from $250 million to $1 billion so that more small banks may qualify to be examined on an 18-month rather than an annual cycle.[1] Under current law, insured depository institutions with total assets of $250 million or less that are well-capitalized, and, as of the most recent examination, are well-managed may be examined on an 18-month cycle, rather than an annual cycle, in a full-scope, on-site examination.[2] Matrix #169 would change only the asset threshold and would not change any of the other requirements in the law.

For national banks, increasing this threshold to $1 billion would mean that approximately 340 more national banks may qualify for the 18-month cycle. Today, approximately 58 percent of all national banks are eligible for the 18-month cycle but, if the law were amended to raise the threshold to $1 billion, approximately 76 percent of all national banks could qualify. This change would ease the examination burden and associated costs for a meaningful number of qualifying national banks.

Matrix #169 does not raise safety and soundness concerns for national banks. Only the top-rated banks would be eligible for the extended cycle, and the Federal banking agencies would continue their active off-site monitoring oversight of these banks, as well as retaining their authority to accelerate the timing of an on-site examination if warranted. The 12- and 18-month examination cycles are maximum time periods during which an on-site examination must be conducted but there is nothing that limits a Federal banking agency's discretion to conduct an examination more frequently if necessary.

Q.3.a. Prior to the Gramm-Leach-Bliley Act, banks engaging in traditional banking services such as trust and fiduciary activities were

[1] Matrix #112 also is described as proposing an increase from $250 million to $1 billion. The OCC does not have legislative text for #112 but the OCC also would support #112 if the language is the same as #169.

[2] In addition, the law requires that an eligible institution must have a composite rating of "1" (or at least "2" if it is a smaller institution) and cannot currently be the subject of an enforcement action or the target of a change-in-control transaction during approximately the last year.

exempt from the definitions of broker and dealer under the Securities Exchange Act of 1934. What protections were in place prior to the Gramm-Leach-Bliley Act to ensure that these activities were conducted in an appropriate manner?

A.3.a. Trust and fiduciary services are core banking functions and ones that banks were authorized to conduct well before the enactment of the Gramm-Leach-Bliley Act (GLB Act) and even well before the enactment of the Securities Exchange Act of 1934. Banks provide securities transaction services as an integral part of their trust, fiduciary, custodial, and other bank functions and have done so throughout the years without raising significant investor protection-related concerns. The trust and fiduciary services that banks provide their customers are governed by well-developed principles of trust and fiduciary laws. In addition, these activities are supervised by the appropriate banking authorities. Together, the existing laws and principles, and regular banking agency examinations have effectively protected trust and fiduciary customers of banks from abusive practices for the considerable period prior to passage of the GLB Act, and the 6 years since its passage. Attached is a more complete description of the OCC's supervision of national banks' trust, fiduciary, custodial, and safekeeping activities.

Q.3.b. Is there any evidence that banks were abusing this exemption or that these activities posed a risk to the system?

A.3.b. The OCC is not aware of any evidence of significant abuses by the banking industry in its long history of providing securities services under the pre-GLB Act brokerage exemption. Similarly, we are not aware of evidence that banks conducted their securities-related services for their customers under the brokerage exemption in a manner that posed a risk to the banking system. Banks have provided the services covered by the exemption for decades prior to the enactment of the GLB Act, and for the 6 years since its passage, under the effective supervision of bank regulators and without creating any significant securities-related concerns.

Q.3.c. The SEC has attempted to implement the amendments made to the definitions of broker and dealer by issuing its Regulation B. What is the status of this regulation?

A.3.c. The SEC has adopted rules implementing the definition of "dealer" under the GLB Act and these rules became effective on October 1, 2003. The SEC also has twice proposed rules to implement the definition of "broker" under the GLB Act. The OCC, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation provided the SEC with detailed comments each time.[3] We urged the SEC to take a fundamentally different approach to make its rules comport with the language and purpose of the "broker" exceptions adopted by Congress in the GLB Act. The agencies contended that the new definition of "broker" should not result in disrupting recognized banking activities that banks have successfully provided to their customers for decades. Proper implementation of the GLB Act's "broker" exceptions is

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[3] *See* comment letters to the SEC from the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, dated June 29, 2001 and October 8, 2004.

critically important to ensuring that banks may continue to provide their customers with traditional banking services. The banking agencies remain committed to working with the SEC to successfully implement the important "broker" exceptions for banks and are engaged in discussions with the SEC to try to identify new approaches.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM JoANN M. JOHNSON

Q.1. The Agencies have devoted considerable time and resources to developing the matrix and have sought input from consumer groups as well as industry representatives. As regulators you bring a unique perspective to the process. Based on that perspective, why do you feel regulatory relief is necessary now?

A.1. The National Credit Union Administration (NCUA) charters and supervises Federal credit unions and insures savings in Federal and most State-chartered credit unions across the country through the National Credit Union Share Insurance Fund (NCUSIF). It is the responsibility of NCUA to ensure the safety and soundness of federally insured credit unions. As a regulator, it is essential that we are able to recognize and adapt to the ever-changing financial marketplace in which our regulated institutions operate.

The credit union industry is a closely regulated sector of the financial services industry. Capital ratios have remained consistently high and the institutions are conservatively run in a not-for-profit manner. These factors, combined with the fact that many of the statutory provisions currently in effect for credit unions were part of the original 1934 Federal Credit Union Act, strongly suggest that legislation eliminating or updating elements of that statute is entirely appropriate. NCUA supports legislative changes that would create a more practical and flexible system for prompt corrective action, allow credit unions to better serve small businesses, and update rules regarding healthy credit union mergers, and modernize investment powers and operational authorities that credit unions exercise.

Regulatory relief measures being considered by the House and Senate would provide a tangible benefit to America's consumers by giving them access to more modern, up-to-date, and efficient financial institutions. Equally important, an overall improvement in regulatory efficiency would be achieved by removing outmoded, duplicative, and unnecessary regulations while maintaining a focus on the primary safety and soundness responsibility that Congress has conferred on the NCUA. By implementing regulatory relief measures that promote safety and soundness and provide consumer protection, regulatory relief will empower NCUA to ensure that America's credit unions operate efficiently, effectively, and competitively in the interest of all consumers.

Q.2. We have received several proposals designed to give regulators additional flexibility in conducting examinations (#42, 68, 112, and 169). Do these types of proposals pose a safety and soundness concern?

A.2. NCUA currently operates under a policy similar to Proposal #42 for the Federal banking agencies, therefore the aforementioned proposals do not apply to NCUA. Accordingly, NCUA has no formal position regarding any of these proposals.

NCUA's flexible examination and supervision scheduling program was implemented in January 2002 to coincide with a major revision to the agency's examination program that focuses on risk rather than standardized parameters. NCUA also implemented quarterly Call Reports for all credit unions to enhance our remote monitoring capabilities.

NCUA refers to its flexible scheduling program as risk-based scheduling because we schedule examinations of Federal credit unions based on an annual risk assessment. Institutions deemed low risk are eligible for having an examination completed on an interval spanning from 12 to 24 months with a target completion frequency of 18 months. Institutions not eligible for the program are examined annually. The examination cycle for federally insured State-chartered credit unions is determined by the individual State regulators.

The following criteria are used to determine if a Federal credit union is eligible for risk-based scheduling:

- Has been assigned a composite CAMEL Code 1 or 2 in the two most recent examinations;
- Has been in operations for at least 10 years;
- Is classified as "well-capitalized" under Prompt Corrective Action (PCA);
- Has a positive return on average assets;
- Is not operating under an informal or formal enforcement action—for example: Preliminary warning letter, letter of understanding and agreement, cease and desist order, and PCA directives; and
- Has no material compliance or safety and soundness weaknesses.

NCUA is committed to the concept of focusing resources based on risk. Since the start of our risk-based scheduling program, we have implemented many changes to our examination and supervision program to ensure its long-term success. An example of the benefits of our risk-based scheduling program was the ability to quickly free resources to address the affects of Hurricane Katrina. By shifting the examination dates for low-risk institutions scheduled for examination in the fall of 2005, NCUA made resources available to address the affects of the storm without exposing the NCUSIF to additional risk.

Q.3.a. Prior to the Gramm-Leach-Bliley Act, banks engaging in traditional banking services such as trust and fiduciary activities were exempt from the definitions of broker and dealer under the Securities Exchange Act of 1934. What protections were in place prior to the Gramm-Leach-Bliley Act to ensure that these activities were conducted in an appropriate manner?

A.3.a. As you know, the definition of broker and dealer did not apply to banks prior to the passage of the Gramm-Leach-Bliley Act (GLBA) due to a blanket exemption for "banks" from the Securities Exchange Act (SEA) of 1934. The GLBA replaced the blanket exemption with certain functional exemptions based on traditional banking services, including an exemption for trust activities.

The Security Exchange Commission (SEC) does not consider credit unions or mutual savings banks (thrifts) to fall within the definition of "bank" for purposes of the banking exemptions to the Securities and Exchange Act of 1934. Therefore previous to GLBA credit unions were not exempt from the SEA of 1934. Even if the pre-GLBA blanket exemption had been available to credit unions, Federal credit unions do not have general trust powers and could not have taken advantage of the exemption for that purpose.

In 2001, subsequent to the passage of GLBA and the creation of functional exemptions for certain specified banking activities, the SEC issued an interim final rule granting thrifts the same functional exemptions available to banks. In the preamble to its rule, the SEC asked if these exemptions "should be extended to any other entities." The NCUA informed the SEC that credit unions should have the same functional exemptions from the SEA (and the associated SEC regulation and oversight) as banks and thrifts. The NCUA gave several reasons, including:

- In credit unions, the members are both the owners and the customers. This structure aligns the interests of the credit union management with those of the members and so reduces the potential for securities fraud and abuse of members and the associated need for SEC oversight.
- NCUA and State regulators provide intensive supervision of credit union activities and therefore add an additional layer of protection for the members.

Q.3.b. Is there any evidence that banks were abusing this exemption or that these activities posed a risk to the system?

A.3.b. The NCUA is not aware of any evidence of banks abusing the exemption to the Security Exchange Act of 1934.

Q.3.c. The SEC has attempted to implement the amendments made to the definitions of broker and dealer by issuing its Regulation B. What is the status of Regulation B?

A.3.c. In June 2004, the Security Exchange Commission (SEC) issued the proposal for Regulation B. The proposal would exempt credit unions from the definition of "broker" for third party networking arrangements and sweep account arrangements and the definition of "dealer" for certain investment, trustee, and fiduciary arrangements. NCUA is not aware of when the SEC will issue the final version of Regulation B.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM LINDA JEKEL

Q.1. Why is regulatory relief necessary now?

A.1. Regulatory relief for State-chartered credit unions and their regulators will ensure the continued safety and soundness of the State credit union system. It allows State credit unions to survive and prosper in today's ever-changing financial marketplace. State credit unions provide consumers' access to a viable alternative financial services provider.

Capital Reform

As we expressed in our testimony, capital reform is necessary in three primary areas to ensure the continued safety and soundness of State credit unions. Without reform, credit union regulators lose an important tool to address troubled credit unions. I am specifically referring to the unintended consequences of the FASB Standard No. 141. These amendments to business combination accounting rules make mergers unattractive for credit unions, even when a State credit union regulator believes a merger would be the best option to protect members' funds.

In addition, NASCUS supports providing credit unions access to risk-based capital. Risk-based capital enables financial institutions to measure capital adequacy and to avoid additional risk on their balance sheets. The system recognizes a one-size-fits-all capital system does not work. A risk-based capital system acknowledges the diversity and complexity in a financial institution's balance sheet. Credit unions are the only insured depository institution not allowed access to risk-based capital.

Further, NASCUS believes credit unions should have access to alternative capital. This is especially true for credit unions striving to meet members' changing needs. The NASCUS White Paper, provided with our written testimony, details why alternative capital makes business sense and provides enhanced safety and soundness for our Nation's credit union system.

Additional Reforms

Additional reforms other than capital are necessary to further safety and soundness among State credit unions. NASCUS believes the National Credit Union Administration (NCUA). the Federal regulator and Federal credit union insurer, should include a Board Member with State credit union regulatory experience. We also believe privately insured credit unions should have access to the Federal Home Loan Bank (FHLB) system. Moreover, credit unions would be better equipped to serve their members needs if regulatory relief was provided to expand member business lending.

Improving Marketplace Viability

Regulatory relief would enhance the capabilities of State-chartered credit unions. Reform enables State credit unions to maintain viability in an increasingly competitive marketplace. It also allows them to provide expanded product and service offerings to better serve consumer members in their field of membership. Additionally, some regulatory relief proposals protect the credit union dual-chartering system, supporting the importance of charter choice and the ability of State and Federal regulators to innovate and promote efficiency. This provides for a continued, robust dual-chartering system.

As a regulator, I believe we should have reform that allows for stronger and safer State credit unions. The regulatory relief provisions for State credit unions that I mention above are logical and prudent from a regulatory perspective and allows for increased safety and soundness. These provisions are outlined in the regulatory relief matrix and were presented in our testimony.

Q.2. We have received several proposals designed to give regulators additional flexibility in conducting examinations (#42, 68, 112, and 169). Do these types of proposals pose a safety and soundness concern?

A.2. These provisions do not impact State credit union regulators; therefore, NASCUS has no position.

Q.3. Prior to the Gramm-Leach-Bliley Act, banks engaging in traditional banking services such as trust and fiduciary activities were exempt from the definitions of broker and dealer under the Securities Exchange Act of 1934. What protections were in place prior to the Gramm-Leach-Bliley Act to ensure that these activities were conducted in an appropriate in manner? Is there any evidence that banks were abusing this exemption or that these activities posed a risk to the system? The SEC has attempted to implement the amendments made to the definitions of broker and dealer by issuing its Regulation B. What is the status of Regulation B?

A.3. NASCUS has no opinion about Parts A and B because they are not applicable to State-chartered credit union regulators. We support the exemptions that Regulation B provides to State-chartered credit unions engaging in limited securities activities that are conducted under the terms applicable to certain bank exceptions from the definitions of "broker" and "dealer." This provides federally insured credit unions parity treatment with commercial banks of registration exemptions granted from the Securities and Exchange Commission (SEC).

In September 2005, the SEC postponed a Regulation B compliance date for banks on broker registration until September 30, 2006. The Commission released a statement that it did not expect banks to comply until it implemented systems to ensure compliance with the new statutory requirements concerning the definition "broker." NASCUS believes regulatory relief is necessary with regard to SEC broker/dealer registration. The proposed regulation contains an exemption for credit unions from the definition of dealer. It permits credit unions to buy and sell securities for investment purposes for themselves, or for accounts for which they act as trustee or fiduciary under the terms of the bank exception in Exchange Act Section 3(a)(5)(C)(ii). This exemption is also not effective until the SEC issues its final rulemaking on Regulation B.

Thank you for asking NASCUS to provide additional comments on regulatory relief. I am always available to further explain why regulatory relief is necessary for State credit union regulators and to answer questions the Committee may have.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM BRADLEY E. ROCK

Q.1. It has been nearly 2 years since we first held a hearing on regulatory relief. In this time, has the overall regulatory environment changed for banks, thrifts, and credit unions? If so, have these changes increased the need for regulatory relief?

A.1. Yes, the overall regulatory burden for banks has increased in the last few years and there is an immediate need for Congress to enact regulatory relief legislation.

Regulatory Burdens Have Increased

Banks are struggling under the weight of increasing levels of regulatory burdens, many of which do not serve the objective of making the Nation's banks operate more soundly or to provide meaningful protections to consumers. These regulatory burdens raise the cost to banks and, consequently, place an unnecessary strain upon banks' abilities to efficiently serve their customers.

It is clear that legislation enacted within the last few years has significantly increased the regulatory burden on the financial services industry. For example, the USA PATRIOT Act, the Sarbanes-Oxley Act, and the Gramm-Leach-Bliley Act are all valuable pieces of legislation that strive to serve the public interest. However, overly complex or redundant compliance requirements render these laws far less effective than they would be otherwise.

Banks, particularly community banks, are strained to the breaking point under the weight of thousands of pages of regulation, guidance, and other mandates. When the cumbersome layering of additional requirements, issued by the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), the American Institute of Certified Public Accountants (AICPA), and the Internal Revenue Service (IRS) are also taken into account, it is abundantly clear that bank resources are being stretched too thin.

For the typical small bank, about $1 out of every $4 of operating expense goes to pay the costs of government regulation. For large banks as a group, total compliance costs run into the billions of dollars annually.

The cumulative effect of new rules and regulations is already leading many community banks to look for merger partners to help spread the costs. Some community banks will go out of business altogether or consolidate with larger banks—a trend that it already underway. Our members routinely mention regulatory burden as the first or second critical factor threatening the viability of their community banks. The pressures to comply with all the regulations and still meet the demands of our customers are enormous. We feel that we must grow the bank rapidly to generate more revenues simply to pay for the ever-increasing regulatory cost. The sad part is that too much time and effort is now devoted to compliance and not to serving our customers. Bankers at all levels, from bank directors and CEO's to compliance managers and tellers, spend endless hours on compliance paperwork. Because of the complexities involved, my bank pays more than $100,000 each year to outside firms to help us with the big compliance issues. On top of this, one person on my staff has a full-time job just to coordinate all the activities throughout the bank related to regulatory compliance. I personally spend about one-and-a-half days per week just on compliance issues. Some CEO's tell me that they are now spending nearly half of their time on regulatory issues. In addition, banks spend billions annually on compliance training, outside compliance support (including accounting firms, consultants, and attorneys), compliance related hardware and software, printing, postage, and telephone connections.

Eliminating CTR's for "Seasoned Customers" Will Help

You asked if changes over the years have increased the need for regulatory relief. The answer from the banking industry is an unequivocal "Yes!" In my written testimony, I mentioned several things that the Committee could include in regulatory relief legislation that would provide real, cost-savings benefits to banks across the Nation. However, in this response I would like to focus on the provision eliminating needless Currency Transaction Reports (CTR's) for "seasoned customers" that was included in regulatory relief legislation (H.R. 3505) passed by the House on March 8 that received very strong bi-partisan support.

ABA and its members strongly believe that the current cash transaction reporting program has been rendered virtually obsolete by several developments: Enhanced customer identification programs, more robust suspicious activity reporting, and the use of the more focused and intensive 314(a) inquiry/response process. We believe that the current CTR screen at the current level generates too many reports that capture extensive immaterial activity wasting law enforcement time and resources that could be spent more effectively on detection and investigation of criminal and terrorist activity.

In fact, as published in the U.S. Money Laundering Threat Assessment released earlier this year, the number of CTR's filed on an annual basis now tops 13.1 million with no signs of abating. Even at FinCEN's conservative estimate of around 25 minutes per report for filing and recordkeeping, it means that the banking industry as a whole devoted around 5½ million staff hours of work to handling CTR's in 2005. Based on our recent survey, the industry paid around $187 million in wages for this staff time.

Based on that same survey, three-quarters of the filings were for business customers who had been with the bank for over a year. That means that the industry spent around four million staff hours and over $140 million last year filing notices on well-established customers!

A typical bank with $2 billion of assets filed 1,400 CTR's in 2005. The filings took 583 staff-hours. And 438 of the staff-hours were simply to report on long-standing customers. This trend is only likely to accelerate and demand more and more staff to report on more and more transactions further burying the real needles of money laundering under an exponentially growing mound of the hay of legitimate business transactions mindlessly recorded at great expense and increasing opportunity cost.

To continue to require CTR filings for business customers whose identity has been verified under a bank's Customer Identification Program (CIP) and tested under a period of experience with the bank and that remain subject to risk-based suspicious activity reporting is an inefficient use of resources by bankers and law enforcement. It also diverts scarce examiner resources by focusing on compliance with *technical* reporting standards, rather than evaluating bank internal controls for detecting transactions that possess a likelihood of involving money laundering and terrorist financing.

Accordingly, *we believe that the best way to improve the utility of cash transaction reporting is to eliminate the routine reports being filed on legitimate American businessmen and businesswomen.* This can be achieved by establishing a seasoned customer exemption for business entities, including sole proprietorships, as endorsed by FinCEN last year in testimony before Congress.

It is important to remember that cash transaction data will not be lost, but rather will continue to reside in the normal bank account data for each seasoned customer. It will, therefore, be available to law enforcement whenever sought in connection with an inquiry from government enforcement entities. In particular, by using the USA PATRIOT Act 314(a) inquiry process, law enforcement will be able to obtain information in far greater detail on the accounts of suspects. Of course, all seasoned business customers would continue to be subject to suspicious activity monitoring and reporting, thereby alerting law enforcement to the kind of conduct that has been investigated and affirmatively considered as having a heightened potential for being illegal.

Eliminating CTR filings for seasoned customers would have the following benefits:

- The vast majority of the over 13 million CTR's filed annually would stop, saving many hours a year in filling out forms and law enforcement resources devoted to processing them.
- There would be an improvement in the quality of SAR's, eliminating those that are filed on routine, legitimate cash transactions that approach but do not reach current CTR levels. Banks would be able to focus their energies on detecting genuinely suspicious handling of currency regardless of artificial thresholds.
- We would make an enormous stride forward in focusing our anti-money laundering efforts—by both law enforcement and the banking industry—on the real crooks and terrorists with far greater likelihood of detecting and stopping their activities.

The redundancy of CTR filings for seasoned customers with transaction accounts and the need to eliminate this inefficient use of resources by bankers and law enforcement was echoed by the Financial Crimes Enforcement Network (FinCEN) and all the bank regulators in Congressional testimony over the last year.

ABA has worked cooperatively with FinCEN and the Federal banking regulators to encourage institutions to make better use of statutory exemptions when they were changed in the late 1990's. Our Association did extensive outreach to our members, and while many institutions adjusted their CTR filing policies and utilized the two-tier exemption process, the general response was lukewarm at best.

Unfortunately, the compliance technicalities for, and examiner second-guessing of, banker use of the exemption and the renewal processes have discouraged many institutions from utilizing the tier-two exemptions. ABA has even received reports from members that examiners have threatened penalties and other formal criticisms for simple late filing of biennial renewal forms, a regulatory climate that demands overhaul. We do not believe that improvements to this process will make a significant dent in the overwhelming number of CTR's filed each year that do little more than record the legal transactions of law-abiding citizens, thereby drawing attention and resources away from the effort to catch and stop criminal activity. Consequently, in adopting a seasoned customer exemption, we must ensure that the regulatory process and requirements that follow do not frustrate the goal of reducing unnecessary CTR filing.

We commend Chairman Shelby for his commitment to regulatory relief and we strongly urge that every thing possible be done to report a strong regulatory relief package out of the Committee as soon as possible so that it can be passed by the Senate and enacted into law this year.

Q.2. The Federal Reserve recently announced it would increase the threshold from $150 to $500 million for its Small Bank Holding Company Policy Statement. This would allow more entities to qualify as small bank holding companies which, in turn, would permit them to use higher levels of debt to finance acquisitions. The Federal Reserve has specifically rejected raising the threshold to $1 billion. Is the Federal Reserve's threshold appropriate?

A.2. The ABA supports raising the threshold to $1 billion in assets. The ABA welcomed the Federal Reserve Board's decision to raise the limit to $500 million, but there are strong arguments for it to go further and it would not have been inappropriate for the Board to have raised the limit to $1 billion. Moreover, the Board added several restrictions that could lessen the positive impact of raising the threshold.

The Board, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the Federal Deposit Insurance Corporation (FDIC) generally set the dividing line between supervision of large, complex institutions and small institutions at $1 billion. For example, the Board, OCC, OTS, and FDIC recently increased the definition of a small bank to $1 billion in assets under CRA. The OCC divides bank supervision into two groups: Community banks and large banks. A community bank is a national bank with total assets less than $1 billion or a national bank that is part of a multibank holding company where none of the national banks within the system has assets of $1 billion or more. Clearly, it would not have been inappropriate for the Board to follow-suit and raise the threshold for eligibility for the Small Bank Holding Company Policy Statement to $1 billion.

Moreover, the ABA is very concerned about the additional restrictions that the Board added to determine eligibility for the Small BHC Policy Statement. As we wrote in our comment letter, the Board's new restrictions are that the BHC:

- is not engaged in significant nonbanking activities, either directly or through a nonbank subsidiary;
- does not conduct significant off-balance sheet activities, including securitizations or managing or administering assets for third parties, either directly or through a nonbank subsidiary; or
- does not have a material amount of debt or equity securities (other than trust preferred securities) outstanding that are registered with the Securities and Exchange Commission.

Additionally, the Board proposes to require that trust preferred securities be treated as debt under most of the requirements of the Policy Statement.

ABA believes that two of these restrictions are unnecessarily applied to activities that should NOT preclude use of the Small BHC Policy Statement. The first restriction on not being engaged in significant nonbanking activities appears to prevent small BHC's with insurance agency subsidiaries from qualifying. We strongly believe that this is unnecessary. As we said in our comment letter:

We have heard from several members that they are concerned that the bank's affiliated insurance agency, a purely agency activity, may generate significant revenue to the holding company that could be interpreted by the Board's staff as a "significant nonbanking activity." *We believe that the Board should provide that purely agency nonbanking activities should not be deemed to be a disqualifying significant activity.*

The Board writes that the reason for these changes is the increased authority for bank holding companies to engage in new activities that may pose significant operational risk, even though the activity is not significantly leveraged. . . . While we understand and agree with the Board's intentions, *we believe that the actual formulation of the condition will disqualify some community BHC's that in fact have significant nonbanking activities but which activities do not pose significant operational risks, such as with an insurance agency.*

ABA notes that by law a State nonmember bank may not engage in any activity not allowed for a national bank unless the Federal Deposit Insurance Corporation (FDIC) has determined that the activity does not pose a significant risk to the insurance funds. The FDIC has regulations imposing these limits on activities of State banks (Part 362 of the FDIC's regulations), *but the FDIC exempts activities conducted by the bank as agent. ABA urges the Board to make a similar exception in its conditions for such agency activities.* At a minimum, ABA urges the Board to except purely insurance agency activity from being considered a significant activity that would bar use of the Policy Statement.

[Emphasis added.]

The second restriction also unnecessarily prevents some small BHC's from qualifying for the Policy Statement by the way it applies to trust assets. As we said in our comment letter:

ABA members have asked whether this would include assets of the bank's trust department, a traditional banking activity. ABA staff have consulted with Board staff and have been told that assets under management in a trust department of the bank would not be directly managed by the BHC and would, since in the bank's trust department, not be through a nonbank subsidiary. . . . However, ABA is still concerned that a small BHC might own a separately chartered trust company that does not take deposits. Under the Bank Holding Company Act, a "bank" does not include such an institution that functions solely in a trust or fiduciary capacity. Such a trust company might hold sufficient assets so as to be a significant off-balance sheet activity, yet it could pose no significant operational risk. The Board apparently does not provide for any mechanism for a small BHC to request that it be allowed to use the Policy Statement if it can show that, while it does not meet the conditions of the Policy Statement, nonetheless, the significant nonbank activities it conducts do not pose any significant operational risk. ABA recommends that the Board add a provision allowing a BHC to request such a determination from the appropriate Federal Reserve District Bank. If the Federal Reserve District Bank's supervisory determination is that the nonbank activity did not pose significant operational risk, then the BHC would qualify for use of the Policy Statement.

Unfortunately, the Board's final revision to the Policy Statement adopted neither of these recommendations, although the Board did state that: "In the Board's view, differing levels of risk in varying business lines and practices among institutions precludes the use of fixed measurable parameters of significance or materiality across all institutions. For this reason, the rule provides the Federal Reserve with supervisory flexibility in determining, on a case-by-case basis, the significance or materiality of activities or securities outstanding such that the BHC should be excluded from the Policy Statement and subject to the Capital Guidelines." This suggests that purely agency or separate trust company activities will have a higher threshold before the Board will treat them as so "significant" as to disqualify a small BHC from using the Policy Statement. However, ABA believes that it would be better if the Board explicitly excluded these activities from consideration toward the "significant" threshold.

We note that the House passed regulatory relief legislation (H.R. 3505) by a strong 415–2 vote on March 3, 2006. Section 616 of the House bill raises eligibility for the Small Bank Holding Company Policy Statement to $1 billion in assets. *For the above reasons, the ABA urges the Committee to include a similar provision in its regulatory relief legislation.*

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM H. GREG McCLELLAN

Q.1. It has been nearly 2 years since we first held a hearing on regulatory relief. In this time, has the overall regulatory environment changed for banks, thrifts, and credit unions? If so, have these changes increased the need for regulatory relief?

A.1. Yes, the environment has changed for credit unions, creating an even greater need for regulatory relief. We now have nearly 8 years of experience under the prompt corrective action (PCA) system Congress established under the *Credit Union Membership Access Act in 1998,* and both credit unions and the regulator, NCUA, recognize that the current system does not work, because it does not take into account the risk assets of a credit union. It simply does not make sense that the current capital system treats a new 1 year unsecured $10,000 loan the same as a 30-year mortgage that is on its last year of repayment.

Additionally, as described in my testimony, the Financial Accounting Standards Board (FASB) has now moved forward with changing how mergers of mutual institutions (such as credit unions) are accounted for—from the "pooling method" to the "purchase method." This necessitates a change in the definition of "net worth" for PCA purposes for credit unions, otherwise those institutions that merge after the FASB rule change will potentially face unintended consequences. Even FASB itself has noted the need for such a change to the *Federal Credit Union Act.*

Credit unions must also provide their members with annual privacy notices, even if their privacy policy has not changed. Furthermore, credit unions have seen an increased regulatory burden from Bank Secrecy Act and USA PATRIOT Act compliance in recent years as they tackle their role in the war on terror and in making this country safer.

Q.2. The Federal Reserve recently announced it would increase the threshold from $150 million to $500 million for its Small Bank Holding Company Policy Statement. This would allow more entities to qualify as small bank holding companies which, in turn, would permit them to use higher levels of debt to finance acquisitions. The Federal Reserve has specifically rejected raising the threshold to $1 billion. Is the Federal Reserve's threshold appropriate?

A.2. NAFCU does not have position on the threshold at this time and will reserve our comments on this matter.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM STEVE BARTLETT

Q.1. It has been nearly 2 years since we first held a hearing on regulatory relief In this time, has the overall regulatory environment changed for banks, thrifts, and credit unions? If so, have these changes increased the need for regulatory relief?

A.1. On question number one, there has been a change in the overall regulatory environment and these changes have increased the need for regulatory relief, the time to enact regulatory relief is now. We should recognize that Congressional action in this area is needed to help streamline the regulatory burden on U.S. companies for the following reasons:

During this 2-year period the regulatory landscape changed for the worse; moreover, many Roundtable companies believe that the current regulatory and enforcement environment is having a negative impact on the economy. For example, financial institutions are currently inundated with reporting requirements and compliance burdens associated with the USA PATRIOT Act, Sarbanes-Oxley Act, Home Mortgage Disclosure Act, the privacy provisions of the Gramm-Leach-Bliley Act, and State insurance laws. Additionally, the new Basel II Capital Accord will place additional stress on compliance departments and risk mangers.

The costs associated with these regulations are staggering. A July 2004 survey by Financial Executives International showed that complying with Section 404 will cost public companies 62 percent more than previously estimated. The cost of compliance is estimated at $3.14 million per company with a total estimated cost of $5.8 billion in 2005. This could have an adverse impact on the economy, including forcing companies to go private to avoid compliance burdens or companies passing on these costs to the consumer.

In addition to reporting requirements, regulatory supervision and enforcement of the regulations have become more vigorous and created unreasonable expectations for depository institutions. The actions being brought against companies by the SEC, State attorneys general, and U.S. Department of Justice, have amounted to regulation by enforcement.

Also, many disturbing trends have arisen surrounding the enforcement of the Bank Secrecy Act and other Anti-Money Laundering (AML) laws. The best evidence of this is the dramatic increase in Suspicious Activity Reports (SAR) filings in recent years. For example, since 1996, national SAR reporting has increased 453 percent. Similarly, FinCEN reported 81,197 filings in 1997 versus 288,343 filings in 2003. In 2004, depository institutions had filed a total of 689,419 SAR's, and the total number of SAR filings is projected to be around 900,000 for 2005.

There are several reasons for this dramatic increase in SAR filings. First, the failure to file SAR's has become a criminal issue; second, there are no clear standards for when SAR's should be filed; and third, Roundtable member companies have encountered a "zero tolerance" policy among the Federal financial regulatory agencies. Under this policy, institutions are held accountable for every single transaction. Finally, there is a lack of coordination among the various agencies and examiners responsible for SAR filings.

The Roundtable has a solution to the defensive SAR issue: The Senate, where appropriate, should review the AML guidelines and include the good faith guidance as a provision in its legislation. The guidance has already been approved by the banking regulators, but it is not enforceable (because it has not been codified into a formal regulation); should include in the Senate legislation the House provision providing an exemption for financial institutions' to file a Currency Transaction Report (CTR) for seasoned customers. Another solution is to help law enforcement receive more useful information, by reducing CTR filings, is to make the exemption automatic after an institution designates the customer to be "seasoned."

Q.2. The Federal Reserve recently announced it would increase the threshold from $150 million to $500 million for its Small Bank Holding Company Policy Statement. This would allow more entities to qualify as small bank holding companies which, in turn, would permit them to use higher levels of debt to finance acquisitions. The Federal Reserve has specifically rejected raising the threshold to $1 billion. Is the Federal Reserve's threshold appropriate?

A.2. With respect to question number two, as you know, the Federal Reserve recently raised the proposed threshold to $500 million and the issue now is whether the request to increase the threshold again to $1 billion is appropriate? The Roundtable supports raising the proposed threshold for Small Bank Holding Company for the following reasons. The new threshold increase would allow smaller institutions to take on more debt through acquisition because of an increase in the debt-to-equity ratio for Bank Holding Companies (BHC). There may be merit in the argument that smaller institutions have less access to the capital markets, so they need support of this proacquisition provision. Moreover, under BHC rules this new provision may provide a more streamline way of disclosing financial information which is truly a regulatory reduction burden.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM MARGOT SAUNDERS

Q.1. It has been nearly 2 years since we first held a hearing on regulatory relief. In this time, has the overall regulatory environment changed for banks, thrifts, and credit unions? If so, have these changes increased the need for regulatory relief?

A.1. In the past 2 years, there has been an ongoing *reduction* in the consumer protections applicable to transactions with banks, thrifts, and credit unions. In 2004, the OCC adopted four broad regulations that purport to preempt State laws in the areas of deposit-taking, non-mortgage lending, mortgage lending and generally, the business of banking.[1] Essentially the agency stated that *no* State law applies to national banks, unless the particular State law has only an "incidental" effect on the business of banking.[2]

The unwarranted preemption of State consumer protections for transactions with national banks, and their operating subsidiaries

[1] 12 CFR § 7.4007 (deposit taking), 7.4008 (non-mortgage lending), 7.4009 (business of banking generally), 34.3 (mortgage lending), 34.4 (mortgage lending), *see* 69 Fed. Reg. 1904 (Jan. 13, 2004).

[2] This preemption of State laws applicable to national banks follows a similar preemption by the Office of Thrift Supervision for thrifts, albeit with more legal justification than OCC's. 12 CFR § 560.2.

has significantly exacerbated efforts to address predatory lending. State laws have traditionally provided the most effective remedies against overreaching, and all too often, national banks and their operating subsidiaries are involved in predatory lending activities.[3]

There are fewer consumer protection laws applicable to banks and thrifts, and consumers are suffering as a result. Now is *not* the time to further reduce consumer protections through regulatory relief.

Q.2. The Federal Reserve recently announced it would increase the threshold from $150 million to $500 million for its Small Bank Holding Company Policy Statement. This would allow more entities to qualify as small bank holding companies which, in turn, would permit them to use higher levels of debt to finance acquisitions. The Federal Reserve has specifically rejected raising the threshold to $1 billion. Is the Federal Reserve's threshold appropriate?

A.2. This is not an issue with which we are familiar. We defer to our colleagues at the Consumer Federation of America on these issues.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM TERRY JORDE

Q.1. It has been nearly 2 years since we first held a hearing on regulatory relief. In this time, has the overall regulatory environment changed for banks, thrifts, and credit unions? If so, have these changes increased the need for regulatory relief?

A.1. The overall regulatory climate for banks has become increasingly burdensome since the Banking Committee began considering regulatory burden relief 2 years ago. For example, compliance with the Bank Secrecy Act has become even more stringent, especially since the Riggs Bank and other high profile violations came to public attention. In addition, compliance with the Sarbanes-Oxley Act has substantially increased the regulatory burden on community banks. A survey of our members last year showed that the typical community bank would have to spend over $200,000 and devote over 2,000 internal staff hours to comply with Section 404 of the Act.

Other areas of increased burden over the past 2 years can be found in the FACT Act (all of the rules and regulations still have not been written), data protection policies and procedures, increased internal audit scrutiny, IT examination procedures, training requirements and more. We even have a directive now from the regulators "encouraging" us to develop policies and procedures for pandemic preparedness. I sit on my local hospital board and they have not received any directive regarding bird flu.

There have been a few areas of improvement. The regulatory agencies have adopted a streamlined examination procedure for "intermediate small banks" (between $250 million and $1 billion in assets). In addition the Federal Reserve has recently increased the asset size to $500 million for holding companies eligible for the

[3] For a long list of cases brought against national banks and their operation subsidiaries regarding predatory lending activities, *see* Comments: To the Office of the Comptroller of the Currency regarding Banking Activities and Operations; Real Estate Lending and Appraisals, Docket No. 03–16, October 2003, *http://www.consumerlaw.org/action*__agenda/preemption/10__6__occ.shtml.

Small Bank Holding Company Policy Statement. The FDIC has also raised the asset size threshold from $500 million to $1 billion for internal control assessments by management and external auditors of privately held banks. However, it is too early to evaluate how important these changes will be.

I also note that there are several items in the regulatory and legislative pipeline that would *increase* the regulatory burden on community banks. For example, the agencies have proposed new commercial real estate lending guidance that could significantly reduce community banks' ability to serve the small business community. And, Congress is considering imposing significant new burdens on banks by requiring them to block payments for Internet gambling transactions. As I said in my prepared testimony on March 1, these proposals could pose a substantial new burden, without having any meaningful effect on the amount of Internet gambling.

I am also concerned that the current legislative process is leading to confusion between technical amendments and proposals to provide true regulatory burden relief. In my opinion the proposals in the Committee's matrix are 85 percent technical and noncontroversial. (Others, like the credit union proposals are not regulatory relief, they are charter enhancement.) Only about 15 percent of the matrix items will make a difference in the resources and time my bank's staff must devote to paperwork and compliance and will ultimately result in our ability to provide better service to my customers and community.

This all suggests to me that Congress should consider regulatory burden relief bills on a regular basis, looking at the risk reward tradeoff between increased regulatory burden and the projected benefit. As I mentioned in my oral remarks before the Committee, the disclosure burden is top of the list. The current requirements are not providing a meaningful benefit to consumers.

In addition to these ongoing problems, changes in technology and industry practices are so frequent that the regulators and Congress need to adjust regulations and laws frequently. We hope these adjustments will generally reduce the regulatory burden. However, we recognize that new problems and concerns are certain to come up in the marketplace, giving rise to proposed reforms. While these proposals might have merit, they could also increase the burden on community banks. Therefore, Congress should have a mechanism to consider regulatory burden relief regularly to offset any new burdens. This has worked well in my State of North Dakota. Every 2 years, our legislature considers a banking bill that takes into account changes in the industry, technology, and consumer needs—making relatively noncontroversial changes in law to reduce regulatory burden and improve our ability to serve our customers and communities.

Q.2. The Federal Reserve recently announced it would increase the threshold from $150 million to $500 million for its Small Bank Holding Company Policy Statement. This would allow more entities to qualify as small bank holding companies which, in turn, would permit them to use higher levels of debt to finance acquisitions. The Federal Reserve has specifically rejected raising the threshold to $1 billion. Is the Federal Reserve's threshold appropriate?

A.2. As indicated in my response to question 1, ICBA is pleased that the Federal Reserve has increased the threshold from $150 million to $500 million for its Small Bank Holding Company Policy Statement. The Federal Reserve adopted the Policy Statement to permit the formation and expansion of small BHC's with debt levels that are higher than what would be permitted for larger BHC's.

ICBA agrees with the Federal Reserve that since 1980 when the Policy Statement was first issued, inflation, industry consolidation, and the normal asset growth of BHC's have caused the $150 million threshold to lose much of its relevance. *However, in order to truly represent the asset size of a small BHC today, ICBA believes that the exemption should be raised to $1 billion.* The lack of indexing for the $150 million over the past 25 years has hindered the ability of small banks to facilitate the transfer of ownership and remain independent, rather than selling out to a larger regional BHC. Increasing the exemption to $1 billion would improve the ability of small local institutions to sell their stock locally, keeping the financial decisions affecting the community in the local area.

Furthermore, we believe it is not until a BHC reaches the $1 billion asset level that it has the necessary access to equity markets to enable it to finance an acquisition with a lower proportion of debt-to-equity. BHC's with assets of between $500 million and $1 billion are usually not followed closely by securities analysts and have only a limited market for their stock and a limited ability to raise equity in the capital markets. The issuance of trust preferred securities, for instance, is generally their best and sometimes their only method of raising capital. The ICBA-backed "Community Banks Serving Their Communities First Act" (S. 1568) introduced by Sen. Sam Brownback (R–Kansas) provides for raising the asset threshold under the Policy Statement to $1 billion.

February 28, 2006

MATRIX OF FINANCIAL SERVICES REGULATORY RELIEF PROPOSALS

– SECTION I –
REGULATORS' PROPOSALS SUPPORTED BY LEGISLATIVE LANGUAGE

The failure to state a position on these items should not be interpreted to mean support or opposition to any of the suggested concepts.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's & Consumer Groups' Positions**
Governor Donald Kohn /Board of Governors of the Federal Reserve System (FRB)		
1. Interest on Reserves (H.R. 1224) Authorize the payment of interest on balances held by depository institutions at a Federal reserve bank. (Similar proposals by ACB and ABA)	Support: CSBS, FDIC, FRB, NCUA, OCC, OTS	Support: ABA, ACB[1], CUNA, FSR[2], ICBA, NAFCU[3]
2. Reserve Requirement Flexibility (H.R. 1224) Provide the Federal Reserve with greater flexibility to set the ratio of reserves a depository institution must maintain against its transaction accounts, allowing a zero reserve ratio, if appropriate. (Similar proposal by ACB)	Support: CSBS, FDIC, FRB, NCUA, OCC, OTS	Support: ABA, ACB[4], CUNA, FSR, ICBA, NAFCU[5]
3. Interest on Demand Deposits (H.R. 1224) Repeal the provisions prohibiting depository institutions from paying interest on demand deposits. (Similar proposals by ACB, NFIB, Mr. Pinto (Lenders Residential Asset Company LLC), as well as ICBA (modified along lines of interstate branching language in H.R. 1375))	Support: CSBS, FDIC[6], FRB, OCC, OTS	Support: ABA[7], ACB[8] Opposed: FSR, ICBA[9], CFOA/ NCLC[10]

[1] ACB supports the related provisions of H.R. 758 and Title VII of H.R. 1375 adopted by the House.
[2] FSR supports it only in conjunction with legislation to pay interest on corporate checking accounts.
[3] NAFCU supports provided that the language of these provisions is similar to the language in this year's House-passed bill H.R. 1224.
[4] ACB supports the related provisions of H.R. 758 and Title VII of H.R. 1375 adopted by the House.
[5] NAFCU supports provided that the language of these provisions is similar to the language in this year's House-passed bill H.R. 1224.
[6] FDIC supports the repeal of the prohibition against the payment of interest on demand deposits, so long as industrial loan corporations are given parallel authority.
[7] ABA supports it with a phase in and ILC compromise (see H.R.1375 branching language).
[8] ACB supports the related provisions of H.R. 1224, as adopted by the House FSC, which provide for business NOW accounts for certain ILCs – those owned by financial companies and certain grandfathered ILCs.
[9] ICBA supports a 24-transfer per month compromise and opposes any new authority for ILCs.
[10] CFOA and NCLC are opposed. Expansion of industrial loan companies is dangerous to the banking system and to taxpayers.

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Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
John M. Reich/Federal Deposit Insurance Corporation (FDIC)		
4. Reporting Requirements Relating to Insider Lending – (H.R. 3505 § 403) (See also #111) Repeal the requirements that - • executive officers of banks report to their board of directors indebtedness to other banks; • each bank must update its report of covered loans to executive officers as of each report of condition; and, • executive officers and principal shareholders report to their board of directors loans from correspondent banks. (Similar proposals by ACB, ICBA, FSR)	Support: FDIC, FRB, OCC, OTS	Support: ABA, ACB, FSR, ICBA
5. Streamlining Depository Institution Merger Application Requirements – (H.R. 3505 § 610) Eliminates the requirement that the responsible agency request a competitive factors report from the other Federal banking agencies. Requires the responsible agency to request a report from the Attorney General and provide a copy of the request to the FDIC (when the FDIC is not the responsible agency).	Support: FDIC, FRB, OCC, OTS	Support: ABA, ACB, FSR, ICBA
6. Shorten the Post-Approval Waiting Period on Bank Mergers and Acquisitions Where There are No Adverse Affects on Competition – (H.R. 1375 § 609 as introduced) (Not in newly introduced House bill) Allows the post-approval waiting periods under the Bank Merger Act and Bank Holding Company Act to be reduced to as few as 5 days with the concurrence of the responsible agency and the Attorney General.	Support: FDIC, FRB, OCC, OTS	Support: ABA, ACB, FSR, Oppose: CG
7. Repeal CRA Sunshine Law Repeal entirely the CRA Sunshine disclosure and annual reporting requirements (Section 48 of the FDI Act, 12 U.S.C. § 1831y) requiring insured depository institutions or affiliates and nongovernmental entities or persons that are parties to agreements providing payments or other consideration in excess of $10,000 or for loans exceeding $50,000 made pursuant to, or in connection with, the fulfillment of the CRA to disclose all such covered agreements to the public and the appropriate Federal banking agency and file an annual report concerning the agreements with the appropriate Federal banking agency.	Support: FDIC, FRB, OCC, OTS	Support: ABA, ACB, FSR, CG Neutral: ICBA

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
JoAnn Johnson/National Credit Union Administration (NCUA)		
8. Prompt Corrective Action: Risk-Based Net Worth (H.R. 3579 § 301) Establish a system for determining risk-based net worth (i.e., capital) for purposes of prompt corrective action. (Similar proposals by CUNA and NAFCU)	Support: NCUA, NASCUS	Support: CUNA, NAFCU[11] Oppose: ABA, ICBA
9. Check Cashing and Money Transfer Services Offered within the Field of Membership (H.R. 3505 § 307, H.R. 749, and similar legislation is also pending in the Senate, S. 1359 and S. 1344) Expand current check selling and cashing authority to persons eligible for membership, and further allow Federal credit unions to receive EFTs for anyone eligible to become a member. (Similar proposals by CUNA, Consumer Groups, NAFCU)	Support: NCUA	Support: CUNA, NAFCU, CFOA/NCLC, CG Oppose: ABA, ICBA
10. Eliminate 12-Year Limitation of Term of Federal Credit Union Loans – (similar to H.R. 3505 § 304 and H.R. 3579 § 104 also found in Section 303 of H.R. 2317) Eliminate 12-year maturity limitation on Federal credit union loans, authorizing the NCUA Board to promulgate rules regarding loan maturity limits as necessary for safety and soundness. (Similar proposals by CUNA, NAFCU)	Support: NCUA	Support: CUNA, NAFCU Neutral: ABA, ICBA Oppose: ACB[12]
11. Increase in 1 Percent Investment Limit in Credit Union Service Organizations – (H.R. 3505 § 305 and H.R. 3579 § 105 also found in Section 304 of H.R. 2317) Raise the aggregate limit for Federal credit unions' investment in CUSOs from 1% to 3% of shares and undivided earnings in such organizations. (Similar proposals by CUNA and NAFCU; **See also # 131** for a related NAFCU proposal)	Support: NCUA	Support: CUNA, NAFCU Oppose: ABA, ICBA

[11] NAFCU supports and recommends the language found in Title I of H.R. 2317 as introduced in the House in the 109th Congress.
[12] ACB understands the NCUA proposal would allow the NCUA to set maturity dates. ACB supported passage of H.R. 1375 because it, on the whole, benefited community banks. However, ACB does not support many provisions of H.R. 1375 outside the context of a balanced bill.

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Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
JoAnn Johnson/National Credit Union Administration (NCUA) - continued		
12. Investments by Federal Credit Unions – (H.R. 3505 § 303 and H.R. 3579 § 103 also found in Section 302 of H.R. 2317) Provide Federal credit unions with additional authority to purchase debt obligations for investment purposes, subject to statutory guidelines and investment grade and percentage limitations, as approved by regulation of the NCUA Board. (Similar proposals by CUNA, NAFCU)	Support: NCUA	Support: CUNA, NAFCU Does not Support: ABA Neutral: ICBA
13. Voluntary Merger Authority – (H.R. 3505 § 308 and H.R. 3579 § 108 also found in Section 306 of H.R. 2317) No longer require NCUA to consider spin-offs of groups greater than 3,000 when reviewing and approving voluntary mergers of multiple common bond Federal credit unions. (Similar proposals by CUNA, NAFCU)	Support: NCUA	Support: CUNA, NAFCU Oppose: ABA, ACB, ICBA
14. Treatment of Credit Unions as Depository Institution Under Securities Laws – (H.R. 3505 § 313 and H.R. 3579 § 115 also found in Section 312 of H.R. 2317) Exempt federally insured credit unions from the requirement to register with the SEC as broker-dealers when engaging in certain de minimis securities activities. (Similar proposals by NASCUS, CUNA, NAFCU)	Support: NCUA, NASCUS	Support: CUNA, NAFCU Oppose: ABA, ICBA
15. Qualified Financial Contracts – (P.L. 109-8) Identifies and provides standards for treatment of qualified financial contracts (QFCs) by a receiver or conservator of an insured financial bank or credit union to avoid destabilization of derivatives market by post-failure repudiation of QFCs.	Support: NCUA	Support: ABA, CUNA, ICBA, NAFCU
16. Leases of Land on Federal Facilities for Credit Unions – (H.R. 3505 § 302 and H.R. 3579 § 102 also found in Section 301 of H.R. 2317) Give military and civilian authorities responsible for buildings erected on Federal property the discretion to extend to credit unions that finance the construction of credit union facilities on Federal land real estate leases at minimal charge. (Similar proposals by CUNA, NAFCU)	NCUA has no safety and soundness concerns	Support: CUNA, NAFCU Oppose: ICBA Does not Support: ABA

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
JoAnn Johnson/National Credit Union Administration (NCUA) - continued		
17. Member Business Loan Exclusion for Loans to Non-Profit Religious Organizations – (H.R. 3505 § 306 and H.R. 3579 § 106 also found in Section 204 of H.R. 2317) Exclude loans to nonprofit religious organizations from the member business loan limit. (Similar proposals by CUNA, NAFCU)	Support: NCUA, NASCUS	Support: CUNA, NAFCU Oppose: ABA, ACB, ICBA
18. Conversions Involving Common-Bond Credit Unions – (H.R. 3505 § 309 and H.R. 3579 § 109 also found in Section 307 of H.R. 2317) In a voluntary conversion of a common-bond credit union into a community credit union, require the NCUA Board to prescribe by regulations criteria under which the Board may determine that a portion of a credit union's existing membership located outside the community can be satisfactorily served by the converting credit union and remain with the field of membership. (Similar proposals by CUNA, NAFCU)	Support: NCUA	Support: CUNA, NAFCU[13] Oppose: ABA, ACB, ICBA
19. Credit Union Governance – (H.R. 3505 § 310 and H.R. 3579 § 110) (See #132 also found in Section 308 of H.R. 2317) Expand the bases for expulsion to encompass "just cause," which includes disruption of credit union operations, as well as nonparticipation by a member in the affairs of the credit union. Also, allows a Federal credit union's bylaws to limit the number of consecutive terms any person may serve on the board of directors, and provides that reimbursement for lost wages due to service on the credit union's board will not be treated as compensation. (Similar proposals by CUNA, NAFCU)	NCUA has no safety and soundness concerns	Support: ABA, CUNA, ICBA, NAFCU
20. Providing the NCUA with Greater Flexibility in Responding to Market Conditions – (H.R. 3505 § 311 and H.R. 3579 § 111 also found in Section 309 of H.R. 2317) In determining whether to lift the usury ceiling for Federal credit unions, allow the NCUA Board to consider rising interest rates or whether prevailing interest rate levels threaten the safety and soundness of individual credit unions. (Similar proposals by CUNA, NAFCU)	Support: NCUA	Support: CUNA, NAFCU No Position: ABA Neutral: ICBA

[13] NAFCU supports and recommends the language found in Section 307 of H.R. 2317.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
JoAnn Johnson/National Credit Union Administration (NCUA) - continued		
21. Exemption from Pre-merger Notification Requirement of the Clayton Act – (H.R. 3505 § 312 and H.R. 3579 § 114 also found in Section 311 of H.R. 2317) Exempt federally-insured credit unions from the pre-merger notification requirements, giving them parity with banks and thrifts. (Similar proposals by CUNA, NAFCU; NASCUS supports expanding proposal to include all State-chartered credit unions)	Support: NCUA, NASCUS	Support: CUNA, NAFCU No Position: ABA
22. Privately Insured Credit Unions Authorized to Become Members of a Federal Home Loan Bank – (H.R. 3505 § 301) Permit certain privately insured credit unions to become members. (Similar proposal by CUNA)	Support: NASCUS No Position : NCUA	Support: CUNA, NAFCU Oppose: ABA, ACB, ICBA, CG
23. Technical Corrections – (H.R. 3505 § 802) Make several technical corrections to the FCUA.	Support: NCUA	Support: CUNA, NAFCU Neutral: ICBA No Position: ABA
24. Redefinition of Regulatory Capital Necessitated by an Accounting Rule Change – (H.R. 3505 § 314 & H.R. 1042) (Same as #167) Redefine regulatory capital to address unintended consequence of impending FASB rule change. The new FASB rule would apply purchase accounting to credit union mergers with the unintended result that the merging credit union's capital would not flow forward as capital to the combined continuing credit union (pre-merger "retained earnings" (capital) becomes post-merger "acquired equity" (not capital)). To follow both the new FASB rule while still allowing the capital of both credit unions to flow forward as regulatory capital and thus preserve the incentive for desirable credit union mergers, the redefinition of regulatory capital for purposes of prompt corrective action is necessary. The FASB is supportive of a legislative solution and is comfortable that a legislative solution will not impact their standards-setting activities. (Similar proposals by CUNA and NAFCU)	Support: NCUA, NASCUS	Support: CUNA, NAFCU[14] Oppose: ABA Against: ICBA

[14] NAFCU supports but prefers inclusion of the text of H.R. 1042, which uses the term "net worth" as that more accurately reflects the issue than the term "regulatory capital."

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
JoAnn Johnson/National Credit Union Administration (NCUA) - continued		
25. Vendor Examinations Permit NCUA examination of third-party vendors that provide data processing and other related services to insured credit unions.	Support: NCUA, NASCUS	Support: ABA, ACB, ICBA Oppose: CUNA[15], NAFCU
Julie Williams/Office of the Comptroller of the Currency (OCC)		
26. Repealing State Opt-In Requirements for <u>De Novo</u> Branching – (H.R. 3505 § 401 as introduced) Remove restrictions on national and State banks' <u>de novo</u> interstate branching by repealing the State opt-in requirement before an out-of-state bank can branch into that State. Eliminates the 5-year age restriction on interstate bank mergers. (<u>Similar proposals by ACB, ICBA, FSR</u>)	Support: CSBS, FDIC[16], OCC[17] Oppose: FRB[18]	Support: ABA[19], ACB[20], FSR, Against: ICBA Oppose: CFOA/NCLC[21], CG
27. Providing Relief for Subchapter S National Banks – (H.R. 1375 § 101) Permit the OCC to allow the use of a debt instrument that is subordinated to other liabilities of the bank to satisfy the qualifying shares requirement by directors of national banks operating or seeking to operate in subchapter S form. Such a subordinated debt instrument would be closely equivalent to an equity capital interest, as the directors could only be repaid if other claims of depositors and nondeposit creditors of the bank (including the FDIC) were first paid in full, and would also ensure that directors retain their personal stake in the financial soundness of the bank.	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR, ICBA

[15] CUNA is opposed to providing the NCUA with vendor examination authority.
[16] The FDIC supports repeal of the state opt-in requirements for <u>de novo</u> interstate branching, so long as industrial loan corporations are given parallel authority.
[17] The OCC supports the removal of the restrictions on interstate <u>de novo</u> branching and the repeal of the state age requirement. The OCC takes no position other provisions in section 401 of the House-passed bill H.R. 3505. In other words, OCC supports repealing the applicable restrictions for national banks. The OCC takes no position on repealing the restrictions for any other type of bank charter.
[18] While the FRB generally supports granting insured banks the right to branch de novo on an interstate basis, the FRB opposes amendments, such as those reflected in section 401 of H.R. 1375, that would grant interstate branching rights to industrial loan companies whose corporate owners are not subject to the consolidated supervision and activity restrictions that apply to the corporate owners of other insured banks under the Bank Holding Company Act.
[19] ABA supports with ILC fix (see H.R. 1375 provisions, as adopted).
[20] ACB supports Sec. 401 of H.R. 1375, which, in addition to commercial banks, applies to ILCs owned by financial companies and certain grandfathered ILCs.
[21] CFOA and NCLC are opposed. Expansion of industrial loan companies is dangerous to the banking system and to taxpayers.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's & Consumer Groups' Positions**
Julie Williams/Office of the Comptroller of the Currency (OCC) - continued		
28. Resolving Ambiguities in Federal Court Jurisdiction – (similar to H.R. 3505 § 213 which applies only to Federal thrifts) (See #58 &184) Expressly provide that a national bank is only a citizen of the State in which its main office is located so that all federally chartered depository institutions that are not incorporated in any State will be treated the same for purposes of determining diversity jurisdiction.	Support: FDIC, , OTS[22] Does Not Support: OCC[23] Oppose: CSBS	Support: ABA, ACB, FSR Oppose: CFOA/NCLC[24], CG
29. Modernizing Corporate Governance – (H.R. 3505 § 102) Permit a national bank to provide in its articles of association which method of electing its directors best suits its business goals and needs -- a national bank could choose whether to allow cumulative voting, which is mandated by the current law.	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR, ICBA
30. Modernizing Corporate Structure Options – (H.R. 3505 § 109) Allow the OCC to prescribe regulations that would permit a national bank to be organized other than as a body corporate and to provide requirements for the organizational characteristics of such national banks consistent with safety and soundness. Generally, all national banks would continue to have the same rights and be subject to the same restrictions and requirements. This would allow a national bank to organize as a limited liability company, which may have tax advantages and may be particularly attractive for community banks.	Support: FDIC, OCC Oppose: CSBS No Position: OTS	Support: ABA, ACB, FSR, ICBA
31. Simplifying Dividend Calculations for National Banks – (H.R. 3505 § 103) (See also # 81, #117) Provide more flexibility than current law to a national bank to pay dividends as deemed appropriate by its board of directors. Consistent with safety and soundness, the amendment retains the current requirements that OCC approval is necessary if the dividend exceeds a certain amount. These same dividend approval requirements also apply to State member banks except the FRB and not the OCC is the approval authority. (Similar proposal by FSR)	Support: FDIC, FRB, OCC No Position: OTS	Support: ABA, ACB, FSR, ICBA

[22] OTS supports but only with #58.

[23] OCC withdraws its support. In light of the recent U.S. Supreme Court decision resolving the issues concerning national banks' citizenship for purposes of federal court diversity jurisdiction, such an amendment is no longer needed.

[24] CFOA and NCLC are opposed. Allowing virtually unlimited diversity jurisdiction in federal courts for national banks and federal thrifts is a bad idea.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's & Consumer Groups' Positions**
Julie Williams/Office of the Comptroller of the Currency (OCC) - continued		
32. Repealing Obsolete Limitations on the OCC's Removal Authority – (H.R. 3505 § 104) Give OCC the same removal authority as the other banking agencies to remove an institution-affiliated party (IAP) from the banking business.	Support: FDIC, FRB, NCUA, OCC, OTS	Support: ABA, ACB, FSR, ICBA
33. Repealing Obsolete Intrastate Branch Capital Requirements – (H.R. 3505 § 105) Eliminate the obsolete requirement that a national bank establishing an intrastate branch must meet the capital requirements imposed by the State on State banks seeking to establish intrastate branches.	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR Neutral: ICBA
34. Clarifying the Waiver of Publication Requirements for Bank Merger Notices – (H.R. 3505 § 106) Clarify that the requirement to publish a notice for shareholders about an impending merger may be waived by the OCC in emergency situations <u>**or**</u> by unanimous vote of the shareholders (technical amendment).	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR, ICBA
35. Repealing Obsolete References to the Main Place of Business of a National Bank – (H.R. 3505 § 110) Replace obsolete language with the modern term "main office" (technical amendment)	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR, ICBA Oppose: CG
36. Deleting Obsolete Language in the National Bank Act Delete references to two obsolete provisions regarding capital requirements, but would make no changes to the requirements that a national bank cannot reduce its capital unless approved by two-thirds of its shareholders and by the OCC (technical amendment).	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR, ICBA
37. Enforcing Written Agreements and Commitments – (H.R. 3505 § 405) Clarify the discretionary authority of the Federal banking agencies to enforce (1) any condition imposed in writing in connection with any action on any application, notice, or other request, or (2) any written agreement between the agency and an IAP, particularly those in which an IAP or controlling shareholder agrees to provide capital to the depository institution, without showing unjust enrichment or limiting recovery to 5% of the institution's assets at the time it became undercapitalized. Also, clarify existing FDIC authority as receiver or conservator to enforce written conditions or agreements. Eliminate the requirement that the insured depository institution receiving the transfer be undercapitalized at the time of the transfer.	Support: FDIC, OCC, OTS	Support: ICBA Do not Oppose: ABA,

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
Julie Williams/Office of the Comptroller of the Currency (OCC) - continued		
38. Barring Convicted Felons from Participating in the Affairs of Depository Institutions – (H.R. 3505 § 613) Extend the prohibition to include noninsured national and State member banks and uninsured offices of foreign banks, but the OCC would have authority with respect to noninsured national banks and Federal branches and agencies and the FRB with respect to noninsured State member banks and State branches and agencies.	Support: FDIC, FRB, OCC, OTS	Support: ABA, ACB, FSR, ICBA
39. Ensuring that Accountants of Insured Depository Institutions Are Held to the Same Standard as Other IAPs – (H.R. 1375 § 614 as introduced) (Not in newly introduced House bill) Strike the "knowing and reckless" standard for independent contractors in the definition of an IAP, so that independent contractors are held to a standard that is more like the standard that applies to other IAPs.	Support: FDIC, OCC, OTS	Support: ICBA Do not Oppose: ABA Oppose: ACB
40. Strengthening the Supervision of Stripped-Charter Institutions – (H.R. 3505 § 409) (See #146) Amend the bases under the Change in Bank Control Act (CBCA) for extending the time period for Federal banking agency action on a CBCA notice so that the bases include the need to analyze either the safety and soundness of the business plan or the future prospects of the institution. Also amend the bases for disapproving the CBCA notice to include the future prospects of the institution.	Support: FDIC, FRB, OCC, OTS Needs Further Analysis: CSBS	Support: ABA Neutral: ICBA
41. Providing a Statute of Limitations for Judicial Review of Appointment of a Receiver for a National Bank – (similar to H.R. 3505 § 402) Provide greater consistency in Federal law governing how much time is available to challenge the determination by the OCC to appoint a receiver for a national bank by expressly providing for a 30-day period for a party to judicially challenge a determination by the OCC to appoint a receiver for a national bank.	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR Neutral: ICBA
42. Allocating Examiner Resources More Efficiently – (H.R. 3505 § 601) (See also #68, 112, & 169) Provide the appropriate Federal banking agencies with discretion to adjust the exam cycle of insured depository institutions to ensure that examiner resources are allocated in a manner that provides for the safety and soundness of, and the effective examination and supervision of, insured depository institutions	Support: NCUA, OTS Prefers #68 Prefers #169: OCC[25] Oppose: FRB	Support: ABA, ACB, FSR, ICBA Oppose: CG

[25] OCC supports item # 169 in lieu of item #42. Item #169 would increase the threshold for the 18-month examination cycle to $1 billion and in included in § 607 of H.R. 3505, as reported by the House Financial Services Committee.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
Julie Williams/Office of the Comptroller of the Currency (OCC) - continued		
43. Enhancing the Ability of Banking Agencies to Suspend or Remove Bad Actors from Depository Institutions – (an expansion of H.R. 3505 § 609) • Clarify that the appropriate Federal banking agency may suspend or prohibit IAPs charged with certain crimes from participation in the affairs of *any depository institution* and not only the insured depository with which the IAP is or was associated. • Allow the agency to use the prohibition authority even when the institution with which the individuals were associated ceases to exist. Extend suspension and removal authority to include an individual who attempts to become involved in the affairs of an institution after being charged with a covered crime.	Support: FDIC, FRB, OCC, OTS, NCUA	Support: ABA, ACB, CUNA, FSR, ICBA
44. Providing Equal Treatment for Federal Agencies of Foreign Banks – (H.R. 3505 § 107) Clarify that a Federal agency of a foreign bank can receive uninsured deposits from any persons who are not citizens or residents of the United States.	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR Neutral: ICBA
45. Maintaining a Federal Branch and a Federal Agency in the Same State – (H.R. 3505 § 108) Repeal the absolute prohibition on maintaining a Federal branch and a Federal agency in the same State and provide that both such offices could be maintained, unless prohibited by State law.	Support: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR Neutral: ICBA
46. Improving Information Sharing With Foreign Supervisors – (H.R. 3505 § 612) Provide that a Federal banking agency may not be compelled to disclose information received from a foreign regulatory or supervisory authority if public disclosure of the information would violate the laws applicable to that authority and the agency obtained the information in connection with the administration and enforcement of Federal banking laws or under a memorandum of understanding between the authority and the agency. • Provide that such information would be exempt under FOIA. • Does not authorize an agency to withhold information from Congress or in response to a court order.	Support: CSBS, FDIC, FRB, NCUA, OCC, OTS	Support: ABA, ACB, FSR Neutral: ICBA
47. Exempting the FDIC, OCC, and OTS from the Federal Advisory Committee Act Permit the FDIC, OCC, and OTS to establish and use advisory committees in the same manner as the FRB.	Support: OCC, OTS	Support: ABA, FSR, ICBA Oppose: CG

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
Julie Williams/Office of the Comptroller of the Currency (OCC) - continued		
48. Improving Information Sharing – (H.R. 3505 § 602) Give all Federal banking agencies the same discretionary authority as the FRB has to share confidential supervisory information.	Support: CSBS, FDIC, NCUA, OCC, OTS	Support: ABA, ACB, FSR Neutral: ICBA
49. Providing an Inflation Adjustment for the Small Depository Institution Exception under the Depository Institution Management Interlocks Act (DIMIA) – (H.R. 3505 § 404) Increase the small depository institution exemption limit under DIMIA from $20 million in assets to $100 million in assets. Unless the institutions have less than $20 million in assets, DIMIA currently prohibits a management official of one institution from serving as a management official of any other nonaffiliated depository institution or depository institution holding company if the institutions or an affiliate of such institutions have offices that are located in the same MSA. The amendment would increase this exemption threshold to $100 million in assets. (Similar proposal by ACB)	Support: FDIC, FRB, OCC, OTS	Support: ABA, ACB, FSR, ICBA
50. Implementing Risk-Based Requirements for Federal Branches and Agencies (H.R. 3505 § 111) Allow the OCC, after consultation with the FFIEC, to adopt regulations allowing the capital equivalency deposit for a Federal branch or agency to be set on a risk-based, institution-by-institution basis, thereby giving the OCC the same authority to implement a risk-based system that State supervisors have under State law in several key States.	Support: FDIC, OCC Oppose: CSBS No Position: OTS	Support: ABA, ACB, FSR, Neutral: ICBA
51. Allowing the Option for a Federal Representative Office License Provide an option for the OCC to approve the establishment of and supervise Federal representative offices of foreign banks to operate in States that do not otherwise prohibit such offices.	Support: OCC Oppose: CSBS No Objection: FDIC No Position: OTS	Support: FSR Neutral: ICBA No Position: ABA
John Bowman/Office of Thrift Supervision (OTS)		
52. Parity for Savings Associations under the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940 – (H.R. 3505 § 201) Amend the definitions of *bank* and *applicable regulatory agency* to include expressly savings associations and the OTS, respectively (thereby subjecting such associations to the same investment adviser and broker-dealer registration requirements as banks). (Similar proposals by ACB, FSR)	Support: FDIC, NCUA, OTS No Position: OCC	Support: ABA, ACB, FSR, ICBA

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
John Bowman/Office of Thrift Supervision (OTS) - continued		
53. Small Business and Other Commercial Loans – (H.R. 3505 § 212) Add small business lending to the list of loans that a Federal savings association may invest in, sell, or otherwise deal in without limitation. Increases the cap on other commercial lending from 10% to 20%. (Similar proposals by ACB, FSR)	Support: FDIC, OTS Oppose: CSBS No Position: OCC	Support: ABA, ACB, FSR, ICBA
54. Repeal of Qualified Thrift Lender Requirement with Respect to Out-of-State Branches – (H.R. 3505 § 211) Eliminate the requirement that a multi-state savings association meet the QTL test on a state-by-state basis. (Similar proposals by ACB, FSR)	Support: FDIC, OTS Oppose: CSBS No Position: OCC	Support: ABA, ACB, FSR Against: ICBA
55. Investments by Federal Savings Associations Authorized to Promote the Public Welfare – (H.R. 3505 § 202) (See also #96) Give Federal savings associations authority parallel to that of national banks and State member banks to make investments primarily designed to promote the public welfare, directly or indirectly, by investing in an entity primarily engaged in making public welfare investments. There is an aggregate limit on investments of 5% of the savings association's capital and surplus, unless OTS determines a higher amount poses no significant risk to the deposit insurance fund and the savings association is adequately capitalized. In no case may the aggregate investments by a savings association exceed 10% of its capital and surplus. Savings associations could use this new community development investment authority without regard to the prohibition against acquiring or retaining corporate debt that is not of investment grade; no similar limit applies to banks. (Similar proposals by ACB, FSR)	Support: FDIC, OTS No Position: OCC	Support: ABA, ACB, FSR, ICBA
56. Eliminating Geographic Limits on Thrift Service Companies – (H.R. 3505 § 503) Permit Federal savings associations to invest in service companies without regard to geographic restrictions.	Support: FDIC, OTS No Objection: OCC[26] Oppose: CSBS	Support: ABA[27], ACB, FSR

[26] OCC does not object if the Bank Service Company Act (BSCA) is similarly amended for bank service companies. The OCC has worked with the OTS and the other federal banking agencies to suggest language for a parity amendment to the BSCA. Such language is included in § 406 of H.R. 3505, as reported by the House Financial Services Committee.
[27] ABA opposes unless a similar change is made to the Bank Service Company Act to eliminate geographic limits on bank service companies.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
John Bowman/Office of Thrift Supervision (OTS) - continued		
57. Mergers and Consolidations of Federal Savings Associations with Non-Depository Institution Affiliates – (H.R. 3505 § 203) Give Federal savings associations authority parallel to that of national banks to merge with one or more of their non-thrift subsidiaries or affiliates. As with national banks' authority, this amendment would not affect the applicability of section 18(c) of the FDI Act (a/k/a the Bank Merger Act).	Support: FDIC, OTS No Position: OCC	Support: ABA, ACB, FSR Neutral: ICBA
58. Clarifying Citizenship of Federal Savings Associations for Federal Court Jurisdiction – (H.R. 3505 § 213) (See also #28) Expressly provide that a Federal savings association is only a citizen of the State in which its main office is located for purposes of determining diversity jurisdiction. (Similar proposals by ACB, FSR)	Support: FDIC, OCC[28], OTS Oppose: CSBS	Support: ABA, ACB, FSR Oppose: CFOA/NCLC[29], CG
59. OTS Statutory Succession Authority - (H.R. 3505 § 622) Authorize the Treasury Secretary to appoint one or more individuals within the OTS to serve as OTS Acting Director in order to assure agency continuity during a vacancy in the office of the Director of the OTS or in the absence or disability of the Director of the OTS, and modernize the existing statutory appointment authority for the OTS Director by permitting an appointee a new five-year term.	Support: FDIC, OTS No Position: OCC	Support: ABA, ACB, FSR, ICBA

[28] OCC supports parity for national banks and federal thrifts. (See #28).
[29] CFOA and NCLC are opposed. Allowing virtually unlimited diversity jurisdiction in federal courts for national banks and federal thrifts is a bad idea.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Groups' Positions
John Allison/Mississippi Commissioner of Banking & Consumer Finance/Conference of State Bank Supervisors (CSBS)		
60. Coordination of Examination Authority – (H.R. 3505 § 619) • Underscore authority of the State regulators for the institutions that they charter (i.e, "home" State regulators). • Require both the home and host State bank supervisors to exercise authority in compliance with the applicable cooperative agreements, thus encouraging coordination among the States. • Unless otherwise provided in a cooperative agreement, allow only a home State to assess supervisory fees on the banks it charters. • Authorize the host State supervisor, upon written notice to the home State, to examine for compliance with applicable host State laws subject to the terms of any applicable cooperative agreement with the home State. (Replaces a blanket authorization for the host State supervisor to examine for compliance with host State laws without regard to the home State supervisor). • For the purposes of safety and soundness supervision, clarify that the chartering State is the primary State supervisor and limit host State supervisors to the express terms of any applicable cooperative agreement. However, host States may act unilaterally and examine the branch of an out-of-state State bank if that bank is determined to be "troubled" (i.e., a 4 or 5 CAMELS rating). • Authorize a host State supervisor to enforce applicable host State law, subject to the terms of any cooperative agreement and with written notice to the home State supervisor. (Similar proposals by ACB, FSR)	Support: CSBS No Objection: FDIC, OCC No Position: OTS	Support: ABA, ACB, FSR

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Group's Positions
John M. Reich/Federal Deposit Insurance Corporation (FDIC)		
61. Exempt Merger Transactions Between An Insured Depository Institution and One or More of Its Affiliates from Competitive Factors Review and Post-Approval Waiting Periods – (See also #69) Exempt merger transactions between insured depository institutions and their affiliates, which are generally accepted as not presenting any competitive issues, from competitive factors review by the Attorney General and other banking agencies and the post-approval waiting period.	Support: FDIC, FRB, OCC, OTS[30]	Support: ABA, ACB, FSR Neutral: ICBA
62. Eliminate Requirement for Prior Written Consent to Establish Branches by Well-Managed, Well-Capitalized, Highly-Rated Institutions (See also #118) Permit well-managed, well-capitalized, highly-rated institutions, with CRA ratings of satisfactory or better to establish branches without prior written consent of the appropriate Federal regulator, requiring only local publication prior to establishment and after-the-fact notice to be filed with the regulators. (Preserve opportunity for consumers to raise CRA concerns.) (Similar proposal by ACB)	Support: FDIC, OTS Has Concerns: OCC[31] Oppose: FRB[32]	Support: ABA, ACB[33], FSR, ICBA Oppose: CG
63. Eliminate Annual Privacy Notice Requirement for Institutions that Do Not Share Personal Information (H.R. 3505 § 617) Eliminate the annual notice requirement for those financial institutions that do not disclose nonpublic personal information to any nonaffiliated third party in a manner that would be subject to a consumer's right to opt out under either § 503 of the Gramm-Leach-Bliley Act (GLBA) or the Fair Credit Reporting Act (FCRA). (Similar proposal by ACB)	Support: CSBS, FDIC Qualified Support: OTS[34] No Objection: OCC[35]	Support: ABA, ACB, CUNA, FSR, ICBA Oppose: CG

[30] OTS supports with #69.

[31] OCC has concerns about impact on CRA and Riegle-Neal interstate banking and branching requirements.

[32] The FRB opposes but has supported an alternative amendment that would authorize state and national banks (other than ILCs that operate under the special exemption in the BHC Act) to open de novo branches nationwide, provided the bank complies with the requirements of the Riegle-Neal Act (other than the state "opt-in" requirement). The FRB opposes proposals that would allow ILCs to open de novo branches nationwide if the corporate owner of the ILC takes advantage of the special exemption in current law that allows the owner to operate outside the prudential framework that Congress has established for corporate owners of other types of full-service insured banks.

[33] ACB supports its proposal, presented in its June 22, 2004 testimony, to eliminate unnecessary branch applications.

[34] OTS feels that further discussion is needed with regard to "constructive sharing" of information with third-parties and initial notifications.

[35] OCC does not object provided the institution does not share nonpublic personal information under GLBA or FCRA of the type that is subject to a consumer's right to opt out and there has been no change in the institution's privacy disclosures from the information disclosed in the most recent prior annual notice. The OCC notes that the federal banking agencies issued an Advance Notice of Proposed Rulemaking (ANPR) on December 30, 2003 (68 FR 75164) requesting public comment on ways to improve the GLBA privacy notices, which may result in more extensive recommendations for changes to privacy notices. We are in the process of conducting consumer testing to decide how to improve privacy notices, and to determine what aspects of the notices consumers find helpful. This testing may result in the Agencies undertaking significant changes to the privacy rules or recommending other legislative changes to Congress.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Group's Positions
John M. Reich/Federal Deposit Insurance Corporation (FDIC) – continued		
64. Waiver of the Three-Day Right of Rescission Authorize the Federal Reserve Board to issue regulations permitting consumers to waive the three-day right of rescission in wider circumstances than the law currently permits, including voluntary waiver by borrowers seeking immediate access to funds with a signed written statement voluntarily waiving or modifying any rights to rescind the transaction. Alternatively, require lenders to provide the closing documents three days prior to closing and incorporate the right of rescission into this three-day period as proposed by the staffs of the Federal Reserve and HUD in 1998. (Similar proposal by ICBA also proposes repealing right)	Support: OTS No Objection: OCC[36] Supports Alternative: CSBS Oppose: FRB[37] Withdraw: FDIC	Support: ABA[38], ACB, FSR, ICBA[39] Oppose: CFOA/NCLC[40], CG
65. Increased Flexibility for Flood Insurance (See also #107) Amend the Flood Disaster Protection Act of 1973 to: • Address the situation where the official flood map is more than ten years old; • Increase the "small loan" exception (currently $5,000) and allow adjustments for inflation on a regular bases; • Amend the forced-placement rules to allow lenders to force-place flood insurance within 30 days (instead of the current 45 days) of notifying the borrower; and • Eliminate mandatory civil monetary penalties when a regulator finds a pattern and practice of certain violations of the National Flood Insurance Program to provide regulators with greater flexibility to tailor their actions more closely to individual cases. (Similar proposal by ICBA)	Support: FRB, OTS Defer to More Study: FDIC Defer Taking Position: OCC[41]	Support: ABA, ACB, FSR[42], ICBA Oppose: CG

[36] OCC does not object provided the amendment is refined to protect consumers from abuses that may occur if a consumer is permitted to waive this right.
[37] The FRB opposes. Because of the importance of the three-day rescission and the current statutory framework for the mortgage process, the FRB believes that changes to the right of rescission should be made by Congress, and not through agency action, and only after obtaining appropriate input from industry and consumer representatives.
[38] ABA supports the first proposal
[39] ICBA supports it if both options are available.
[40] CFOA and NCLC are opposed. Diluting the protections provided through the disclosures and the right of rescission in the Truth in Lending Act would be very harmful to consumers.
[41] OCC defers taking a position in light of other pending legislation.
[42] FSR supports providing more guidelines on flood insurance and consumer access to flood zone information and to determine if the information is current.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Group's Positions
John Bowman/Office of Thrift Supervision (OTS)		
66. Apply the International Lending Supervisors Act (ILSA) to Savings Associations Subject Federal and State thrifts and their subsidiaries and affiliates to the ILSA on the same basis as other banking institutions. (Similar proposal by ACB)	Support: OTS No Objection: FDIC No Position: OCC	Support: ABA, ACB, FSR Neutral: ICBA
67. OTS Representation on the Basel Committee Amend ILSA to give the OTS equal representation on the Committee on Banking Regulations and Supervisory Practices of the Group of Ten Countries and Switzerland (a/k/a/ the Basel Committee) (Similar proposal by ACB)	Support: OTS No Objection: FDIC, OCC	Support: ABA, ACB, FSR Neutral: ICBA
68. Enhanced Examination Flexibility – (See also #42, #112 &169) Increase the small institution exemption in the examination cycle provision from $250 million to $500 million.	Support: CSBS[43], FDIC, FRB, OTS Prefers #169: OCC[44]	Support: ABA[45], ACB, FSR, ICBA Oppose: CG
69. Streamlining Agency Action Under the BMA – (Same as #5) (See also #61) Eliminate the requirement that each Federal banking agency request a competitive factors report from the other three banking agencies and the Attorney General. Continue requiring only two filings - one with the Attorney General and one with the FDIC, as insurer.	Support: FDIC, FRB, OCC, OTS	Support: ABA, ACB, FSR, ICBA
John Allison/Mississippi Commissioner of Banking & Consumer Finance/Conference of State Bank Supervisors (CSBS)		
70. Regulatory Flexibility for the Federal Reserve Remove limitations on the powers of State member banks in the Federal Reserve Act eliminating distinction in powers between State-chartered member banks and State nonmember banks.	Support: CSBS No Objection: FDIC No Position: OTS Oppose: OCC[46]	Support: ABA, FSR, ICBA

[43] CSBS supports increasing the small institution exemption to $1 billion.

[44] OCC supports item # 169 in lieu of item #68. Item #169 would increase the threshold for the 18-month examination cycle to $1 billion and in included in § 607 of H.R. 3505, as reported by the House Financial Services Committee.

[45] ABA supports applying it to all institutions.

[46] OCC opposes as this amendment undoes key safety and soundness parity between state member banks and national banks regarding financial subsidiary activities.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's & Consumer Group's Positions
John Allison/Mississippi Commissioner of Banking & Consumer Finance/Conference of State Bank Supervisors (CSBS) - continued		
71. Tax Treatment for Limited Liability Corporations Encourage the IRS to provide State banks organized as State-chartered LLCs the same pass-through tax treatment as is given to partnerships.	Support: CSBS No Position: FDIC[47], FRB[48] OCC[49]	Support: ABA[50], ACB, ICBA
72. Federal Financial Institutions Examination Council (FFIEC) Add a representative State regulator as a full voting member on the FFIEC.	Support: CSBS, NASCUS No Objection: FDIC Oppose: FRB[51], OCC	Support: ICBA No Position: ABA
Roger W. Little/Deputy Commissioner, Credit Unions, Michigan Office of Financial and Insurance Services/National Association of State Credit Union Supervisors		
73. Expand Prompt Corrective Action Provision to Federal Credit Union Act Obligate Federal credit unions to include all forms of capital when calculating required net worth ratio. Credit unions should have access to alternative capital structures to ensure that ownership interest of a credit union remains with its members, the not-for-profit structure of credit unions is preserved, and it is allowed under GAAP. Structured correctly, alternative capital is complementary to the proposed risk-based capital system.	Support: NASCUS	Needs More Detail: CUNA[52] No Position: NAFCU[53] Oppose: ABA, ACB, ICBA
74. Expand Business Lending Authority • Raise the statutory basket for member business loans from 12.25% to 20% of total assets; • Redefine member business loan to increase the current limit from $50,000, possibly by using the Fannie/Freddie conforming loan limit, approximately $359,000, as of January 2005.	Support: NASCUS	Support: NAFCU[54] Oppose: ABA, ACB, ICBA

[47] FDIC was unable to formulate a position since there was no legislative language for this proposal.
[48] The FRB takes no position since the proposal lacks implementing statutory language.
[49] OCC has no position until legislative language is provided.
[50] ABA supports it for all bank LLCs.
[51] The FRB opposes. The existing structure of the FFIEC includes a liaison committee composed of five representatives of state financial institution supervisors. This structure provides an effective mechanism for the federal agencies represented in the Council to coordinate and discuss supervisory and regulatory issues with state supervisors as appropriate.
[52] CUNA supports efforts to address concerns with the required net worth ratio and prompt corrective action, but would prefer to review the specifics of any proposed language regarding this provision before stating an official position.
[53] NAFCU supports efforts to address concerns with the required net worth ratio and prompt corrective action, but would prefer to review the specifics of any proposed language regarding this provision before stating an official position.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's & Consumer Group's Positions**
John Allison/Mississippi Commissioner of Banking & Consumer Finance/Conference of State Bank Supervisors (CSBS)		
75. Federal Preemption of State Regulation of Consumer Protection Practices Encourage Congress to intervene to block continuing OCC preemption of State laws.	Support: CSBS, NASCUS No Position: FRB[55] Oppose: OCC	Support: CG Oppose: ABA, ACB,

[54] Recommend the language from Section 201 and 202 of H.R. 2317.

[55] The FRB takes no position since the proposal lacks implementing statutory language.

– SECTION II –
MEMBERS' PROPOSALS

The failure to state a position on these items should not be interpreted to mean support or opposition to any of the suggested concepts.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's and Consumer Group's Positions**
Senator Mary L. Landrieu		
76. Consumer Rental Purchase Agreement Act of 2003 – (S. 884) Amend the Consumer Credit Protection Act to require disclosure of the terms of rental-purchase agreements, including disclosure of all costs to consumers under such agreements, and to provide certain substantive rights to consumers under such agreements. The bill exempts credit sales, consumer leases, or transactions giving rise to a debt incurred in connection with the business of lending money from the definition of a "rental-purchase agreement."	No Position: OCC Oppose: FRB[56]	No Position: ABA Oppose: CFOA/NCLC[57], CG
Senator Blanche Lincoln		
77. Clarification of Scope of Applicable Rate Provision – (S. 904 and H.R. 3505 § 504) Allow nonbank lenders in Arkansas, who are currently subject to a State usury restriction, to charge the same rates of interest that their out-of-state competitors are legally importing into Arkansas under Federal law.	No Position: OCC	No Position: ABA Oppose: CFOA/NCLC[58], CG

[56] FRB opposes. The FRB does not have direct experience with rent-to-own transactions and dealers covered by S. 603 as most rent-to-own dealers are not within the supervisory jurisdiction of the FRB. The FRB believes that it would be more appropriate for Congress to provide the FTC with rule-writing authority for implementing S. 603 if the provisions of the bill are enacted.
[57] CFOA and NCLC are opposed. S. 603, entitled, 'The Consumer Rental-Purchase Agreement Act of 2005" is not a consumer protection bill. It is solely designed to protect the rent to own industry from having to provide meaningful consumer protections.
[58] CFOA and NCLC are opposed. Preemption of the voter-mandated constitutional interest rate ceilings in the state of Arkansas is terribly unfair to Arkansas voters, as it would completely remove the state's ability to impose any limits on any loans in the state.

– SECTION III –

FINANCIAL INDUSTRY REPRESENTATIVES' PROPOSALS SUPPORTED BY LEGISLATIVE LANGUAGE

The failure to state a position on these items should not be interpreted to mean support or opposition to any of the suggested concepts.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's and Consumer Group's Positions**
Mark Macomber/President & CEO, Litchfield Bancorp/America's Community Bankers		
78. Expand Availability of Small Institution Exam Cycle (H.R. 3952) (See also #102) Allow banks with less than $1 billion in assets to participate in the longer CRA exam cycle, which requires a routine CRA examination not more than once every 60 months if the institution was rated "outstanding" in its most recent exam, and not more than once every 48 months if the institution was rated "satisfactory" in its most recent exam. (Similar proposals by ICBA, along with an increase to $2 billion with inflation adjustment)	Has Concerns: OCC[59] Oppose: FDIC[60], FRB	Support: ABA, ACB, ICBA Oppose: CFOA/NCLC[61], CG
79. Mortgage Servicer Exemption to FDCPA (H.R. 1025 as passed by House) Provide that mortgage servicers of federally related mortgage loans do not have to provide the "mini-Miranda" notices to the borrower before beginning collection efforts on defaulted loans under the FDCPA. (Similar proposal by FSR)	Support: OTS No Position: OCC Oppose: FDIC	Support: ABA, ACB, FSR, ICBA Oppose: CFOA/NCLC[62], CG
80. Elimination of RESPA Imprisonment Sanction Strike the imprisonment sanction for violations of section 8 of the Real Estate Settlement Procedures Act (12 U.S.C. § 2607(d)(1))	Oppose: FDIC[63], OCC No Position: OTS	Support: ACB, FSR, ICBA No Position: ABA

[59] OCC has concerns. Item #78 may not be necessary in light of the recent regulation promulgated by the OCC, FRB, and FDIC to reduce burden on small depository institutions with respect to CRA.

[60] The FDIC opposes. Examination frequency should be based on policy considerations by the agency. The agencies currently have the flexibility to adjust the frequency of examinations for larger institutions, and the FDIC would prefer to retain that flexibility.

[61] CFOA and NCLC are opposed. Congress oversight is critical to ensure that CRA regulations are not weakened.

[62] CFOA and NCLC are opposed. The proposed mortgage servicers' exemption from a requirement in the Fair Debt Collection Practices Act is bad public policy and will undermine efforts to rein in foreclosure inducing practices of some mortgage servicers.

[63] The FDIC opposes. Criminal sanctions are appropriate for the offenses for which imprisonment is currently an option under RESPA. It is questionable that a $10,000 fine for RESPA violation(s) would be sufficient to deter fee-splitting, kickbacks, and charging for work that was not performed in the mortgage settlement services industry.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's and Consumer Group's Positions**
Mark Macomber/President & CEO, Litchfield Bancorp/America's Community Bankers - continued		
81. Eliminating Dividend Notice Requirements -- (H.R. 3505 § 204) (See also #31 & #117) Eliminate requirement that a well-capitalized savings association in an S&L holding company notify OTS of its intention to pay a dividend, so long as the association will remain well capitalized after paying the dividend. (Similar proposal by FSR)	Support: FDIC, OCC[64] Oppose: OTS	Support: ABA, ACB, FSR, ICBA
82. Removal of Limitations on Investments in Consumer Loans -- (Similar to H.R. 3505 § 208) Eliminate restriction on Federal savings associations that limit the amount of loans made for personal, family, or household purposes (consumer loans) to 35% of total assets. (Similar proposal by FSR)	Support: FDIC, OTS No Position: OCC	Support: ABA, ACB, FSR, ICBA
Marilyn F. James/CEO, NEPCO Federal Credit Union/Credit Union National Association		
83. Credit Union Conversion Voting Requirements (H.R. 3579 § 113) Require a majority vote of at least 20% of the membership to approve a credit union conversion.	Oppose: NASCUS[65]	Support: NAFCU[66] Neutral: CUNA[67] Oppose: ABA, ACB, ICBA
84. Limits on Member Business Loans (H.R. 3579 § 201) Eliminate the current asset limit on member business loans at a credit union from the lesser of 1.75 times actual net worth or 1.75 times the minimum net worth required for a well-capitalized credit union and replaces it with a flat rate of 20% of the total assets of a credit union. (Similar proposal by NAFCU)	Support: NASCUS	Support: CUNA[68], NAFCU Oppose: ABA, ACB, ICBA

[64] The OCC supports this amendment only if the OCC dividend amendment is included in the legislation. (See #31)

[65] NASCUS strongly believes that the process form converting a state-chartered credit union to another financial institution charter is a matter that should be determined by state law and regulation. NASCUS strongly endorses states rights.

[66] NAFCU supports it only as a part of an overall package of regulatory relief.

[67] CUNA's position is that while it believes the credit union charter a better choice for consumers, it recognizes the right of credit union members to determine the appropriate charter for themselves without having undue restrictions on their ability to make that choice, so long as it is fully informed through proper disclosure.

[68] CUNA's position on the issue, through testimony before the House and Senate and its strong support of H.R. 3579, is that it prefers that the MBL cap be eliminated totally, but it supports efforts to increase the cap to 20%.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Marilyn F. James/CEO, NEPCO Federal Credit Union/Credit Union National Association - continued		
85. Definition of Member Business Loan (H.R. 3579 § 202) Amend the current definition of member business loan to facilitate such loans by giving the NCUA the authority to exclude loans of $100,000 or less as de minimis, rather than the current limit of $50,000. (Similar proposal by NAFCU)	Support: NASCUS	Support: CUNA, NAFCU Oppose: ABA, ACB, ICBA
86. Restrictions on Member Business Loans (H.R. 3579 § 203) Give the NCUA discretion to allow an undercapitalized credit union to make new member business loans.	Support: NASCUS	Support: CUNA, NAFCU Oppose: ABA, ACB, ICBA

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Mark Macomber/President & CEO, Litchfield Bancorp/America's Community Bankers		
87. Increase Limits for Thrifts on Commercial Real Estate Loans (H.R. 3505 § 214) Allow thrifts to have commercial real estate loans amounting to 500% of capital and give OTS the flexibility to increase that limit.	Support: FDIC, OTS No Position: OCC	Support: ABA, ACB, FSR
88. Eliminate "Per Unit" limit in Residential Housing Development Provision for LTOB Purposes (H.R. 3505 § 215) Eliminate the limitation in the Loans to One Borrower provision applicable to thrifts that restricts loans to develop domestic residential housing units to units with a purchase price that does not exceed $500,000.	Support: FDIC, OTS No Position: OCC	Support: ABA, ACB, FSR, ICBA
89. Permit S&L Holding Companies to Acquire Thrifts in Other States under the Same Rules as BHCs (H.R. 3505 § 217) Allow multiple S&L holding companies to acquire thrifts in other States under the same rules that apply to bank holding companies under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 by eliminating restrictions that prohibit an S&L holding company from acquiring a thrift if it would cause the holding company to become a multiple S&L holding company controlling thrifts in more than one State.	Support: OTS No Objection: FDIC No Position: OCC	Support: ABA, ACB, FSR
90. Allow Savings Associations to Act as Agents for Affiliated Depository Institutions - (H.R. 3505 § 505) Give savings associations the same authority as banks to act as agents for their affiliated depository institutions. (Similar proposal by FSR)	Support: FDIC, OTS No Position: OCC	Support: ABA, ACB, FSR Neutral: ICBA
91. Continuing Debt Collection Efforts Make clear that a debt collector need not wait for the 30-day period that a debtor has to dispute a debt to begin collection efforts.	Support: FDIC[69] No Objection: OCC[70] No Position: OTS	Support: ABA, ACB, FSR Oppose: CG

[69] FDIC support conditioned on the further requirements that: i) the initial written communication conspicuously informs the debtor that additional collection efforts will cease upon written notice of dispute; and ii) the FTC promulgate implementing regulations including specific language to be used and defining "conspicuous notice."

[70] The OCC does not object provided amendment only clarifies current law.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Mark Macomber/President & CEO, Litchfield Bancorp/America's Community Bankers - continued		
92. Repeal of Overlapping Rules for Purchased Mortgage Servicing Rights (H.R. 3505 § 206) Eliminate a cap on the valuation of purchased mortgage servicing rights at 90% of fair value and thereby permits savings associations to value PMSRs, for purposes of certain capital and leverage requirements, at more than 90% up to 100% of fair market value, if the banking agencies jointly find that doing so would not have an adverse effect on the insurance funds or the safety and soundness of insured institutions, consistent with section 475 of FDICIA, as amended by section 1208 of the American Homeownership and Economic Opportunity Act of 2000 (Pub. L. No. 106-569).	Support: FDIC, OTS No Objection: OCC	Support: ABA[71], ACB, FSR, ICBA
93. Repeal $100,000 Lending Limit on Loans to Executive Officers (See # 111) Eliminate the provision requiring the appropriate Federal banking agencies to set a regulatory lending limit on other purpose loans to executive officers and replaces it with the limit on loans to one borrower.	Support: FDIC[72], OCC, OTS[73] Oppose: FRB[74]	Support: ABA[75], ACB, FSR, ICBA
94. Investments in Service Companies (in part reflected in H.R. 3505 § 406, which allows savings associations to invest in bank service companies) Provide parallel investment authority for banks and thrifts to participate in both bank service companies and thrift service companies, while preserving existing activity limits and maximum investment rules, as well as the roles of the Federal regulatory agencies with respect to subsidiary activities of the institutions under their primary jurisdiction.	Support: FDIC, OCC[76], OTS Oppose: FRB[77]	Support: ABA, ACB, FSR

[71] ABA supports it if it is applied equally to all.
[72] FDIC only supports proposal with an increased limitation on "other purpose loans" to $250,000.
[73] OTS supports an increase to $250,000.
[74] FRB opposes. The federal banking agencies already have the authority to raise the existing $100,000 limit if the agencies determine that such action would be consistent with safety and soundness. FRB expects to commence a comprehensive review of Regulation O in the near future and expects, as part of this process, to consider whether it would be appropriate to raise the existing $100,000 aggregate limit.
[75] ABA supports an increase to $250k.
[76] See also #56.
[77] FRB opposes. This amendment would allow savings associations to invest in bank service companies without complying with the investment limitations, approval requirements, and other limitations that apply to bank investors in a bank service company. FRB staff worked closely with industry representatives in developing an alternative amendment, which was included in the regulatory relief bill that passed the House last year (H.R. 1375). The alternative amendment would allow savings associations to invest in bank service companies in the same manner, and subject to the same terms and conditions, that insured banks may invest in bank service companies.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Mark Macomber/President & CEO, Litchfield Bancorp/America's Community Bankers - continued		
95. Streamlining Savings Association Subsidiary Notifications Eliminate the requirement that a savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary, but a savings association would still be required to notify OTS.	Support: OTS Oppose: FDIC No Position: OCC	Support: ABA, ACB, FSR
96. Authorizing Additional Community Development Activities (See also #55) Allow Federal savings associations to invest directly in community development corporations, as national and State member banks are permitted.	Support: FDIC No Position: OCC, OTS[78]	Support: ABA, ACB, FSR, ICBA
97. Reimbursement for the Production of Records Require the government to reimburse banks for the cost of assembling and providing records of corporate bank customers that the government is investigating and clarifies that the reimbursement requirement under the Right to Financial Privacy Act applies to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001.	No Objection: FDIC No Position: OCC[79], OTS	Support: ABA, ACB, CUNA, FSR, ICBA
98. Extending Divestiture Period Provide that unitary savings association holding companies that become multiple savings association holding companies have 10 years (instead of 2 years) to divest non-conforming activities, consistent with the rule applicable to new financial services holding companies under GLBA.	Support: OTS No Objection: FDIC No Position: OCC	Support: ACB, FSR No Position: ABA Oppose: ICBA, CG
99. Credit Card Savings Associations - (H.R. 3505 § 216) Permit an S&L holding company to charter a credit card savings association and still be exempt from the activity restrictions imposed on multiple S&L holding companies, consistent with current authority to charter a credit card national or State bank and maintain that exemption. (Similar proposal by FSR)	Support: OTS No Objection: FDIC No Position: OCC	Support: ACB, FSR Neutral: ICBA No Position: ABA

[78] OTS prefers #55.
[79] The OCC takes no position on this amendment and defers to Treasury and FinCEN.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's and Consumer Group's Positions**
Mark Macomber/President & CEO, Litchfield Bancorp/America's Community Bankers - continued		
100. Protection of Information Provided to Banking Agencies Provide that when a depository institution submits information to a Federal, State, or foreign bank regulator as part of the supervisory process, the institution does not waive any privilege it may claim with respect to that information. (Similar proposal by FSR)	Support: FDIC, FRB[80], OCC[81], OTS	Support: ABA, ACB, FSR, ICBA
Dale L. Leighty/Chairman/President, First National Bank of Las Animas (CO)/Independent Community Bankers of America		
101. Industrial Loan Company Exemption Eliminate exemption for industrial loan companies from regulation and supervision of parent company as bank holding company. (Similar proposal by Consumer Groups)	No Position: FRB[82], OCC[83] Oppose: FDIC[84], CSBS	Support: ABA[85], ICBA, CFOA/NCLC, CG Oppose: ACB, FSR
102. Community Reinvestment Act Amendments (See also #78) Increase the asset size limit for eligibility for the small bank streamlined CRA examination process to $2 billion in assets and increase the CRA small bank size limit for examination cycle purposes to $2 billion with inflation adjustments.	No Position: FRB[86] Oppose: FDIC[87], OCC,	Support: ABA[88], ACB[89], ICBA Oppose: CFOA/NCLC[90], CG

[80] The FRB also strongly supports broadening the amendment to cover bank holding companies, foreign banks, and other persons who may submit information to a federal, state, or foreign banking authority as part of the authority's supervisory or regulatory process.
[81] The OCC supports the general intent of this amendment but has concerns with its current language in ACB's 6/22/04 draft.
[82] The FRB takes no position since the proposal lacks implementing statutory language.
[83] The OCC has no position until legislative language is provided.
[84] The FDIC opposes. While no legislative language is currently available, this proposal has been described generally as eliminating the exemption for industrial loan companies (ILCs) from regulation and supervision of parent company as bank holding company. It is the FDIC's view that ILC charters pose no greater risk to the insurance fund than any other charter type, and ILCs are adequately supervised under current law. The FDIC and state chartering authorities directly supervise ILCs, and ILCs are subject to the same range of examination programs, supervisory activities, and enforcement actions as any other state nonmember bank.
[85] ABA supports compromise provisions of H.R. 1375 (108th Congress) in dealing with de novo branching. ABA supports payment of interest on corporate checking in H.R. 1224 (109th Congress, reported by House Financial Services Committee).
[86] The FRB takes no position since the proposal lacks implementing statutory language.
[87] The FDIC opposes. The agencies are in the process of making changes to the CRA regulations, in part to reduce regulatory burden, and the FDIC believes that it would be more productive to finish that rulemaking than to amend the CRA statute in this manner.
[88] ABA supports but will consider regulatory alternatives.
[89] ACB supports its proposal described at #78.
[90] CFOA and NCLC are opposed. Congressional oversight is critical to ensure that CRA regulations are not weakened.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Dale L. Leighty/Chairman/President, First National Bank of Las Animas (CO)/Independent Community Bankers of America - continued		
103. Tiered Regulation Continue to refine a tiered regulatory and supervisory system that recognizes the differences between community banks and larger, more complex institutions.	Support: CSBS No Position: FDIC[91], FRB[92], OCC[93]	Support: ACB[94], ICBA Oppose: ABA[95], CG
104. Truth in Lending Act Amendments 1. Direct the Federal Reserve to prescribe regulations authorizing customers who borrow from Federally insured depository institutions to waive the three-day right of rescission.	No Objection: OCC[96] Oppose: FDIC, FRB[97], OTS,	Support: ABA, ACB[98], FSR, ICBA Oppose: CFOA/NCLC[99], CG
2. Eliminate right of rescission when refinancing with a new lender where: A. no new money is advanced and; B. for home equity lines of credit	A)Oppose: FDIC, FRB, OCC[100], OTS B) Oppose: FDIC, FRB, OCC, OTS	
3. Direct the Federal Reserve to study options to simplify, relax, or eliminate existing requirements on what may be included and what must be included in advertisements under regulations implementing the Truth in Lending Act.	No Position: OCC[101] Oppose: FDIC, FRB[102], OTS	

[91] FDIC was unable to formulate a position since there was no legislative language for this proposal.
[92] The FRB takes no position since the proposal lacks implementing statutory language.
[93] The OCC has no position until legislative language is provided.
[94] ACB supports reducing regulatory burden on community banks, whenever and wherever feasible.
[95] ABA is opposed to a separate regulatory structure because the public would perceive them as less safe.
[96] The OCC has no objection to allowing greater latitude to waive provided consumers are protected from abuses that may occur from allowing a consumer to waive this right.
[97] FRB opposes. See discussion under item 64.
[98] ACB supports all of the provisions except #7, which it takes no position on.
[99] CFOA and NCLC are opposed. Diluting the protections provided through the disclosures and the right of rescission in the Truth in Lending Act would be very harmful to consumers.
[100] OCC opposes expanding exemption in current law to new creditors.
[101] The OCC has no position until legislative language is provided.
[102] FRB opposes. The FRB already initiated a comprehensive review of Regulation Z, which implements the TILA. The FRB has issued an advance notice of propose rulemaking (ANPR) that requests public comment on all aspect of the regulation's provisions affecting revolving credit accounts other than home-secured accounts, including ways to simplify, reduce, or improve the disclosures that must or may be provided under TILA. The ANPR also seeks public comment on whether there are any statutory changes to TILA that the FRB should consider recommending to Congress.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
4. Simplify the definition of the finance charge so that all consumers can understand the annual percentage rate.	No Position: FRB[103], OCC[104] Oppose: FDIC, OTS	
5. Synchronize and coordinate early TILA and RESPA disclosures and focus on the information that consumers want most, such as the principal amount of the loan, simple interest rate on the promissory note, amount of the monthly payment, and costs to close the loan.	No Position: FRB[105], OCC[106] Oppose: FDIC, OTS	
6. Expand time frames for resolution of billing errors to allow banks to investigate and resolve errors and avoid fraud; also increase penalties for frivolous error claims.	No Position: FRB[107], OCC[108] Oppose: FDIC, OTS	
7. Provide a de minimis level of $50 for which no restitution need be ordered for inadvertent errors and allow flexibility so banks do not have to review large numbers of consumer files for inadvertent errors and make restitution of nominal amounts where the costs far outweigh the minimal benefits to the consumer.	No Position: FRB[109], OCC[110] Oppose: FDIC, OTS	
105. Home Mortgage Disclosure Act Amendments 1. Increase the asset threshold for the HMDA exemption from $34 million to at least $250 million, with inflation adjustment;	May Support a Lesser Increase: OCC[111] No Position: OTS Oppose: FDIC[112], FRB[113]	Support: ABA[114], ACB[115], FSR, ICBA Oppose: CFOA/NCLC[116], CG

[103] The FRB takes no position since the proposal lacks implementing statutory language.
[104] The OCC has no position until legislative language is provided.
[105] The FRB takes no position since the proposal lacks implementing statutory language.
[106] The OCC has no position until legislative language is provided.
[107] The FRB takes no position since the proposal lacks implementing statutory language.
[108] The OCC has no position until legislative language is provided.
[109] The FRB takes no position since the proposal lacks implementing statutory language.
[110] The OCC has no position until legislative language is provided.
[111] While the OCC believes that an increase in this exemption to $250 million may be too high, the OCC may be able to support a lesser increase.
[112] The FDIC opposes. In general, while these proposals would seem likely to reduce compliance burden, the question remains as to whether they would also result in diminished protection for consumers and a reduced access to home mortgage data for governmental and other interested parties.
[113] FRB opposes. While the FRB would support some increase in the current $34 million asset threshold, the Board does not believe that this threshold should be raised to $250 million.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's and Consumer Group's Positions**
2. Exempt banks that make fewer than 100 reportable loans per year per category;	No Objection: OCC[117] No Position: OTS Oppose: FDIC[118], FRB[119]	
3. Allow the banking agencies to develop a definition of "Metropolitan Statistical Area" that applies to banks, instead of using the Census Bureau definition, to avoid covering certain rural banks;	No Position: OTS Oppose: FDIC[120], FRB[121], OCC	
4. Limit reporting to purchase money mortgages and refinancing of such mortgages; and	No Position: OTS Oppose: FDIC[122], FRB[123], OCC	
5. Direct the Federal Reserve to streamline HMDA data collection and reporting and eliminate requirements that are not cost-justified.	Support: OCC No Position: OTS Oppose: FDIC[124], FRB[125]	

[114] ABA supports an increase to $100M.

[115] ACB supports all the provisions except 3, which it takes no position on.

[116] CFOA and NCLC are opposed. Reducing the number of financial institutions required to provide HMDA disclosures would be a serious mistake at this critical juncture.

[117] The OCC does not object provided the "per category" criteria is deleted and the small reporter criteria for banks is the same as the criteria for nonblank lending institutions. See 12 CFR 203.2(e)(2)(iii)(B)) (i.e., the bank, savings association, or credit union makes fewer than 100 home purchase loans in a calendar year, including refinancings).

[118] FDIC: Refer to footnote #111.

[119] FRB opposes. The FRB supports providing an exemption to depository institution that make a de minimis number of HMDA-reportable loans. However, determining the proper threshold for such an exemption requires careful analysis. As a result, it would preferable for Congress to direct the FRB to initiate a rulemaking to create an exemption for depository institutions that make a de minimis number of HMDA-reportable loans in a given year and to determine the appropriate terms and conditions for such an exemption.

[120] FDIC: Refer to footnote #111.

[121] FRB opposes. It is easier for the federal banking agencies, other public officials, financial institutions, community groups, and other interested parties to understand and analyze the data reported under the statute using a common geographic standard.

[122] FDIC: Refer to footnote #111.

[123] FRB opposes. The FRB has used its exemptive authority to exclude all home equity lines of credit (HELOCs) from HMDA reporting requirements. Therefore, the amendment would not alter the exiting data collection or reporting obligations of financial institutions with respect to HELOCs under HMDA. The FRB should retain the flexibility to cover HELOCs in the future if it determines that such action would be appropriate.

[124] FDIC: Refer to footnote #111.

[125] FRB opposes. This amendment is unnecessary. Under current FRB policy, the FRB periodically reviews each of its regulations, including Regulation C, which implements HMDA, to update and, where appropriate, streamline them. Regulation C was reviewed in 2002.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Dale L. Leighty/Chairman/President, First National Bank of Las Animas (CO)/Independent Community Bankers of America - continued		
106. Bank Secrecy Act, USA Patriot Act, Anti-Money Laundering Compliance • Increase the threshold for filing a Currency Transaction Report from $10,000 to $30,000, adjust it for inflation, and increase other reporting thresholds as well; • Allow banks filing fewer than 50 CTRs a month to file quarterly; • Expand ability for banks to exempt from CTR filings certain regular, known customers and eliminate annual recertification for exempt customers; and • Change record retention requirement under the USA Patriot Act for closed accounts from five to two years.	No Position: FDIC[126], FRB[127], OCC[128], OTS[129]	Support: ABA, ACB[130], CUNA[131], FSR, ICBA
107. Flood Insurance (See also #65) • Streamline and simplify flood insurance requirements; and • Allow exceptions to flood insurance requirements for agricultural real estate where the value of most of the collateral is represented by land, not permanent structures.	No Position: FDIC[132], FRB[133], OCC[134], OTS[135]	Support: ABA, ACB, FSR, ICBA
108. Privacy Notices Allow banks that do not share information other than pursuant to the processing or service provider exceptions to provide a short statement to that effect printed on the customer's bank statement.	Qualified Support: OTS[136] No Objection: OCC[137] (See comments #63) Oppose: FDIC[138]	Support: ABA, ACB, FSR, ICBA Oppose: CG

[126] FDIC was unable to formulate a position since there was no legislative language for this proposal.
[127] The FRB takes no position since the proposal lacks implementing statutory language.
[128] OCC has no position until legislative language is provided.
[129] OTS is awaiting language.
[130] ACB supports increasing Currency Transaction Report thresholds to a reasonable level and reducing the record retention period to a reasonable period of time in order to reduce unnecessary regulatory burden.
[131] CUNA supports increasing Currency Transaction Report thresholds to a reasonable level and reducing the record retention period to a reasonable period of time in order to reduce unnecessary regulatory burden.
[132] FDIC was unable to formulate a position since there was no legislative language for this proposal. FDIC prefers # 65.
[133] The FRB takes no position since the proposal lacks implementing statutory language.
[134] OCC has no position until legislative language is provided.
[135] OTS is awaiting language.
[136] OTS wants the statement to include information regarding the "constructive sharing" of information with third parties.
[137] OCC does not object provided the institution does not share nonpublic personal information under GLBA or FCRA of the type that is subject to a consumer's right to opt out and there has been no change in the institution's privacy disclosures from the information disclosed in the most recent prior annual notice. The OCC notes that the Federal banking agencies issued an Advance Notice of Proposed Rulemaking (ANPR) on December 30, 2003 (68 FR 75164) requesting public comment on ways to improve the GLBA privacy notices, which may result in more extensive recommendations for changes to privacy notices. We are in the process of conducting consumer testing to

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Dale L. Leighty/Chairman/President, First National Bank of Las Animas (CO)/Independent Community Bankers of America - continued		
109. Call Report Streamlining (H.R. 3505 § 606) Direct all federal banking agencies to conduct a review of Call Report requirements every five years to determine which data requirements are no longer necessary or appropriate.	Support: CSBS, FDIC, FRB, OCC, OTS	Support: ABA, ACB, FSR, ICBA Oppose: CG
110. Sarbanes-Oxley Act • Exempt banks with less than $10 billion in assets from internal control attestation and audit requirement; and • Establish additional exemption levels under other sections of the Act for small banks/bank holding companies.	No Position: FRB[139] Oppose: FDIC, FRB[140], OCC[141], OTS[142]	Support: ABA[143], ACB[144] FSR, ICBA Oppose: CG
111. Credit to Insiders (Reg O) (See also #4 & #93) 1. Direct agencies to expand overly restrictive executive officer borrowing authority, for example, by increasing dollar amounts officers may borrow for personal residence and children's education and for other purposes.	No Position: FRB[145], OCC[146] Oppose: FDIC, OTS	Support: ABA[147], ACB[148], FSR, ICBA

decide how to improve privacy notices, and to determine what aspects of the notices consumers find helpful. This testing may result in the Agencies undertaking significant changes to the privacy rules or recommending other legislative changes to Congress.

[138] The FDIC opposes. While the FDIC objects to this proposal, we support alternative language, i.e., statutory and regulatory amendments that would eliminate the annual notice requirement for institutions that operate in a manner that does not require them to offer customers the opportunity to opt out of information sharing with either affiliated or unaffiliated parties. See #63 on the matrix.

[139] The FRB takes no position on the second bullet since it lacks implementing statutory language.

[140] FRB opposes the first bullet. The FRB supports the continuing efforts of the SEC and the Public Company Accounting Oversight Board to reduce the compliance burden associated with internal control and audit requirements of section 404 of the Sarbanes-Oxley Act, and harmonize the requirements of section 404 with those of section 36 of the Federal Deposit Insurance Act.

[141] OCC is opposed to $10 billion exemption from SOX and has no position on the second item until legislative language is provided.

[142] OTS opposes and believes that now is not the right time to take up these issues; more study is needed.

[143] ABA supports ideas to reduce impact of SOX on smaller institutions.

[144] ACB supports setting appropriate exemption levels for small banks and small bank holding companies.

[145] The FRB takes no position since the proposal lacks implementing statutory language.

[146] OCC has no position until legislative language is provided.

[147] ABA has strong support for 1 & 2.

[148] ACB supports its proposal described in No. 93.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
2. Allow the Federal Reserve to make exceptions to the aggregate credit limit for all bank officers for banks up to $1 billion in assets.	Oppose: FDIC, FRB[149], OCC, OTS	
3. Lift a requirement that a bank's loan to a bank officer become due and payable on demand if that officer takes out loans from another bank larger than permissible from his own bank, if on arm-length terms.	Oppose: FDIC, OTS No Objection: OCC	
4. Streamline and reduce certain reporting requirements regarding loans to executive officers and loans from correspondent banks to executive officers and shareholders.	Support: OCC No Position: FRB[150] Oppose: FDIC, OTS	
112. Examination Cycle (See also #42, #68 &#169) Give Federal banking agencies greater flexibility to determine the examination interval for well-rated, well-capitalized banks with less than $1 billion in assets.	Support: CSBS Prefer #68: FDIC No Position: OCC[151], OTS[152], Oppose: FRB[153]	Support: ABA, ACB, FSR, ICBA Oppose: CG
113. Money Market Deposit Accounts (Reg D) Expand the number of permissible transfers from money market deposit accounts from 6 to 24 per month.	No Position: FRB[154], OCC[155] Support: FDIC Conditional Support: OTS[156]	Support: ABA, ACB, CUNA, FSR, ICBA

[149] FRB opposes. Although the FRB would support some upward adjustment of the $100 million statutory threshold, such as to reflect inflation and the growth in U.S. banking assets, the FRB does not believe it is appropriate or necessary to raise the statutory threshold to $1 billion. The FRB has no objection to converting the statute's deposit-based threshold to an asset-based threshold set at an appropriate level.
[150] The FRB takes no position since the proposal lacks implementing statutory language.
[151] OCC cannot take a position on this specific item until legislative language is provided but the OCC supports item #169.
[152] OTS is awaiting language.
[153] FRB opposes. The FRB supports an alternative amendment (item 68) that would raise this asset threshold to $500 million.
[154] The FRB takes no position since the proposal lacks implementing statutory language.
[155] OCC has no position until legislative language is provided but defers to the Fed on monetary policy concerns.
[156] OTS is awaiting language.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Dale L. Leighty/Chairman/President, First National Bank of Las Animas (CO)/Independent Community Bankers of America - continued		
114. Expedited Funds Availability (Reg CC) Streamline and simplify these requirements.	No Position: FDIC[157], FRB[158], OCC[159]	Support: ABA, FSR, ICBA Oppose: CG
115. Electronic Fund Transfer Act (Reg E) • Increase consumer liability from $50 to $500 for unauthorized transfers resulting from writing PIN on card or keeping PIN in the same location as the card; and • Extend notification requirement for a change in account terms or conditions contained in the initial Reg E disclosure from 21 days to 30 days consistent with Reg DD.	Support: FDIC, FRB second bullet only No Objection: OCC No Position: FRB first bullet Support Change in Notification Period: OTS	Support: ABA[160], CUNA, FSR, ICBA Support 2nd Bullet: ACB Oppose: CG
116. Bank Holding Companies (Reg Y) - (H.R. 3505 § 616) • Direct the Federal Reserve to increase the size limit for banks eligible for the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors from $150 million to $1 billion; • Allow the holding company to qualify if it (1) is not engaged in any non-banking activities involving significant leverage, and (2) does not have a significant amount of outstanding debt held by the general public; and • Increase the size threshold for streamlined application and information requirements from $150 million to $1 billion.	No Objection: FDIC No Position: OCC, OTS Oppose: FRB[161]	Support: ABA[162], FSR, ICBA
117. Dividends (See also #31 & #81) Eliminate the requirement that the Comptroller of the Currency approve dividends that exceed a bank's net income, so long as the bank is well-managed and well-capitalized and will be well-capitalized following the declaration of the dividend.	No Objection: FDIC No Position: OTS Oppose: OCC[163]	Support: ABA, ACB, FSR, ICBA

[157] FDIC was unable to formulate a position since there was no legislative language for this proposal.
[158] The FRB takes no position since the proposal lacks implementing statutory language.
[159] OCC has no position until legislative language is provided.
[160] ABA supports combining.
[161] FRB opposes. The FRB believes that any changes to its Policy Statement should be carefully evaluated to ensure the changes do not compromise the safety and soundness of insured banks. The FRB expects to request public comment in the near future on proposed changes to the Policy Statement, including an increase in the $150 million asset threshold.
[162] ABA has asked for $800M.
[163] OCC opposes. See OCC dividend proposal #31.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's and Consumer Group's Positions**
Dale L. Leighty/Chairman/President, First National Bank of Las Animas (CO)/Independent Community Bankers of America - continued		
118. Branch Applications/Notices (See also #62) • Banks and thrifts that are well-managed and well-capitalized are permitted to branch without prior approval, provided they notify their federal regulator within 30 days; and • Exempt ATMs, branch acquisitions in the acquirer's service area, branches moved in the same local market, and branches closed due to emergency acquisition or FDIC assistance.	Oppose: FDIC No Position: OTS 1. See Comments #62: OCC Oppose: FRB[164] 2. No Position: FRB[165], OCC[166]	Support: ABA, ACB[167], FSR, ICBA Oppose: CG
119. SIPC Coverage Provide community banks with the same protection afforded other investors and other depository institutions for their brokerage account assets when a broker dealer fails.	Support: FDIC, OTS[168] No Position: OCC	Support: ABA, ACB, FSR, ICBA
120. Government Securities Act Amend the reporting requirements under the Government Securities Act so that banks do not need to send a statement whenever money is swept from a deposit account into a government repurchase agreement.	Support: FDIC, OTS No Position: OCC	Support: ABA, ACB, FSR, ICBA
Marilyn F. James/CEO, NEPCO Federal Credit Union/Credit Union National Association		
121. Leasing Space in Building with Credit Union Offices in Underserved Area Allow credit union to lease excess space in a building or on property in an underserved area on which the credit union maintains a physical presence to other parties. (Similar proposal by NAFCU)		Support: CUNA, NAFCU[169] Oppose: ABA[170], ICBA

[164] FRB opposes. This amendment is inconsistent with the agencies' obligation to consider an institution's record of performance under the CRA in connection with the establishment of a branch.
[165] The FRB takes no position since the proposal lacks implementing statutory language.
[166] OCC has no position until legislative language is provided.
[167] ACB presented its own proposal to eliminate unnecessary branch applications during testimony given on June 22, 2004
[168] OTS supports this item with item #52.
[169] NAFCU recommends using language from Section 205 of H.R. 2317.
[170] ABA opposes because it extends tax subsidies to real estate development activities.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
Marilyn F. James/CEO, NEPCO Federal Credit Union/Credit Union National Association - continued		
122. Reduce Restrictions on Member Business Loans Allow credit unions to make member business loans unless they are significantly undercapitalized at 4% or less.		Support: CUNA, NAFCU[171] Oppose: ABA, ACB, ICBA
123. Community Credit Union Membership Allow community credit unions to continue adding members from groups that were part of the field of membership before the credit union converted to a community charter but are now outside that community. (Similar proposal by NAFCU)		Support: CUNA, NAFCU[172] Oppose: ABA, ACB, ICBA
124. Credit Union ATMs Allow credit unions to serve underserved areas with an ATM.		Support: CUNA, NAFCU Oppose: ABA, ACB, ICBA
125. NCUA Board Membership Requirement Eliminate the requirement that only one NCUA Board member can have credit union experience.		Support: CUNA, NAFCU Oppose: ABA, , ICBA
126. Increase in 1 Percent Borrowing Limit for CUSOs (See also #11 & #131) Raise the aggregate borrowing limit that currently restricts loans from credit unions to CUSOs from 1% to 3%.		Oppose: ABA, ICBA
Margot Saunders/National Consumer Law Center & Edmund Mierzwinski/U.S. PIRG (Consumer Groups)		
127. Clarify Application of TILA to Bounce Loans Require that bounce protection loans be treated like other extensions of credit under the Truth in Lending Act by requiring disclosure to consumers of the cost of this type of credit.	No Position: FDIC[173], FRB[174]	Support: CFOA/NCLC, CG Oppose: ABA, ACB, ICBA, No Position: CUNA[175], NAFCU[176]

[171] NAFCU recommends using the language from Section 203 of H.R. 2317.

[172] NAFCU recommends the language found in Section 307 of H.R. 2317.

[173] FDIC was unable to formulate a position since there was no legislative language for this proposal.
[174] The FRB takes no position since the proposal lacks implementing statutory language.
[175] CUNA supports the Federal Reserve Board's position that bounce loans should not be governed by the TILA.
[176] NAFCU supports the Federal Reserve Board's position that bounce loans should not be governed by the TILA.

Witness/Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal** (Similar proposals by other witnesses noted to the extent given in their testimony)	**Regulators' Position**	**Industry's and Consumer Group's Positions**
Margot Saunders/National Consumer Law Center & Edmund Mierzwinski/U.S. PIRG (Consumer Groups) - continued		
128. Payday Lending Prohibit all banks from providing payday loans in violation of State laws, including through "rent-a-bank" arrangements.	No Position: FDIC[177], FRB[178]	Support: CFOA/NCLC[179], CG Oppose: ABA, ACB[180]
129. Update TILA and the Consumer Leasing Act Increase the jurisdiction limits and statutory penalties in TILA and the Consumer Leasing Act and provide for future adjustments for inflation.	No Position: FDIC[181], FRB[182]	Support: CFOA/NCLC[183], CG Oppose: ABA, ACB, ICBA
130. Expand Application of EFTA Apply the protections of the EFTA to all forms of electronically processed payments, including all checks that are processed in whole or in part by the transmission of electronic information.	No Position: FDIC[184], FRB[185]	Support: CFOA/NCLC, CG Oppose: ABA, ACB, ICBA
William Cheney/President/CEO, Xerox Federal Credit Union/National Association of Federal Credit Unions		
131. Further Changes to Investment Limit in Credit Union Service Organizations (See also #11, #126) Give the NCUA Board authority to establish an appropriate investment limit for a credit union's investment in CUSOs.		Support: CUNA, NAFCU[186] Oppose: ABA, ACB, ICBA

[177] FDIC was unable to formulate a position since there was no legislative language for this proposal.
[178] The FRB takes no position since the proposal lacks implementing statutory language.
[179] CFOA and NCLC support this proposal. All banks, including state chartered banks, should be prohibited from providing exorbitantly priced payday loans in violation of state laws.
[180] ACB supports the OCC's authority to preempt state laws.
[181] FDIC was unable to formulate a position since there was no legislative language for this proposal.
[182] The FRB takes no position since the proposal lacks implementing statutory language.
[183] CFOA and NCLC support this proposal. The jurisdiction limits and statutory penalties of the Truth in Lending Act and the Consumer Leasing Act need to be brought up to 21st century standards.
[184] FDIC was unable to formulate a position since there was no legislative language for this proposal.
[185] The FRB takes no position since the proposal lacks implementing statutory language.
[186] NAFCU recommends the language found in Section 304 of H.R. 2317.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
William Cheney/President/CEO, Xerox Federal Credit Union/National Association of Federal Credit Unions - continued		
132. Additional Changes to Credit Union Governance (See also #19) • Allow the NCUA Board to set the amount at which the credit union board of directors must approve a loan to, or guaranteed by, a director or member of the credit union supervisory or credit committee (currently set by statute at $20,000); and • Allow the NCUA Board to determine policies for review of approved or pending applications for membership to the credit union (currently required monthly).		Support: CUNA, NAFCU Neutral: ICBA Oppose: ABA
133. Reasonable Proximity Requirement Eliminate outdated requirement that a credit union have a physical presence within a reasonable proximity of the location of a group that the credit union wants to add to its field of membership. (Similar proposal by NAFCU)		Support: CUNA, NAFCU Oppose: ABA, ACB, ICBA
William A. Longbrake/Vice Chair, Washington Mutual Incorporated/Financial Services Roundtable		
134. Simplify Privacy Notice Direct the relevant Federal agencies to develop, by rulemaking, a summary privacy notice and an easy, standardized opt-out form, preempt State law so that the simple notice and opt-out form supersede State privacy notices and forms, and replace the annual notice requirement with a requirement that institutions distribute the summary notice when a customer relationship is established and whenever the terms of the institution's privacy policy change materially. Require that an institution's privacy policy be available and provided upon request.	Qualified Support: OTS[187] No Objection: FDIC Oppose: FRB[188], OCC[189]	Support: ABA[190], ACB, FSR, ICBA[191] Oppose: CG

[187] OTS wants the notice to include information regarding the "constructive sharing" of information with third parties.
[188] The FRB opposes. The proposed amendment's timeframe could significantly disrupt the consumer testing process of a streamlined or "short-form" privacy notice created by a consultant hired by the banking agencies currently underway. This consumer testing is expected to be completed by September 30, 2005. The results of the consumer testing will be used to determine if changes to the agencies' privacy regulations, or whether legislative changes would be needed.
[189] OCC opposes. Timetable does not provide for adequate consumer testing to be conducted to determine appropriate information to be included in any simplified privacy notice.
[190] ABA supports proposal to eliminate unnecessary cost of providing privacy notices, including elimination of annual notice if there are not changes in privacy policy.
[191] ICBA supports it if the simplified notice is optional.

Witness/Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal (Similar proposals by other witnesses noted to the extent given in their testimony)	Regulators' Position	Industry's and Consumer Group's Positions
William A. Longbrake/Vice Chair, Washington Mutual Incorporated/Financial Services Roundtable - continued		
135. Flexibility for Limited Purpose Credit Card Banks for CRA Compliance Permit limited purpose credit card banks to invest in, or directly offer, residential mortgage, small business and agriculture loans to help meet the credit needs of low and moderate income persons to meet the obligations of the CRA.	No Objection: OCC No Position: OTS Oppose: FDIC[192]	Support: ABA[193], ACB, FSR Oppose: CG
136. Anti-tying Modernization Amendment Limit anti-tyng restrictions to products and services offered by a bank to individual consumers and small businesses or, alternatively, limit the restrictions to products and services offered by a bank to customers who are not "qualified investors" as defined in GLBA (in effect, exempt large corporate customers from the anti-tying provisions).	No Objection: FDIC No Position: OCC, OTS	Support: ABA, ACB, FSR, ICBA Oppose: CG

[192] The FDIC opposes. The FDIC believes that there is insufficient information to support this proposal or to evaluate its implications.
[193] ABA prefers not to amend CRA.

SECTION IV-
REGULATORY RELIEF PROPOSALS
RECEIVED AFTER THE JUNE 22, 2004 BANKING COMMITTEE HEARING

The failure to state a position on these items should not be interpreted to mean support or opposition to any of the suggested concepts.

Proposing Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal**	**Regulator's Position**	**Industry's & Consumer Group's Positions**
Board of Governors of the Federal Reserve System (FRB)		
137. (a) Restore Board's Authority to Determine the New Activities are "Closely Related to Banking" Restores the Board's ability to determine that activities are "closely related to banking" under section 4(c)(8) of the Bank Holding Company Act and thus permissible for all bank holding companies, including those that have not elected to become financial holding companies. Bank holding companies would still have to become a financial holding company under the GLB Act to engage in merchant banking activities, and expanded securities underwriting, insurance sales and insurance underwriting activities.	Support: FRB, OTS[194] No Position: FDIC Oppose: OCC[195]	(a) Support: ABA, FSR No Objection: ACB, ICBA
137. (b) Permit Bank Holding Companies to Engage in Insurance Agency Activities - (alternative to (a)) Allow all bank holding companies (including those that have not elected to become financial holding companies) to act as <u>agent</u> in the sale of insurance. Most banks are permitted to engage in insurance sales activities either directly or indirectly through a subsidiary.	Support: FRB No Position: FDIC	(b) Support: ABA, FSR, ICBA No Objection: ACB,
138. Interstate Mergers between Insured Banks and Savings Associations or Trust Companies - (H.R. 3505 § 401) Allow an insured bank to directly acquire, by merger, an insured savings association or uninsured trust company in a different home state without first converting the target savings association or trust company into an insured bank.	Support: FDIC, FRB, OTS No Objection: OCC[196]	Support: ACB, FSR No Objection: ABA, ICBA

[194] OTS supports but only with comparable OTS authority with regard to the S&LHC's.

[195] OCC objects unless an amendment is included to provide parity to national banks also to engage in general insurance agency activities without necessity of establishing a financial subsidiary structure. See OCC Amendment #1.

[196] OCC does not object (same language included in § 401 of HR 3505) if additional language from § 401 of HR 3505 also is included that would amend the National Bank Consolidation and Merger Act to facilitate interstate consolidations and mergers of national bank trust companies. The OCC also strongly supports other provisions in § 401 that would repeal the state opt-in requirement for *de novo* interstate branching for national banks. *See* Item #26.

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Board of Governors of the Federal Reserve System (FRB) - continued		
139. Modify Cross-Marketing Restrictions on Merchant Banking and Insurance Company Investments - (H.R. 3505 § 501) Allow depository institution subsidiaries of an FHC to engage in cross-marketing activities with portfolio companies that are held under the GLB Act's merchant banking authority to the same extent as such activities are currently permissible for portfolio companies held under the GLB Act's insurance company investment authority. The amendment also would allow the depository institution subsidiaries of an FHC to engage in cross-marketing activities with a portfolio company held under either the merchant banking or insurance company investment authority if the FHC does not control the portfolio company.	Support: FRB No Position: OCC, OTS Oppose: FDIC	Support: ABA, FSR No Objection: ACB Oppose: ICBA
140. Provide Board with Discretion Concerning the Control of Shares Held by Trusts (H.R. 3505 § 502) Permit the Board to waive the attribution rule in section 2(g)(2) of the BHC Act (12 U.S.C. 1841(g)(2)) in appropriate circumstances. This attribution rule currently provides that, for purposes of the Bank Holding Company Act, a company is deemed in all circumstances to own or control any shares that are held by a trust (such as an employee benefit plan) for the benefit of the company or its shareholders or employees.	Support: FRB, OTS[197] No Position: FDIC, OCC	Support: ABA, ACB, ICBA No Position: FSR
141. Authorization for Member Banks to Use Pass-Through Reserve Accounts - (H.R. 1224 and S. 1586) Permit banks that are members of the Federal Reserve System to count as reserves the deposits in other banks that are "passed through" by those banks to the Federal Reserve as required reserve balances. Nonmember banks already are able to use such pass-through reserve accounts.	Support FDIC, FRB, OCC[198] No Position: OTS	No Objection: ABA, ACB, FSR, ICBA
142. Restriction on the Ability of Convicted Individuals from participating in the Affairs of a BHC or Edge or Agreement Corporation – (H.R. 3505 § 613) Prohibit a person convicted of a criminal offense involving dishonesty, breach of trust or money laundering from participating in the affairs of a bank holding company (other than a foreign bank) or an Edge or Agreement Corporation without the consent of the Board. The amendment also would provide the Board greater discretion to prevent convicted individuals from participating in the affairs of a nonbank subsidiary of a bank holding company.	Support: FDIC[199], FRB, OCC[200], OTS[201]	Support: ACB No Objection: ABA, FSR, ICBA

[197] OTS supports but only with comparable OTS authority with regard to S&LHC's.
[198] OCC supports (same language included in HR 1224, as passed by the House on 5/24/05, and S. 1586, as introduced in the Senate on 7/29/05).
[199] FDIC support conditioned on similar authority for FDIC to remove individuals from subsidiaries under proposed section 8(e)(2)(A)(iv).
[200] OCC supports but with an amendment to this item and § 613 of HR 3505 to give the Federal banking agencies authority under 12 U.S.C. 1829 to remove such persons from nonbank subsidiaries of depository institutions. See OCC amendment #2.
[201] OTS supports but only with comparable OTS authority with regard to the S&LHC's

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Board of Governors of the Federal Reserve System (FRB) - continued		
143. Elimination of Outdated Provisions of the Bank Holding Company Act – (H.R. 3505 § 804) Eliminates certain outdated provisions of the BHC Act that no longer have any effect.	Support: FRB, OTS No Position: FDIC, OCC	No Objection: ABA, ACB, FSR, ICBA
Federal Deposit Insurance Corporation (FDIC)		
144. (a) Technical Amendment to Section 8(i) of the Federal Deposit Insurance Act - (H.R. 3505 § 614) Clarifies that a Federal banking agency may take enforcement action against a person for conduct that occurred during his or her affiliation with a banking organization even if the person resigns from the organization, regardless of whether the enforcement action is initiated through a notice or an order. **144. (b) Technical Amendment to Section 206(k) of the Federal Credit Union Act** Section 206(k) (3) of the FCU Act parallels Section 8(i) of the FDI Act. If Section 8(i) is amended, the same amendment should be made to the FCU Act.	Support: FDIC, FRB, OCC, OTS (b) Support: NCUA Neutral: NASCUS	(a) Support: ACB No Objection: ABA, FSR, ICBA (b) No Position: CUNA, NAFCU
145. Require Consideration of Potential Adverse Effects on Insurance Funds Resulting from Bank Merger or Holding Company Organization Amend the Bank Merger Act and Bank Holding Company Act to require consideration of the potentially adverse effects on the insurance funds of any proposed bank merger transaction or holding company formation or acquisition.	Support: FDIC, OTS See Footnote: OCC[202] Has Concerns: FRB[203]	No Objection: ABA, FSR, ICBA No Position: ACB
146. Clarify Bases for Disapproval and Extension of Time to Consider Change in Control Notices (H.R. 3505 § 409) Amend the Change in Bank Control Act to clarify the bases for which change-in-control notices may be disapproved and to expand the bases for extensions of time for consideration of certain notices raising novel or significant issues.	Support: FDIC, FRB, OCC, OTS	No Objection: ABA, ACB, FSR, ICBA

[202] The OCC is not convinced the amendment is necessary. The criteria considered by the banking agencies under current law examines the same factors that would be applied to determine the effect on the insurance funds; under both the Bank Merger Act and the Bank Holding Company Act, the respective Federal banking agency must consider the financial and managerial resources and the future prospects of the institutions involved in the transactions before the transaction may be approved. *See* 12 U.S.C.§§ 1828(c)(5); 1842(c)(2)

[203] The FRB believes that the proposed amendment is unnecessary. The Bank Merger Act and the Bank Holding Company Act already require the appropriate federal banking agency to consider the financial and managerial resources and future prospects of the companies or depository institutions involved in any bank merger or acquisition proposal. Consistent with these factors, the agencies already have the ability to, and do, consider the capital strength, risk management controls, business plans, and managerial experience of the organizations involved in a bank merger or acquisition and potential likelihood that the combined organization may fail and present a risk to the deposit insurance fund.

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Federal Deposit Insurance Corporation (FDIC) - continued		
147. (a) Clarification of Enforcement Authority – (H.R. 3505 § 614) Amend section 8 of the Federal Deposit Insurance Act to clarify authority to enforce conditions imposed in connection with a notice, including a change-in-control notice. **147. (b) Clarification that Change in Control Conditions Are Enforceable** Section 206 of the FCU Act has parallel sections to portions of Section 8 of the FDI Act. The FCU Act should be amended in the same manner as the FDI Act.	Support: FDIC, FRB, OCC[204], OTS (b) Support: NCUA Neutral: NASCUS	(a) No Objection: ABA, ACB, FSR, ICBA (b) No Position: CUNA, NAFCU
148. Authority to Enforce Conditions on the Approval of Deposit Insurance Amend section 8 of the Federal Deposit Insurance Act to provide each of the other three appropriate Federal banking agencies with express authority to enforce conditions imposed in writing in connection with the approval of an institution's application for deposit insurance.	Support: FDIC, FRB[205], OCC, OTS	Support: ACB, ICBA No Objection: ABA, FSR
149. Enforcement of Agreements and Conditions (H.R. 1375 § 405 - 108th Congress) (Not in newly introduced House bill) Clarify that the Federal banking agencies may enforce (i) conditions imposed in writing, and (ii) written agreements, in which an institution-affiliated party agreed to provide capital to the institution without first establishing that the institution-affiliated party was unjustly enriched. It also clarifies existing authority of the FDIC as receiver or conservator to enforce written conditions or agreements entered into by insured depository institutions, institution-affiliated parties, and controlling shareholders. The proposal also eliminates the requirement that an insured depository institution be undercapitalized at the time of a transfer of assets from an affiliate or controlling shareholder to prevent a claim against a Federal banking agency for the return of the assets under bankruptcy law.	Support: FDIC, OCC[206], OTS No Position: FRB	No Objection: ABA, ACB, FSR, ICBA

[204] OCC supports § 405 of HR 3505 (addresses this item and Item #149) with certain technical changes supported by the federal banking agencies. See OCC amendment #3.

[205] The FRB supports this provision but wants to clarify that it is the appropriate federal banking agency for a depository institutions that would have primary authority to enforce a written condition imposed by another federal banking agency. Section 8(t) of the Federal Deposit Insurance Act gives the FDIC "back-up" authority to enforce a written condition against an insured depository institution that the institution's appropriate federal banking agency has the authority to enforce against the institution. The FDIC's back-up enforcement authority does not extend to bank holding companies, and only the Board has the authority to bring an enforcement action against a bank holding company or a nonbank subsidiary of a bank holding company.

[206] OCC supports § 405 of HR 3505 with technical amendments (*see* comments and OCC amendment associated with Item #147).

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Federal Deposit Insurance Corporation (FDIC) - continued		
150. Clarification of Section 8(g) Prohibition Authority (H.R. 1375 § 606 - 108th Congress) (Not in newly introduced House bill) Clarify that the appropriate Federal banking agency may suspend or prohibit individuals charged with certain crimes from participation in the affairs of *any* depository institution and not solely the insured depository institution with which the institution affiliated party is or was associated. Further clarify that the section 8(g) remedy may be imposed even where the institution with which the individuals were associated ceases to exist. The proposed amendment also allows the appropriate Federal banking agency to suspend or remove an individual who attempts to become involved in the affairs of an insured depository institution after being charged with a crime involving dishonesty or a breach of trust and clarifies the standards and process for issuing a suspension or removal order in situations where an individual terminates his or her affiliation with one depository institution after being charged with a crime, but then becomes or seeks to become affiliated with another.	Support: FDIC, FRB, OTS Does Not Support: OCC[207]	Support: ACB No Objection: ABA, ICBA No Position: FSR
151. Cross Guarantee Authority (H.R. 3505 § 407) Clarify the scope of cross guarantee liability to include all insured depository institutions commonly controlled by the same company.	Support: FDIC, FRB, OCC, OTS	No Objection: ABA, ACB, FSR, ICBA
152. Golden Parachute Authority (H.R. 3505 § 408) Clarify that authority to prohibit golden parachute payments includes nonbank holding companies, as well as depository institution holding companies.	Support: FDIC, FRB, OCC, OTS	No Objection: ABA, ACB, FSR, ICBA
153. Parity in Standards for Institution-Affiliated Parties (H.R. 1375 § 614 - 108th Congress) Remove the "knowing or reckless" requirement from the standard of proof required to make independent contractors liable as institution-affiliated parties.	Support: FDIC, OCC, OTS No Position: FRB	No Objection: ABA No Position: FSR Oppose: ACB, ICBA
154. Clarification of Certain Application Requirements for Optional Conversion of Federal Savings Associations Clarify that conversions, which result in more than one bank, would continue to require deposit insurance applications from the resulting institutions, as well as review and approval by the appropriate Federal banking agency. In addition, the amendment would clarify that no applications under the Bank Merger Act would be required for such conversions.	Support: FDIC, OTS Recommended an Additional Amendment: OCC[208] No Position: FRB	No Objection: ABA, ICBA No Position: ACB, FSR

[207] OCC does not support. In lieu of Item #150, support § 609 of HR 3505 as reported by the House Financial Services Committee which includes technical amendments supported by the federal banking agencies.
[208] OCC recommends an additional amendment deleting the requirement that a federal savings association and any branch to be retained upon conversion must be operational before 12/19/99. See OCC amendment #4.

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Federal Deposit Insurance Corporation (FDIC) - continued		
155. (a) Receiver's or Conservator's Consent Requirement Require the consent of the receiver or conservator before a party to a contract to which the depository institution is a party could exercise any right or power to terminate, accelerate, or declare a default under any contract, or to obtain possession of or exercise control over any property of the institution or affect any contractual rights of the institution. **155. (b) Receiver's or Conservator's Consent Requirement** Require the consent of the receiver or conservator before a party to a contract to which the credit union is a party could exercise any right or power to terminate, accelerate, or declare a default under any contract, or to obtain possession of or exercise control over any property of the credit union or affect any contractual rights of the credit union.	Support: FDIC, FRB, OCC[209], OTS (b) Support: NCUA Neutral: NASCUS	(a) No Objection: ABA, ACB No Position: FSR Do Not Support: ICBA (b) No Position: CUNA, NAFCU
156. (a) Acquisition of FICO Scores Amend the Fair Credit Reporting Act to define an FDIC request for FICO scores as part of its preparation for a resolution as a permissible purpose, enabling the FDIC to obtain FICO scores by contacting credit reporting agencies and to obtain current consumer credit reports. **156. (b) Acquisition of FICO Scores** Amend the Fair Credit Reporting Act to define a NCUA request for FICO scores as part of its preparation for a resolution as a permissible purpose, enabling the NCUA to obtain FICO scores by contacting credit reporting agencies and to obtain current consumer credit reports.	Support: FDIC, OTS No Position: FRB, OCC (b) Support: NCUA Neutral: NASCUS	(a) No Objection: ABA, ICBA No Position: ACB, FSR (b) No Position: CUNA, NAFCU

[209] OCC supports technical changes to ensure that rights under qualified financial contracts and netting contracts are not affected (see OCC amendment #5); also, considering whether to recommend corresponding amendments to provide receivers and conservators of *un*insured national banks and Federal branches and agencies that are resolved under national banking laws with the same authority that receivers and conservators have with respect to insured depository institutions under the Federal Deposit Insurance Act.

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Federal Deposit Insurance Corporation (FDIC) - continued		
157. (a) Elimination of Criminal Indictments Against Receiverships Amend the Federal Deposit Insurance Act to require that any criminal indictment against a bank be dismissed, if the FDIC is appointed receiver of that bank. **157. (b) Elimination of Criminal Indictments Against Receiverships** Amend the Federal Credit Union Act to require that any criminal indictment against a credit union be dismissed, if the NCUA is appointed receiver of that credit union.	Support: OTS No Position: FRB, OCC See Footnote: FDIC[210] (b) Support: NCUA Neutral: NASCUS	(a) No Objection: ABA, FSR, ICBA No Position: ACB (b) Support: CUNA, NAFCU
158. (a) Resolution of Deposit Insurance Disputes Clarify that the APA standard of review, the 60-day limitation period, and U.S. district court jurisdiction apply to the FDIC's final determination of insurance coverage whether made pursuant to procedural regulations or not. **158. (b) Resolution of Credit Union Deposit Insurance Disputes** Section 207(d) of the FCU Act (12 U.S.C. 1787(d)) parallels Section 11(f) of the FDI Act. The FCU Act should be amended in the same manner as the FDI Act.	Support: FDIC, OTS No Position: FRB, OCC (b) Support: NCUA Neutral: NASCUS	(a) No Objection: ABA, ACB, FSR, ICBA (b) No Position: CUNA, NAFCU
159. Judicial Review of Receivership Appointments - (H.R. 3505 § 402 - 109th Congress[211]) Amend the Bank Conservation Act and the Federal Deposit Insurance Act to provide greater consistency regarding the time an insured depository institution has to challenge the appointment of a receiver.	Support: FDIC, OCC, OTS No Position: FRB	No Objection: ABA, ACB, FSR, ICBA

[210] FDIC is reviewing further and not seeking language at this time.

[211] As included in H.R. 1375 from the 108th Congress, this provision would amend the National Bank Receivership Act, the Federal Deposit Insurance Act, and the Federal Credit Union Act to establish a 30-day limit for seeking judicial review of the appointment of a receiver or liquidating agent. This amendment appears to have been drafted to address inconsistencies and inadvertent omissions in banking statutes. The National Bank Receivership Act places no statutory limit on the time during which a national bank may challenge the appointment of a receiver. (See 12 U.S.C. § 191). The Federal Deposit Insurance Act includes a general 30-day limit for seeking judicial review of FDIC's appointment as receiver, but this provision does not specifically include all circumstances when FDIC is the receiver. (See 12 U.S.C. § 1821(c)(7)). The Federal Credit Union Act does not contain similar omissions or inconsistencies, and provides 10 days for insured credit unions to challenge the appointment of NCUA as liquidating agent. (See 12 U.S.C. § 1787(a)(1)). NCUA believes that this 10-day period allows sufficient time for insured credit unions to bring action to challenge the appointment of NCUA as liquidating agent. Extending this time period to 30 days would only add to the period of uncertainty and delay the payout to account holders by an additional 20 days. Unlike the banking statutes, the Federal Credit Union Act is not in need of clarification on this point, and the NCUA request that the portion of proposal #159 that amends section 206(a)(1) of the Federal Credit Act (12 U.S.C. 1787 (a)(1)) be deleted.

Proposing Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal**	**Regulator's Position**	**Industry's & Consumer Group's Positions**
Federal Deposit Insurance Corporation (FDIC) - continued		
160. (a) Recordkeeping Amendment (H.R. 3505 § 604 - 109th Congress) Permit the FDIC to destroy records that are 10 or more years old at the time of its appointment as receiver, unless directed not to do so by a court or a government agency or prohibited by law.	Support: FDIC, OCC, OTS No Position: FRB	Neutral: NASCUS (a) No Objection: ABA, ACB, FSR, ICBA
160. (b) Recordkeeping Amendment Permit the NCUA to destroy records that are 10 or more years old at the time of its appointment as receiver, unless directed not to do so by a court or a government agency or prohibited by law.	(b) Support: NCUA	(b) Support: CUNA, NAFCU

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Federal Deposit Insurance Corporation (FDIC) - continued		
161. (a) Preservation of Record by Optical Imaging and Other Means (H.R. 3505 § 605 – 109th Congress) Permit the FDIC to destroy records that are 10 or more years old at the time of its appointment as receiver, unless directed not to do so by a court or government agency or prohibited by law. **161. (b) Preservation of Record by Optical Imaging and Other Means** Permit the NCUA to destroy records that are 10 or more years old at the time of its appointment as receiver, unless directed not to do so by a court or government agency or prohibited by law.	Supports: FDIC, FRB, OCC, OTS (b) Support: NCUA Neutral: NASCUS	(a) No Objection: ABA, ACB, FSR, ICBA (b) Support: CUNA, NAFCU
162. Exclude Advisory Committees to the Banking Agencies from the Federal Advisory Committee Act Permit the OCC, FDIC, and OTS to establish and use advisory committees on the same basis as the Federal Reserve System.	Support: OCC, OTS No Position: FRB Withdrawn: FDIC	No Objection: ABA, FSR, ICBA No Position: ACB Oppose: CG
163. Technical Amendments to Information Sharing Provision Amend section 11(t) of the Federal Deposit Insurance Act to clarify that the FDIC is a "covered agency" for purposes of privilege, regardless of the type of failed depository institution to which transferred information pertains.	Support: FDIC, OTS No Position: FRB, OCC	Support: ACB No Objection: ABA, FSR, ICBA
164. Technical and Conforming Amendments Relating to District Banks (H.R. 3508 § 123 - 109th Congress is the language supporting this provision) Technical and conforming amendments reflecting the transfer of authority for the supervision and regulation of District banks from the Office of the Comptroller of the Currency to the Federal Deposit Insurance Corporation.	Support: FDIC, FRB, OCC[212], OTS	No Objection: ABA, ACB, FSR, ICBA
Office of the Comptroller of the Currency (OCC)		
165. Enhancing the Authority for National Banks to Make Community Development Investments - (H.R. 3505 § 112) Increase the maximum limit for investments designed primarily to promote the public welfare, including the welfare of low- and moderate-income communities or families, either directly or by purchasing interests in an entity primarily engaged in making these investments from 10% to 15%.	Support: OCC, OTS[213] No Position: FDIC Has Concerns: FRB[214]	Support: ABA, ACB, FSR, ICBA

[212] OCC supports (also included in DC authorization bill, HR 3508, which passed the House on 12/14/05 but has not yet cleared the Senate).
[213] OTS supports, but only with corresponding increase for savings associations in #55.
[214] The FRB has concerns. The FRB supports efforts to help banks meet the community development needs of their local communities. However, the FRB is concerned that the public welfare and community development standards, as currently interpreted may be misused to allow investments that do not serve the community development needs of local communities. The FRB is willing to work with the OCC to ensure that investments made under this authority are properly focused on helping meet the public welfare needs of the community.

Proposing Agency or Organization **Subject Matter (related bills, if known)** **Brief Summary of Proposal**	**Regulator's Position**	**Industry's & Consumer Group's Positions**
Office of the Comptroller of the Currency (OCC) - continued		
166. Parity and Flexibility for a National Bank to Relocate Its Main Office Provide authority to national banks to designate any office resulting in an intrastate merger or consolidation as its main office as is currently permitted if it were involved in an interstate merger or consolidation. Also, provide a national bank more flexibility when relocating its main office to a branch location within the same state.	Support: OCC No Position: FDIC, FRB, OTS Oppose: CSBS	Support: ABA, ACB, FSR, ICBA Oppose: CG
National Credit Union Administration (NCUA)		
167. Net Worth Amendment (H.R. 1042 & H.R. 3505 § 314) (Same as #24) Amend the definition of *net worth* in the Federal Credit Union Act to include amounts previously held as *retained earnings* by other credit unions prior to a merger, thus effectively including the combined retained earnings of all merged credit unions in the net worth of the resulting credit union.	Support: NASCUS, NCUA No Position: FDIC, OCC	Support: CUNA, FSR, NAFCU[215] No Objection: ACB, ICBA Do Not Support: ABA
Credit Union National Association (CUNA)		
168. (a) Eliminate or Modify the Limitation on Credit Union Experience for NCUA Board Members - (See also #125) Eliminate the current Federal Credit Union Act limitation that not more than one NCUA Board member may have immediate or recent involvement with an insured credit union at the time of appointment as a Board member or modify the limitation into a requirement that a minimum of not less than one Board member shall have immediate or recent involvement with an insured credit union at the time of appointment as a Board member.	No Objection: NASCUS, NCUA No Position: FDIC, OCC	Support: CUNA, FSR, NAFCU Oppose: ABA, ACB, ICBA
National Association of State Credit Union Supervisors (NASCUS)		
168. (b) Eliminate or Modify the Limitation on Credit Union Experience for NCUA Board Members Include a provision in the Federal Credit Union Act that one NCUA Board member shall have state credit union supervisory experience.	Support: NASCUS No Position: NCUA	Do Not Oppose: ABA[216], ACB[217], ICBA[218] Oppose: CUNA[219], NAFCU

[215] NAFCU supports. Currently credit union mergers are accounted for by using the "pooling method" meaning that the net worth of each merging credit union is combined to form the net worth of the surviving credit union. However, the Financial Accounting Standards Board has proposed eliminating pooling and imposing the "purchase method" of accounting on credit union mergers. Under the purchase method of accounting only the surviving credit union's retained earnings count as net worth for PCA purposes. Consequently, the surviving credit union may have trouble meeting PCA requirement, unless credit union net worth is redefined. NAFCU supports including language from H.R. 1042, the Net Worth Amendment for Credit Unions Act in any regulatory relief package. This amendment is intended to address a narrow and technical accounting issue and in this process simply maintain the status quo with respect to merging credit unions

[216] ABA does not oppose as long as the proposal does not include 168(a), the state supervisory experience is substantial and at a high level, and is not used to circumvent the restriction on recent credit union involvement.

[217] ACB does not oppose as long as the proposal does not include 168(a), the state supervisory experience is substantial and at a high level, and is not used to circumvent the restriction on recent credit union involvement.

[218] ICBA does not oppose as long as the proposal does not include 168(a), the state supervisory experience is substantial and at a high level, and is not used to circumvent the restriction on recent credit union involvement.

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Conference of State Bank Supervisors (CSBS)		
169. 18-Month Exam Cycle for Certain Small Institutions (H.R. 3505 § 607) (See also 42, 68, &112) Authorize an 18-month exam cycle for well-capitalized well-managed institutions below $1 billion in assets.	Support: OCC, OTS Prefers #68: FDIC, FRB[220]	Support: ABA, ACB, FSR, ICBA
170. Deposit Insurance for International Bank Branches Authorize the Federal Deposit Insurance Corporation to grant deposit insurance to branches of international banks to do business in the United States.	No Position: FRB[221], OCC[222] Oppose: FDIC	No Position: FSR Oppose: ABA, ACB, ICBA
American Bankers Association (ABA)		
171. Clarification of Cross Marketing Provision (H.R. 3505 § 501) (Same as #139) Amend the Bank Holding Company Act to permit financial holding companies to cross market their commercial activities if they own or control less than twenty-five percent of the total equity or any class of voting security of a non-financial company.	Support: FRB No Position: OCC, OTS Oppose: FDIC	Support: ABA, FSR No Objection: ACB Oppose: ICBA
172. Exclude Certain Insurance Products from FDIA Disclosure Requirement Amend the investment risk disclosure requirement of section 47 of the FDIA to exclude credit insurance, fixed rate annuities, and term life insurance.	No Position: OCC Has Concerns: FRB[223] Oppose: FDIC, OTS	Support: ABA, ICBA No Objection: ACB No Position: FSR Oppose: CG

[219] CUNA opposes unless Congress eliminates the requirement that no more than one NCUA Board Member may have immediate or recent involvement with an insured credit union at the time of appointment as a Board Member; otherwise, no position at this time.

[220] The FRB supports an alternative amendment (proposal #68) that would raise this asset cutoff to $500 million. The FRB, however, does not believe this threshold should be raised to $1 billion. Institutions that have assets approaching $1 billion tend to have more complex risk profiles than institutions with assets of less than $500 million and may operate business lines on a regional or national basis and, thus, warrant more frequent on-site exams. e

[221] The FRB has no position since this proposal lacks statutory language.

[222] OCC has no position until legislative language is provided.

[223] The FRB does not believe it would be appropriate to completely exempt credit insurance products from the insurance sales disclosure requirements of section 47. The federal banking agencies previously have noted that the disclosure requirements in section 47 concerning the lack of FDIC insurance or government guarantees help prevent possible confusion about the nature and status of credit insurance products. In addition, while creditors typically provide certain disclosures to consumers pursuant to the Truth in Lending Act when credit insurance is sold in connection with an extension of credit, the disclosures required by section 47 differ from, and are an important supplement to the Truth in Lending Act disclosures. The FRB also does not believe it would be appropriate to exempt all fixed-rate annuities from the investment risk disclosures provided for by section 47. Fixed annuities can be structured in a wide variety of ways and some products currently marketed or sold as "fixed" or "fixed rate" annuities may involve investment risk, particularly when viewed through the eyes of an unsophisticated consumer.

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
American Bankers Association (ABA) - continued		
173. Safe Harbor from the BHCA Attribution Rules for Shares Held in Employee Benefit Plans, Mutual Funds and Common and Collective Investment Trust Funds - (H.R. 3505 § 502) Amend the attribution rules of section 2(g)(2) of the Bank Holding Company Act to provide a safe harbor for: (1) shares held in trust through a regulated employee benefit plan; (2) mutual fund shares held in trust provided any investment adviser or affiliate with the power to vote 25% of the shares of the investment company transfers the vote to the beneficial owners or an independent entity; or (3) for shares held in a common or collective fund. The amendment also provides the Federal Reserve Board with the authority to grant additional exemptions to 2(g) (2).	Support: OTS[224] No Position: FDIC, OCC[225] Prefers #140: FRB[226]	Support: ABA, ACB No Objection: ICBA No Position: FSR
174. Replace GLBA's Annual Privacy Disclosure Requirement with a Requirement for an Initial Disclosure and Subsequent Disclosure upon Material Change in Privacy Policy - (Similar to H.R. 3505 § 617) Amend section 503(a) of GLBA to replace the annual privacy notice requirement with a requirement that notice must be given at the time that a customer relationship is established with a consumer and whenever there is a material change in the privacy policies of the financial institution.	Support: OCC[227] OTS prefers #63 No Position: FRB Oppose: FDIC	Support: ABA, ACB, CUNA, FSR, ICBA Oppose: CG
175. Amend Section 404 of the Sarbanes-Oxley Act Amend the internal control and management attestation requirements of section 404 of the Sarbanes Oxley Act to exempt financial institutions with $1 billion or less in assets that are subject to Section 36 of the Federal Deposit Improvement Act.	No objection: OCC No Opposition: OTS No Position: FRB Oppose: FDIC	Support: ABA, ACB, FSR, ICBA Oppose: CG
176. Seasoned Customer CTR Exemption - (H.R. 3505 § 701) Provide an exemption for domestic financial institutions from filing Currency Transaction Reports (CTRs) for transactions between the domestic institution and "seasoned customers" of the institution. A "seasoned customer" would be defined is a business customer of the institution that has been the subject of the institution's Customer Identification Program (CIP) and that has maintained an account for at least 12 months and has engaged in multiple currency transactions subject to CTR reporting.	Defer to FinCen: OCC, OTS No Position: FRB See Footnote: FDIC[228]	Support: ABA, ACB, CUNA, FSR, ICBA, NAFCU

[224] OTS supports, but only with comparable OTS authority.

[225] OCC has no position. FRB's amendment included in § 502 of HR 3505 would give the FRB the discretion to exclude. See item #140.

[226] The FRB supports #140, which gives the Board discretion to waive the attribution rule in section 2(g)(2) of the Bank Holding Company Act on a case-by-case basis. Proposal #173, however, would create three statutory exceptions that the FRB believes are too broad and may allow a company to use a trust that it or its management controls to evade the restrictions in the Bank Holding Company Act on the acquisition of banks and nonbanking firms.

[227] OCC supports concept but prefers version included in § 617 of HR 3505. As reported by the House Financial Services Committee, § 617 provides an exception to the Gramm-Leach-Bliley Act's (GLBA) annual notice requirement if the financial institution (1) has not changed its privacy policies, (2) discloses nonpublic personal information to third parties only pursuant to the exceptions in GLBA, and (3) does not share any information with affiliates that is subject to a consumer's opt-out rights under the Fair Credit Reporting Act.

[228] FDIC understands that FinCEN is working to address this issue.

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Financial Services Roundtable (FSR)		
177. Direct the Federal Agencies to Finalize the Pending Simplified Privacy Notices, and for Other Purposes Direct the agencies to finalize a proposal for a uniform simplified privacy notice to satisfy the requirements of the Gramm-Leach-Bliley Act.	No Objection: OCC[229] Has Concerns: FRB[230] Oppose: FDIC, OTS	Support: FSR Support if Optional: ABA, ACB, ICBA No Position: CUNA[231] Oppose: CG
178. Enhanced Flexibility for Credit Card Banks to Meet CRA Obligations - (Similar to H.R. 3505 § 506) Permit credit card banks to make community development loans to help meet their CRA obligation.	No Position: FRB, OCC[232], OTS Oppose: FDIC	Support: ABA, FSR No Objection: ACB, ICBA Oppose: CG
179. Public Welfare Investments by Credit Card Banks - (Similar to H.R. 3505 § 506) Permit an institution that engages primarily in credit card operations to make loans that would help meet the credit needs of low-and-moderate income people and neighborhoods while maintaining the institution's Bank Holding Company Act exemption.	Support: FRB[233] No Position: OCC[234], OTS Oppose: FDIC	Support: ABA, FSR No Objection: ACB, ICBA Oppose: CG
180. Good Faith Basis for Non-filing of Suspicious Activity Reports Require publication of proposed regulations before the end of the six-month period beginning on the date of the enactment of this Act that provide a good faith basis for not filing a suspicious activity report, clarifying that isolated incidents of non-filings should not trigger an enforcement action against a financial institution, as long as that institution has implemented a satisfactory anti-money laundering program and, as part of that program, generally adheres in good faith to the requirement to file suspicious activity reports.	Defer to FinCen: OCC Has Concerns: FRB[235] Oppose: FDIC, OTS	Support: CUNA, FSR[236] No Objection: ABA, ACB, ICBA Oppose: CG

[229] OCC does not object to the concept of this amendment but oppose the three-month deadline in the amendment as drafted; instead amendment should allow adequate time for the agencies to complete the current consumer testing that is being conducted and to draft a final rule.

[230] The FRB has concerns. The federal banking agencies, along with the NCUA, CFTC, FTC, and SEC, already have solicited comments from the public on ways to improve the privacy notices that financial institutions must provide consumers under the GLBA, including whether institutions should be permitted to use a streamlined or "short-form" privacy notice and encouraged the agencies to engage in consumer testing to ensure that any short-form notice developed ins understandable and an improvement over existing notices. That process is well underway and is continuing. The proposed amendment could significantly disrupt this ongoing process and require the agencies to establish a simplified notice before the agencies have sufficient time to evaluate the results of consumer testing and solicit and review public comments on any proposed changes.

[231] CUNA wants to see what the agencies are going to come up with, which may change the rules before supporting anything.

[232] OCC has no position (substantially included in § 506 of HR 3505).

[233] The FRB supports. Because credit card banks are evaluated for CRA purposes under a special community development test, there is no need to authorize them to make non-credit card loans for CRA purposes unless those loans would qualify as community development loans.

[234] OCC has no position (substantially included in § 506 of HR 3505).

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Financial Services Roundtable (FSR) - continued		
181. Amendment to Effectuate Congressional Intent for Revised Definition of Broker and Dealer in the Securities Exchange Act of 1934 Amend GLBA by striking sections 201 and 202 which force many traditional banking activities out of the bank and into SEC registered brokers and dealers.	Support: OTS[237] See Footnote: FDIC[238], OCC[239] No Position: FRB	Support: ABA, ACB[240], FSR, ICBA Needs More Detail: CUNA
182. Savings Association Acting as Agents for Affiliated Depository Institutions (H.R. 3505 § 505) This amendment would (1) repeal the limitations in current law for savings associations to act as agents for affiliated banks, and (2) permit savings associations to act as agents for any affiliated bank or savings association, so that savings association and banks are treated equally for purposes of agency relationships.	Support: OTS No Position: FDIC, OCC[241] Has Concerns: FRB[242]	Support: ACB, FSR No Objection: ABA, ICBA
183. Credit Card Savings Association – (H.R. 3505 § 216) The amendment would permit a savings and loan holding company to charter a credit card savings association and still be exempt from the activity restrictions imposed on multiple savings and loan holding companies. Under this proposal, a company could take advantage of the efficiencies of having its regulator be the same as the credit card institution's regulator.	Support: OTS No Position: FDIC, FRB, OCC	Support: ACB, FSR No Objection: ABA, ICBA
184. Diversity Jurisdiction Amendments to the National Bank Act and the Home Owners' Loan Act Amendments that would make National banks and Federal savings associations citizens of the state in which the institution maintains its home office and, if different therefrom, the state in which the association has its principal place of business.	Support: OTS[243] No Position: FDIC, FRB Does Not Support: OCC[244]	Support: ABA, ACB, FSR, ICBA

[235] The FRB does not believe this amendment is necessary or appropriate. The new interagency BSA/Anti-money Laundering Examination Manual published in June 2005 provides that, in the absence of bad faith, intentional misconduct, or significant problems of a systemic nature, financial institutions with appropriate anti-money laundering and SAR programs generally should neither be second-guessed nor penalized for failing to file a single SAR. The banking agencies and FinCEN have taken several steps to ensure that this policy is clearly communicated to banking organizations and consistently applied by the agencies.

[236] The FSR supports. The Treasury Department should issue regulations to clarify that isolated incidents of SAR non-filings should not trigger enforcement actions against financial institutions that otherwise have satisfactory AML programs and make a good faith efforts to file SARs in accordance with the existing SAR regulations.

[237] OTS supports, but only with parity for the savings association industry.

[238] FDIC is working with the SEC and other banking agencies to develop a broker rule.

[239] OCC is working with the SEC and other banking agencies to encourage the SEC to develop a broker rule that is consistent with Congressional intent to allow banks to continue to engage directly in traditional banking activities.

[240] ACB supports as long as thrifts have parity under securities laws.

[241] OCC has no position (substantially included in § 505 of HR 3505).

[242] The FRB has concerns. Enactment of this proposal could create inequities if Congress does not also give banks the authority to branch de novo across state lines. So long as banks can not branch as widely as savings associations, organizations will have an incentive to use a savings association subsidiary to skirt the branching limits imposed on an affiliated bank. This would be particularly advantageous to commercial and other firms that own a savings association and an ILC because it would allow these companies to use their subsidiary savings association to effectively expand the geographic branch network of its subsidiary ILC nationwide.

[243] OTS supports in light of recent Supreme Court decision regarding National Banks, OTS seeks parity and supports citizenship of home state only.

Proposing Agency or Organization Subject Matter (related bills, if known) Brief Summary of Proposal	Regulator's Position	Industry's & Consumer Group's Positions
Financial Services Roundtable (FSR) - continued		
185. Amend the "Anti-Tying" Provisions of the Bank Holding Company Act This amendment would limit the "anti-tying" restrictions imposed on banks prohibiting the offering or discounting of its products and services on the condition that a customer obtain additional products or services from the bank to those products and services offered by a bank to individual consumers and small businesses.	No Position: FDIC, FRB, OCC, OTS	Support: ABA, FSR No Objection: ICBA No Position: ACB Oppose: CG
186. CLA Assigned Liability Initiative Amends the definition of "lessor" in the TILA to limit liability to actual parties to a consumer lease agreement.	No Position: OCC, OTS Has Concerns: FRB[245] Oppose: FDIC	No Objection: ABA, ICBA No Position: ACB, FSR Oppose: CG
187. Clarification of Cross Marketing Provision – (H.R. 3505 § 501) (Same as #139) Provide that the cross-marketing prohibition applicable to financial holding companies and their merchant banking investments would apply only to entities *controlled* by a financial holding company. The current cross-marketing provision was enacted by GLBA to provide a safeguard against the mixing of banking and commerce. As a practical matter, this proposal would allow cross-marketing arrangements between depository institutions and non-financial companies when the shares of those companies are owned or controlled by a securities firm or its affiliate, because those are not merchant banking activities or between depository institutions and non-financial entities where the financial holding company does not *control* the entity in which it has a interest under merchant banking authority.	Support: FRB No Position: OCC, OTS Oppose: FDIC	Support: ABA, FSR No Position: ACB Oppose: CG, ICBA

[244] The OCC does not support an amendment clarifying national banks' citizenship, since such an amendment is no longer needed. The U.S. Supreme Court has resolved the issues concerning national banks' citizenship for purposes of Federal-court diversity jurisdiction and a legislative amendment for national banks no longer is necessary. *See Wachovia Bank, N.A. v. Schmidt*, No. 04-1186, 546 U.S.____________ (Jan. 17, 2006).

[245] The FRB has concerns. The proposed amendment would exclude persons who regularly offer or arrange consumer leases from the definition of "lessor" under the Consumer Leasing Act unless the person was a party to the actual lease agreement with the customer. The Consumer Leasing Act was adopted to ensure that consumers receive meaningful disclosures about the terms of consumer leases, especially those involving automobiles and other durable goods, and that the advertising for such leases is fair and not misleading. Because automobile leases typically are arranged by, and negotiated with, the dealer, the statute's definition of "lessor" was purposefully crafted broadly to include entities such as car dealers, who regularly arrange consumer lease transactions. Narrowing the definition of "lessor" in the way proposed would weaken consumer protections in leasing transactions and remove an important incentive that car dealers and other lease arrangers have to ensure that their advertising is fair and accurate.

February 28, 2006

KEY:

Regulators

CSBS – Conference of State Banking Supervisors
FDIC – Federal Deposit Insurance Corporation
FRB – Federal Reserve Board
NASCUS – National Association of State Credit Union Supervisors
NCUA – National Credit Union Administration
OCC – Office of Comptroller of the Currency

Industry

ABA – American Banking Association
ACB – America's Community Bankers
CUNA – Credit Union National Association
FSR – Financial Services Roundtable
ICBA – Independent Community Bankers of America
NAFCU – National Association of Federal Credit Unions

Consumer Groups

CG – Consumer Groups (National Community Reinvestment Coalition, Consumer Federation of America, U.S. PIRG, National Association of Consumer Advocates, National Consumer Law Center, Consumer Union, Center for Responsible Lending)
CFOA – Consumer Federation of America
NCLC – National Consumer Law Center

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WRITTEN STATEMENT OF THE
NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION
TO THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
REGARDING
FINANCIAL SERVICES REGULATORY RELIEF LEGISLATION
MARCH 1, 2006

This statement is submitted on behalf of the North American Securities Administrators Association (NASAA).[1] State securities regulation predates the creation of the Securities and Exchange Commission and the NASD by almost two decades and has protected Main Street investors from fraud for nearly 100 years. State securities regulators are responsible for licensing firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, providing investor education, and most importantly, enforcing our states' securities laws.

The role of state securities regulators has become increasingly important as growing numbers of Americans rely on the securities markets to prepare for their financial futures, such as a secure and dignified retirement or sending their children to college. While securities markets are global, most Americans still rely on local investment representatives in their home states when investing their funds. State securities regulators currently oversee the representatives that operate in their states.

NASAA appreciates this opportunity to provide information to the Committee on your latest regulatory relief initiative. We commend the Committee for striving to make our financial services sector even more efficient, and for being attentive to the concerns of those who wish to ensure that efficiency does not undermine the system of investor protection that has made the U.S. markets the fairest in the world.

The majority of the provisions under consideration for inclusion in a regulatory relief bill do not directly impact state securities regulation, and we expect that the functional regulators for those issues will offer direct comment. However, there is one provision in the House version of the Financial Services Regulatory Relief Act that affects the ability of state securities regulators to license certain individuals in our states who are selling non-traditional deposit products. At one time, most CDs were fully FDIC insured and paid a fixed interest rate until they reached maturity. But, like many other products in today's markets, CDs have become more complex.

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, the U.S. Virgin Islands, and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

Investors may now choose among variable rate CDs, jumbo CDs, callable CDs and CDs with other special features. These CDs pose significantly greater risks to investors.

Accordingly, NASAA suggests fine-tuning the Section 209 "Selling and Offering of Deposit Products" language that is contained in H.R. 3505, the Financial Services Regulatory Relief Act of 2005. By adding the phrase "fixed rate fully FDIC insured," as shown below, Congress can preserve the licensing authority of state securities regulators over independent agents who sell unconventional and risky deposit products. This in turn will help protect investors who traditionally have come to expect that CDs are generally a fixed rate product that are all fully FDIC insured and who would not otherwise invest in a risky CD.

We recognize that the current language in Section 209 represents an effort to balance regulatory relief with investor protection, but, the market has continued to evolve and the language we are now seeking helps to address new issues that have emerged. Independent contractors, not employees of thrifts are selling jumbo deposit products and market-based CDs. These products can exceed the limits of FDIC insurance and are more complex and riskier than traditional products. Because of the potential risk to investors, we believe that states should retain the right to require these independent contractors or agents to become licensed with their state securities regulator in order to sell these unconventional products.

The preemptive language of Section 209 raises a number of concerns. In order to protect investors, current federal and state laws allow states to regulate individuals who offer or sell securities, even if those securities are deposit products. At the same time, Congress and the states generally recognize that licensing exemptions are appropriate under certain circumstances – where for example, deposit products are sold by a bank through its employees. Our concern lies with non-bank employees, often referred to as "independent agents" of the bank.

These are individuals who do not have the employee affiliation with the thrift, do not necessarily have adequate training, and do not fall under the supervision of the thrift. The problem is exacerbated because many investors assume that a salesperson representing a financial institution is an employee, fully backed by the institution. Yet this is not the case, and these independent agents need oversight if they are going to offer the more complex and riskier deposit products. NASAA's proposed amendment to Section 209 would help make that oversight available, without disturbing the licensing exemption for *bank employees* selling deposit products.

Section 209, as written, would increase the potential of fraudulent sales of deposit products to investors. Any person, regardless of training, knowledge of investment products and risks, or disciplinary background, could sell deposit products such as jumbo or market-based CDs. NASAA has consistently listed unregistered individuals as one of the top ten scams in the country. And history shows that abuses can and do occur in the sale of CDs. The types of misconduct we see include the sale of bogus CDs; the use of CDs in bait and switch schemes; and misrepresentations and omissions regarding the rate of return on the CD, the duration of the investment, and its liquidity.

Licensing is an important aspect of investor protection, conferring many benefits. Licensing requirements enable states to insist upon a minimum level of education and expertise among those who sell investment products. Those requirements also enable state securities regulators to verify that a salesperson does not have a disciplinary history of fraud or misconduct. And, a licensing framework provides for the supervision of agents, disclosure of commissions, suitability requirements, complaint reporting and other benefits. Any cost of licensing is certainly outweighed by the positive return to investors. In short, Section 209 undermines the need to monitor individuals who are taking people's investment funds to the public.

Our proposed change in Section 209 is in keeping with well-established legal principles governing the regulation of CDs. The overarching principle that has emerged from the federal and state courts is this: regulating CDs as securities is necessary and appropriate if those CDs pose risks to investors and if those risks are not adequately addressed by other regulatory regimes. Thus, in *Marine Bank v. Weaver,* 455 U.S. 551 (1982), the Supreme Court held that it was unnecessary to subject fixed-rate, insured CDs to regulation as securities because investors were abundantly protected under federal banking laws and, through FDIC insurance, were "virtually guaranteed payment in full." *Id.* at 558-59. By the same token, however, where CDs pose risks that other laws do not address, the courts will invoke securities regulation to ensure that investors are adequately protected. Our proposed change in Section 209 simply codifies this principle: unless CDs are fixed-rate and fully-insured, states will retain their authority to impose licensing requirements on those who sell them, for the benefit of the investing public.

NASAA's suggested language to Section 209 is <u>underlined</u> below:

SEC. 209. SELLING AND OFFERING OF DEPOSIT PRODUCTS.
Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(h)) is amended by adding at the end the following new paragraph:

`(4) SELLING AND OFFERING OF DEPOSIT PRODUCTS- No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall directly or indirectly require any individual who is an agent of 1 Federal savings association (as such term is defined in section 2(5) of the Home Owners' Loan Act (12 U.S.C. 1462(5)) in selling or offering <u>fixed rate fully FDIC insured</u> deposit (as such term is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(l)) products issued by such association to qualify or register as a broker, dealer, associated person of a broker, or associated person of a dealer, or to qualify or register in any other similar status or capacity, if the individual does not—

`(A) accept deposits or make withdrawals on behalf of any customer of the association;
`(B) offer or sell a deposit product as an agent for another entity that is not subject to supervision and examination by a Federal banking agency (as defined in section 3(z) of the Federal Deposit Insurance Act (12 U.S.C. 1813(z)), the National Credit Union Administration, or any officer, agency, or other entity of any State which has primary regulatory authority over State banks, State savings associations, or State credit unions;
`(C) offer or sell a deposit product that is not a <u>fixed rate fully FDIC</u> insured deposit (as defined in section 3(m) of the Federal Deposit Insurance Act (12 U.S.C. 1813(m)));
`(D) offer or sell a deposit product which contains a feature that makes it callable at the option of such Federal savings association; or
`(E) create a secondary market with respect to a deposit product or otherwise add enhancements or features to such product independent of those offered by the association.'.