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# FINANCIAL SERVICES REGULATORY RELIEF: PRIVATE SECTOR PERSPECTIVES

## HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

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# FINANCIAL SERVICES REGULATORY RELIEF: PRIVATE SECTOR PERSPECTIVES

**Thursday, May 19, 2005**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to call, at 10:05 a.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, Jones, Royce, Kelly, Ryun, Biggert, Hensarling, Brown-Waite, Pearce, Neugebauer, McHenry, Sanders, Maloney, Sherman, Moore of Kansas, Carson, Hinojosa, Green, Moore of Wisconsin, and Clay.

Chairman BACHUS. [Presiding.] The Subcommittee on Financial Institutions and Consumer Credit is meeting here today on regulatory relief that will provide representatives of the financial services industry with an opportunity to identify regulations that they consider outdated or not cost-effective. In addition, the witnesses will have a chance to offer their recommendations for alleviating the burdens imposed by those regulations.

At this time, I am going to yield to Mr. Royce for an opening statement because he is chairing a committee on international relations, and I want to let him do that so he can appear at that meeting.

Mr. ROYCE. Thank you, Mr. Chairman. I thank you for holding this hearing to address the issue of regulatory relief for the financial services industry, which is a measure that I believe is constructive and well reasoned and very long overdue.

For far too long Congress has burdened our country's federally chartered banks and thrifts and credit unions with well intentioned, but onerous and often outdated rules and regulations preventing them from operating as efficiently and competing as effectively as they could. I support the efforts of this subcommittee to reduce these unnecessary burdens.

One week ago, Representative Paul Kanjorski and I introduced H.R. 2317, the Credit Union Regulatory Improvements Act, or CURIA, which is an updated version of legislation we first offered in the 108th Congress. As of this morning, I am pleased to announce we already have garnered the support of 27 cosponsors for this measure from both parties.

CURIA in the 109th Congress contains significant modifications regarding the applicable prompt corrective actions, standards and

net worth requirements for credit unions. The most important changes replace the capital reform language contained in Title III of H.R. 3579 with a more comprehensive and robust capital provision incorporated into Title I of the new CURIA.

Title I of the new CURIA now contains the PCA capital reforms recently recommended by the National Credit Union Administration, which oversees federally chartered credit unions and administers the National Credit Union Share Insurance Fund. The new PCA provisions in CURIA are modeled after FDIC capital standards applicable to banks and to thrifts.

I am pleased to see that the testimony of one of our witnesses today will lay out more specifics on our legislation, so in the interests of time I would just ask that as this committee addresses regulatory relief provisions for financial institutions. I hope that the chairman and other members strongly consider the needed reforms Mr. Kanjorski and I have put forward for credit unions.

I would like to thank you, Mr. Chairman, for the opportunity to speak on behalf of my legislation here for a minute this morning, and I look forward to the testimony of our witnesses today.

I yield back.

[The prepared statement of Hon. Edward R. Royce can be found on page 46 in the appendix.]

Chairman BACHUS. Thank you.

I would like to say to our panel of witnesses and to the audience that Mr. Royce, Mr. Hensarling, Mr. Ryun, Mr. Kanjorski, and Mr. Moore on this side of the aisle all are on legislation to give regulatory relief to our financial institutions. Most of them are here today, and they are playing a leading role in the legislative package.

At this time, I recognize the ranking member of the subcommittee, the gentleman from Vermont, Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chairman, for holding this important hearing.

I am delighted to welcome our witnesses to be with us today.

The focus of this hearing is on providing regulatory relief to financial institutions, which this committee has tried on several occasions to accomplish.

Mr. Chairman, let me begin by saying that I do believe credit unions are one of the most highly regulated and restricted of all depository institutions in this country.

To ease these regulatory burdens and help credit unions succeed in the 21st century, I am pleased to be an original cosponsor of the Credit Union Regulatory Improvement Act introduced by Congressmen Royce and Kanjorski and the Credit Union Net Worth Amendment Act introduced by the chairman.

Among other things, CURIA will expand credit union investments in small businesses and create decent-paying jobs. The Credit Union Net Worth Amendment Act will also update statutory language to conform to new accounting practices for mergers of credit unions. I look forward to working with everyone on this committee to advance these bills.

But, Mr. Chairman, I do not understand why large banks that have been making record-breaking profits for the past 5 consecutive years need further regulatory relief while consumers, who are

over $2 trillion in debt, also a record, are far too often left out of the mix. I think we might want to pay attention not only to the needs of large banks, but also to the needs of consumers.

Having said that, Mr. Chairman, I would be pleased to work with you on regulatory relief legislation if we can also include a provision to expand employee ownership in this country, and I think we are going to be hearing from Mr. Keeling later on about that issue.

Let me give you an example of what I am talking about.

Last night, I introduced the Employee Ownership Opportunity Act, a very bipartisan, tripartisan piece of legislation, with Representatives Don Manzullo, Carolyn Maloney, Dana Rohrabacher and Barbara Lee. This legislation would provide a Community Reinvestment Act credit to financial institutions that offer assistance to employees to establish employee stock ownership plans, ESOPs, or eligible worker-owned cooperatives, EWOCs.

Mr. Chairman, providing a CRA credit for the expansion of employee ownership is, I believe, a win-win. It will be good for banks looking for new ways to fulfill their CRA requirements, and it will be good for workers who would like to own their own businesses.

In addition, Mr. Chairman, workers who are also owners, and one of the important points about worker ownership is that people who own their own businesses are not going to be going to China; they are not going to be going to Mexico. They are going to be reinvesting in decent-paying jobs in their own community. They are going to be empowered. Productivity will go up, and it is a direction that I would like to see our country go.

Frankly, I think it makes a lot more sense for the Federal Government to be helping workers own the places that they work in, rather than providing huge amounts of corporate welfare to large multinationals that are going to China.

Mr. Chairman, when we are talking about employee ownership, we are talking about protecting and creating decent-paying jobs in this country. Broad-based employee ownership has proven to increase employment, increase productivity, increase sales, and increase wages in the United States. According to a Rutgers University study, broad-based employee ownership boosts company productivity by 4 percent, shareholder return by 2 percent, and profits by 14 percent. Similar studies have shown that ESOP companies pay their hourly workers between 5 percent to 12 percent better than non-ESOP companies.

Mr. Chairman, last Congress I thought that one of the most interesting hearings in our subcommittee, and I thank you very much for holding that, and your interest in this issue, dealt with the issue of employee ownership. I was delighted that we were able to work together on that hearing. Another person who remembers that hearing will be here with us today, and we are delighted that Mr. Keeling is back again.

This issue, Mr. Chairman, I think is one that can bring conservatives and progressives together. It is absolutely nonpartisan. All of us are concerned about lower wages in America, the loss of good-paying jobs. We want people to participate in their economy. So we look forward to working with you and all members of this committee on the issue of employee ownership.

Thank you very much, Mr. Chairman.

[The prepared statement of Hon. Bernard Sanders can be found on page 49 in the appendix.]

Chairman BACHUS. Thank you, Mr. Sanders.

I will say for the record that employee stock ownership plans and eligible worker-owned cooperatives, encouraging those, is a win-win situation for America. I know your legislation. I believe Dana Rohrabacher and Don Manzullo, who is Chairman of the Small Business Committee, have already indicated that they will be supporting your legislation.

Mr. SANDERS. That is right.

Chairman BACHUS. I am very supportive of that legislation, too.

Mr. SANDERS. Thank you very much, Mr. Chairman.

Chairman BACHUS. Thank you.

At this time, I recognize Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. Thank you for holding this important hearing. Thank you for your leadership in trying to help us reduce the regulatory burden on our Nation's financial institutions.

When laws are passed and regulations are promulgated, we just cannot walk away from them. Not unlike a ship that picks up barnacles, it has to be cleaned from time to time. The same is true of regulations. Many have costs that are passed on to the consumer in one form or fashion. Many outlive their purposes. Many have unintended consequences.

The bottom line is that excessive, redundant, and costly regulations can make credit more expensive and less accessible. They can keep Americans from purchasing their first home, buying a second automobile to go to work, financing their child's education, or maybe launching a small business that creates new jobs in a small town.

I believe with thoughtful regulatory relief, we can free up more capital for these valuable purposes without undermining safety and soundness. I think, Mr. Chairman, we all know that the Federal regulatory burden particularly falls disproportionately on our smaller banks and credit unions. These are institutions that typically have branches that are located in rural and more scarcely populated areas.

Let's look at just banks for a moment. Assuming that $1 billion in assets is the dividing line between small and medium-to-large banks, the total number of small banks has declined from roughly 12,000 at year's end in 1993 to a little over 8,000 at the end of 2003. In other words, a decline of almost one-third in just a decade.

Now, I am sure there are a number of reasons for the mergers and consolidations that led to this decline, but from talking to folks in my home State Of Texas, I am convinced that the cost and burden of Federal regulation certainly ranks among the top reasons and really one of the top challenges to their continued profitability and viability.

This is very worrisome because our smaller financial institutions are often the economic lifeblood of these small communities. Let me give you one example in my district. First State Bank of Athens, Texas, they make almost 100 charitable contributions a year to groups like the American Heart Association, Meals on Wheels, Dis-

abled Veterans. They have funded close to $3 million for a 36-unit low-income housing unit for seniors. They fund Texas Ragtime, a key employer with 90 employees; Nelson's Henderson County Door, Future Matrix Medical Devices, creating hundreds of jobs in Henderson County, Texas.

But every dollar they spend on regulatory compliance is a dollar they cannot spend on Meals on Wheels or to fund capital improvements at Ragtime to create new jobs. The fact is that this one bank in Athens, Texas, spends close to $500,000 annually on BSA compliance, Reg B, Reg E, Reg D, CRA, HMDA, HOPA, Reg O, and the list goes on and on and on.

We must ensure that the banking system, the financial system, and the people of Henderson County, Texas, are at least receiving $500,000 in value for the regulatory burden. I fear this may not be the case.

For that reason, Mr. Chairman, I applaud you for holding this hearing. I thank you for doing it.

I look forward to working with members of this committee, especially my colleague from Kansas, Mr. Moore, to draft a comprehensive bill that will put more resources into the hands of those on the frontlines of community lending and enable more American families to realize their dreams.

I yield back.

[The prepared statement of Hon. Jeb Hensarling can be found on page 40 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Moore, I know you are joining Mr. Hensarling on comprehensive regulatory relief legislation.

Mr. MOORE OF KANSAS. Yes.

Chairman BACHUS. I commend both you gentlemen.

Mr. MOORE OF KANSAS. Thank you.

Mr. Chairman, I would like to thank you for scheduling today's hearing, your leadership in calling this hearing on regulatory relief measures for depository institutions in our country.

I look forward, as Mr. Hensarling just said, to working with him, Congressman Hensarling, in the weeks and months ahead, and to hearing suggestions from our witnesses today on how we can reduce the regulatory burden on financial institutions.

This subcommittee and the full committee both passed the regulatory relief bill by voice vote during the 108th Congress, and the House passed it 1 year ago by a wide margin. I think it was about 392 to 25. I hope and believe that we will continue this broad bipartisan cooperation on this legislation that we have enjoyed in the past.

Regulatory relief should not be about Republicans and Democrats. It should be about doing the right thing for the lenders in our communities who have played such an important role in expanding homeownership and creating opportunities for businesses and for consumers.

Again, Chairman Bachus, thank you very, very much for convening this hearing. I look forward to hearing from the witnesses.

[The prepared statement of Hon. Dennis Moore can be found on page 43 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Ryun?

Mr. RYUN. Mr. Chairman, thank you. I appreciate your holding this hearing on regulatory relief for our financial institutions.

I believe the institutions across the spectrum of the financial services industry do a remarkable job of serving our communities and making our financial services infrastructure the envy of the world, and we want to keep it that way.

I believe that virtually all segments of the industry are in need of some form of regulatory relief, which is why I am pleased to see this effort to move again forward. I am grateful to my colleagues on this committee for spearheading the debate, specifically Mr. Hensarling and Mr. Moore for making this issue a priority.

I am pleased to make a contribution to this debate by sponsoring H.R. 2061, the Communities First Act, which will provide targeted regulatory relief for community banks and their customers. I wholeheartedly supported H.R. 1375 in the last Congress. H.R. 1375 was a comprehensive regulatory relief bill and provides us a good starting point as we again begin to address this issue.

However, there are additional measures that should be added to this communities bank issue and the service to small towns and rural communities of America. The Communities First Act is intended to call attention to the needs of the customers who use these community banks. Specifically, I believe it is important to identify areas where resources can be better used for serving customers than with compliance with burdensome and unnecessary regulations.

As this broader regulatory relief effort moves forward, I encourage the committee to have a similar focus on serving the needs of the customers. I also want to say that my intent in introducing H.R. 2061 is to supplement the debate we are going to have today. I have some concerns that I believe should be addressed and will work with those concerned, including in the package a comprehensive package that helps move forward with some more relief.

I am also certainly supportive of the broader effort as I believe the comprehensive approach is appropriate and needed. I look forward to participating in this debate and helping my colleagues craft the best bill possible.

Today, I look forward to hearing from our distinguished panel and have had the opportunity to work with almost all of you, all the different organizations represented, and I thank each of you for joining us today and providing your advice and insight to what we should do as we move forward in this process.

I am confident that we will be able to address many of the concerns of each of the organizations, and again I thank you for being here.

Mr. Chairman, I yield back my time.

[The prepared statement of Hon. Jim Ryun can be found on page 47 in the appendix.]

Chairman BACHUS. Thank you.

Ms. Maloney?

Mrs. MALONEY. Thank you so much, Chairman Bachus, for holding this hearing.

I welcome all of the witnesses. You represent a sector of the financial services industry that is extremely important to the city

that I represent, New York City, and to our Nation as a whole. I am glad that we have an opportunity to hear from you today about the burdens that regulation and reporting requirements impose on our financial institutions, particularly those that are not mega-large, huge institutions, but are more community based.

Whenever and wherever I go in my district, institutions large and small tell me how hard and very costly it is to comply with the requirements of the Bank Secrecy Act, to file the currency transaction reports and the suspicious activity reports, and to comply with the Patriot Act's know-your-customer requirements. We have placed tremendous burdens on our banks, and they are on the frontlines of combating terrorism financing, and they have not shrunk from this incredibly important role.

But we must make sure that they receive the necessary support from the regulators, both in terms of examinations and guidance, and in terms of regulatory requirements. It makes absolutely no sense for banks to spend an incredible amount of time and money to file SARs, or the suspicious activity reports, at the maximum of the regulatory requirement, when Treasury, by the account of its own Inspector General, cannot even track properly all of the data that is given to them.

When regulators interpret regulations so as to require compliance at a level that is obviously wasteful because it is beyond what has any useful purpose, it undermines the legitimacy of the regulation itself. SARs, CTRS, and know-your-customer all serve a very important purpose, but the Administration's inability to set the reporting requirements at a level that makes sense in terms of the data's usefulness to law enforcement is absolutely counterproductive.

Not only does the industry suffer the costs for no benefit for society, but even worse, terrorist data is more likely to go unnoticed in a huge pile of irrelevant and unnecessary information. More SARs are not better. We have to figure out how to use this information and to streamline it better.

The burdens are particularly heavy on the smaller institutions for which the costs of compliance are a much higher proportion of their resources. In light of the failure of the Administration to fix this problem, Congress is forced to step in.

In the last Congress, this committee reported regulatory reform legislation. The House passed it. It did not move in the other body. I expect we will move shortly to advance similar reforms again in this House. I look forward to any ideas that can make these programs more effective and less burdensome on the institutions so that we can really achieve the goal that is set forth.

In that vein, I am proud to be a cosponsor of not only the bill that passed last year, but three or four other reform bills in the regulatory relief area. So I look forward to your testimony, and believe me, I believe both sides of the aisle want to work in any way to make the system work better for you and for the public.

[The prepared statement of Hon. Carolyn B. Maloney can be found on page 42 in the appendix.]

Chairman BACHUS. I thank the gentlelady.

Are there any other members who wish to make opening statements?

I reserved my opening statement because Mr. Royce had to chair another committee. So at this time, I am going to make a brief opening statement simply to say that the annual cost of regulations on our financial institutions, on our banks alone, is $36 billion.

While some of those are necessary for safety and soundness, to comply with consumer protection laws, to comply with, as Ms. Maloney mentioned, the Bank Secrecy Act or the Patriot Act or money laundering measures, or financial crimes legislation, many of them are not necessary, and many of them, even with the Bank Secrecy Act or the Patriot Act, seem to be overly burdensome.

The Chairman of our committee, Chairman Oxley, in 2001 really because of additional burdens placed on our financial institutions when the Patriot Act was passed into law, indicated at that time that as a part of the overall legislation on the Patriot Act that assurances were made to our financial institutions that Congress would make a comprehensive review of our bank regulations and try to both offset the cost of the Patriot Act to the new costs imposed by the Congress because of those regulations and other regulations of that nature.

He also indicated at that time that we would look at the Bank Secrecy Act and review that. We continue to get indications that the Bank Secrecy Act in some cases is being used in ways it was not intended by U.S. attorneys and others who simply do not understand the act or its purpose, and in my mind, in fact on certain occasions, go against the guidance and counsel of the bank regulators.

Mr. Hensarling and Mr. Moore have taken H.R. 1375, which was introduced last year. They have refined that and they have, or you are going to introduce in the near future. I think a result of this hearing and what you say today will impact that legislation. It is their intention, along with others, to introduce comprehensive legislation on reg relief.

Also, we have two other pieces of legislation which have already been introduced, one by Mr. Royce and Mr. Kanjorski, which is regulatory relief for our credit unions. Mr. Royce has mentioned that bill, and Mr. Ryun has legislation to try to help our small independent banks.

Mr. Sanders mentioned that the large banks, he did not note the need for relief there, but Mr. Ryun's bill is particular targeted at our small community banks. They do pay a disproportionate share of their funds and their resources to comply with regulatory relief. So after this hearing, we will be looking at all those legislations and, hopefully, moving legislation very quickly.

[The prepared statement of Hon. Spencer Bachus can be found on page 36 in the appendix.]

Chairman BACHUS.At this time, I would like to introduce our panel.

Our first panelist is Ms. Terry Jorde, president and CEO of CountryBank USA—that is in North Dakota, is that right?—on behalf of the Independent Community Bankers of America; Mr. Bradley Rock, chairman, president, and CEO of the Bank of Smithtown, New York, on behalf of the American Bankers Association; Mr. Mark Macomber, president and CEO of Litchfield Bancorp, on behalf of the America's Community Bankers; and Mr. Robert Mar-

quette, president and CEO of the Members First Federal Credit Union in Pennsylvania.

Where in Pennsylvania is that located?

Mr. MARQUETTE. Mechanicsburg.

Chairman BACHUS. Okay. Thank you.

Mr. Marquette testifies on behalf of the National Association of Federal Credit Unions, and Mr. Richard Ensweiler, president of the Texas Credit Union League, on behalf of the Credit Union National Association; and finally, Mr. Michael Keeling, president of the ESOP Association, employment stock ownership plans.

Mr. Sanders mentioned legislation dealing with those and the CRA credits, so we welcome you.

At this time, we will start with Ms. Jorde, with your testimony.

We welcome all of you to the committee and look forward to our hearing today.

**STATEMENT OF MS. TERRY J. JORDE, PRESIDENT AND CEO, COUNTRYBANK USA (ND), ON BEHALF OF INDEPENDENT COMMUNITY BANKERS OF AMERICA**

Ms. JORDE. Thank you.

Good morning, Mr. Chairman, Ranking Member Sanders, 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. 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 27 employees and $39 million in assets.

ICBA appreciates this opportunity to testify. We are especially pleased that the committee is apparently open to expand on previous regulatory relief bills, since they included very little true relief for community banks. That is one reason why the ICBA worked closely with Representative Jim Ryun on his Communities First Act. It includes relief critical to community banks and their customers.

Other financial groups that have been working on the interagency regulatory burden reduction project led by FDIC Vice Chairman John Reich endorse virtually all of the regulatory provisions in the bill. ICBA hopes that Representative Hensarling will include many of them in the broader bill he is developing.

Recent studies highlighted in my written statement show that community banks are losing market share. I agree with FDIC Vice Chairman Reich that the disproportionate impact of the regulatory burden on community banks is a leading cause of consolidation in our industry.

It is not just smaller community banks like mine that are feeling the pain. Larger community banks as well are drowning in paperwork and regulatory burden. They are hiring two or three full-time employees to do nothing but Bank Secrecy Act compliance. They have spent hundreds of thousands of dollars for Sarbanes-Oxley Act compliance. In addition, credits unions, with their tax-exempt advantages and loose membership rules, have made inroads into small banks' market segments. That is one reason that ICBA is unalterably opposed to the credit union industry's new proposal to increase their charter powers, H.R. 2317.

I assure you, community bankers are not crying wolf. If we do not get meaningful relief soon, more and more of them will throw up their hands and give up their independence. This would hurt communities and reduce access to credit by small business, the primary job-creating engine of our economy. Banks with less than $1 billion in assets make 37 percent of small business loans, almost three times their share, 13 percent, of bank industry assets. And they account for 64 percent of total bank lending to farms.

Community banks are particularly attuned to the needs of their communities and are uniquely equipped to facilitate local economic development. For example, I spend many hours each month on my local hospital board and our economic development corporation working to bring new business to our community. Branches of large mega-banks do not provide the same commitment.

While we do not offer legislative changes to the Bank Secrecy Act, community bankers do have serious concerns about the enforcement. It is topic 1(A) when bankers discuss regulatory burden. However, the agencies do have the authority to address most of the problems. This committee should continue its oversight to ensure that BSA compliance does not impose an unproductive burden on the economy and truly achieves its important goals.

The bank regulatory reduction project led by FDIC Vice Chairman Reich has done an excellent job in identifying those banking regulations that are unnecessarily burdensome. Many of them are hard-wired into Federal statute. The Communities First Act would make key changes, building on the concept of a tiered regulatory and supervision system as recommended by Vice Chairman Reich.

Let me give you a couple of examples that would affect my bank. Section 102 of the act would permit strong banks with assets of $1 billion or less to file a short call report form in 2 quarters of each year. The current call report instructions and schedules fill 458 pages. A key employee in my bank spends the better part of April, July, October, and January working on this report. She never takes a vacation during these months and God help us if she would ever get sick at those times.

While expensive and time consuming to produce, these quarterly filings by community banks are not essential to the agencies. The fact is in banks like mine, 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 we file a short form every other quarter and Mr. Greenspan will still be able to conduct monetary policy without our real-time data.

Let me give you another example. One of the most wasteful provisions of the Gramm-Leach-Bliley Act has been the requirement that financial institutions send annual privacy notices. They must be written in impossible-to-understand legalese. Fixing the language is daunting. Section 203 of the Communities First Act would at least greatly reduce the number of notices that must be mailed. It says that if an institution does not share information, except for narrow purposes, 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 garbage collectors would

also be grateful. These are just two examples from the Communities First Act. I am sure other community bankers would highlight others.

ICBA strongly urges this committee to closely examine each of the regulatory provisions in the bill and include as many as possible in your broader regulatory relief measure.

We thank you for the opportunity to testify.

[The prepared statement of Terry J. Jorde can be found on page 97 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Rock?

**STATEMENT OF BRADLEY E. ROCK, CHAIRMAN, PRESIDENT AND CEO, BANK OF SMITHTOWN (NY), ON BEHALF OF AMERICAN BANKERS ASSOCIATION**

Mr. ROCK. Mr. Chairman and members of the subcommittee, my name is Brad Rock. I am chairman, president, and CEO of Bank of Smithtown, a $750 million community bank founded in 1910, which is located on Long Island in Smithtown, New York.

I would like to make three key points. First, compliance costs drain bank resources, taking away from the needs of our customers and our communities. Every new law, regulation or rule means two things: more expensive bank credit and less of it. During the past decade, banks have shouldered the effects of some of the most imposing legislation of the past 100 years.

Compliance costs for banks today are between $35 billion and $42 billion per year, and these do not include costs associated with the USA Patriot Act, the Sarbanes-Oxley Act, the SEC, FASB, and the Public Company Accounting Oversight Board. If we were to reduce the regulatory costs by just 20 percent, the reduction would support additional bank lending of up to $84 billion. The impact on our economy would be huge.

Second, regulatory burden is significant for banks of all sizes, but small banks struggle the most. There are more than 3,200 banks with fewer than 25 employees. Nearly 1,000 banks have fewer than 10 employees. These banks simply do not have the human resources to implement the thousands of pages of regulations, policy statements, and directives they receive every year.

Countless hours are spent on compliance paperwork at all levels, from bank directors and CEOs to managers and tellers. At my bank, every person has major compliance responsibilities, and one person has a full-time job just to coordinate all the compliance activities.

I personally spend about 1.5 days per week on compliance issues. Some CEOs tell me that they are now spending nearly half their time on regulatory issues. This means that bank CEOs spend more than 5 million hours each year on compliance, time that could be better spent on ways to improve banking in their communities and to meet the changing needs of their customers. But the costs do not stop there. My bank pays more than $100,000 each year to outside firms to help us to comply with regulatory burdens. This one expense alone, if it were used as capital, would support additional $1 million of lending in my community.

My third point is this: Only the involvement of Congress can result in a reduction of costly regulatory burdens. Bankers have seen previous relief efforts come and go without effect, while the overall burden has kept rising. In my written testimony, I list some of the areas in which ABA is seeking reform. Let me briefly describe two which have been particularly costly in recent years.

Under the Bank Secrecy Act, banks fill out more than 13 million cash transaction reports annually. In my area, many of these reports are filed for small businesses like delis, gas stations, and flower shops, which have nothing to do with potentially criminal activity. The 35-year-old rules related to cash transaction reports have lost their usefulness due to several developments, including more extensive suspicious activity reporting. Consider a small bank that has 25 employees or less. Many banks of this size have had to hire an additional full-time employee for the sole purpose of completing reports related to the Bank Secrecy Act. The cost-benefit analysis does not make sense.

Second, as a result of the Sarbanes-Oxley Act, accountants have more than doubled their fees. One community bank in New York saw its accounting fees jump from $193,000 in 2003 to more than $600,000 in 2004. New accounting standards frequently cause almost complete duplication of bank internal audits without increasing safety and soundness.

In conclusion, unnecessary paperwork and regulation erodes the ability of banks to serve customers and support the economic growth of our communities. We look forward to working with you to find ways to bring greater balance to the regulatory process.

Thank you, Mr. Chairman.

[The prepared statement of Bradley E. Rock can be found on page 220 in the appendix.]

Chairman BACHUS. Thank you, Mr. Rock.

Mr. Macomber?

**STATEMENT OF MARK E. MACOMBER, PRESIDENT AND CEO, LITCHFIELD BANCORP (CT), ON BEHALF OF AMERICA'S COMMUNITY BANKERS**

Mr. MACOMBER. Good morning, Chairman Bachus, Congressman Sanders, and members of the committee. I am Mark Macomber, president and CEO of Litchfield Bancorp in Litchfield, Connecticut. Litchfield Bancorp is a $175 million State-chartered community bank, and is part of a two-bank mutual holding company that operates as a mutual savings bank. I am here this morning representing America's Community Bankers. I serve on ACB's board of directors and its executive committee and am ACB's second vice chairman.

I want to thank Chairman Bachus, Congressman Hensarling, and Congressman Moore of Kansas for their leadership in addressing the impact of outdated and unnecessary regulations on community banks and the communities they serve. ACB is pleased to discuss ways to reduce the burden of unnecessary regulations on community banks.

Many of ACB's specific recommendations have been included in past regulatory relief legislation adopted by the Financial Services Committee and the House, including the Financial Services Regu-

latory Relief Act of 2004, H.R. 1375. The House adopted H.R. 1375 by an overwhelming bipartisan vote of 392 to 25. We greatly appreciate the past support of the Financial Institutions Subcommittee and the Financial Services Committee, and we hope members of the committee will support the recommendations that we will discuss today.

This hearing and this topic are important and timely. Ten years ago, there were 12,000 banks in the United States. Today, there are only 9,000 of us left. ACB is concerned that community banks are significantly hindered in their ability to compete because of the costs and burden of unnecessary and outdated regulations. We are particularly concerned about how laws intended to prevent money laundering and to promote corporate governance are being implemented by regulatory agencies.

Community bankers fully support the goals of the laws against money laundering, and we are resolute participants in the fight against crime and terrorism. Yet we face an atmosphere of uncertainty and confusion because regulatory staff in the field, region, and in Washington are giving banks inconsistent messages. Community bankers also support the Sarbanes-Oxley Act.

However, the implementation of the act by the Securities and Exchange Commission and the Public Company Accounting Oversight Board, together with the way accounting firms interpret the regulations, have led to unintended consequences that are costly and burdensome. That is true for all community banks, including those that are privately held stock institutions and mutual community banks like mine.

ACB has provided concrete suggestions to the banking agencies and other regulators on ways to cut the cost of compliance. We commend the banking agency in FinCEN on their recent guidance on money services businesses and the SEC and the PCAOB on the recent guidance on internal controls. We hope these efforts will bring greater certainty and lower compliance costs. Yet more needs to be done. ACB will continue to work with Government agencies to improve the regulation of our anti-money laundering and corporate governance laws.

A new concern that has been raised by our members is that the Federal Housing Finance Board may be contemplating imposing on the community bank members of the Federal Home Loan Bank system a third layer of predatory lending regulations. State and Federal banking regulators already oversee the banking system for unscrupulous lending practices. However, our members see no value in adding another regulator to duplicate what others are already doing. This can only lead to conflicting requirements and more and higher costs to the system and its borrowers.

Our written statements endorse 31 amendments to current laws that will reduce unnecessary regulations on community banks. Let me mention three. First, a modest increase in the lending limit for savings associations is a high priority for ACB members. In recent years, community banks have experienced an increased demand for small business loans.

To meet this demand, ACB wants to eliminate the lending limit restriction on small business loans. We would increase the lending limit on other commercial loans to 20 percent of assets. This ex-

panded authority would enable savings associations to make more loans to small-and medium-size businesses. That would enhance their role as community-based lenders. It would promote community development and contribute to economic growth and job creation.

Second, ACB vigorously believes that savings associations should have parity with banks under the Securities Exchange Act and the Investment Advisers Act. Savings associations and banks should operate under the same basic regulatory requirements when engaged in identical trust, brokerage, and other activities. 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 regulations as banks engaged in the same services.

Third, ACB urges that unnecessary restrictions on the ability of national and State banks to engage in interstate branching be removed. Currently, national and State banks may only engage in de novo interstate banking if State law expressly permits. This restriction should be eliminated.

These recommendations, along with those in our written statement, will make it easier and less costly for us to help our communities grow and prosper and create new jobs. On behalf of America's Community Bankers, I want to thank you for your invitation to testify. We look forward to working with you and your staff to accomplish this goal.

I will be happy to answer any questions you may have. Thank you.

[The prepared statement of Mark E. Macomber can be found on page 122 in the appendix.]

Chairman BACHUS. Thank you, Mr. Macomber.

Mr. Marquette?

**STATEMENT OF ROBERT MARQUETTE, PRESIDENT AND CEO, MEMBERS 1ST FEDERAL CREDIT UNION (PA), ON BEHALF OF NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS**

Mr. MARQUETTE. Good morning, Mr. Chairman, Ranking Member Sanders, and members of the subcommittee. My name is Bob Marquette. I am the president and CEO of Members 1st Federal Credit Union, located in Mechanicsburg, Pennsylvania. I am here today on behalf of the National Association of Federal Credit Unions to express our views on the need for regulatory relief and reform for credit unions.

As with all credit unions, Members 1st is a not-for-profit financial cooperative governed by a volunteer board of directors who are elected by our member-owners. We were founded in 1950 by nine members putting $5 in a hat, and from those humble beginnings, and solely through the support of our member-owners and their funds, we have grown to our current size, meeting their everyday financial needs.

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. A 2004 Filene Research Institute study entitled, "Who Uses Credit Unions?" found that the average household income of those who hold accounts solely at a credit

union was less than $43,000, while this average for those who solely hold accounts at a bank was almost $77,000.

Because of our cooperative not-for-profit structure, our members find that our product service offerings remain widely available to them irrespective of economic or stock market conditions. Such dependability means we are not in a particular market or product offering today, but out of that area tomorrow simply to bolster our net income growth. Such a long-term view is only possible because of our not-for-profit mutual ownership structure, which benefits not only our members, but also our economy and our local businesses as well.

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 86 million Americans. At the same time, according to data obtained from the Federal Reserve Board, credit unions have the same market share today in terms of financial assets as they did in 1980, 1.4 percent, and as a consequence provide little competitive threat to other financial institutions.

Mr. Chairman, as your subcommittee considers regulatory relief, we hope that you will look at the credit union provisions included in last year's House-passed Financial Services Regulatory Relief Act. We believe these provisions are a positive step in addressing many of the regulatory burdens and restrictions on Federal credit unions. The facts confirm that credit unions are more heavily regulated than other consumer financial services providers.

We also hope that you will consider including additional provisions from the Credit Union Regulatory Improvements Act of 2005. I would like to thank Congressmen Royce and Kanjorski for taking the lead in introducing this vital legislation.

NAFCU urges the subcommittee to include language in any regulatory relief bill to modernize credit union capital requirements by redefining the net worth ratio to include risk assets as proposed by the NCUA and included in the CURIA bill. This would result in a new, more appropriate measurement to determine the relative risk of a credit union's balance sheet and also improve the safety and soundness of credit unions and our share insurance fund.

NAFCU also asks the subcommittee to refine the member business loan cap established as part of the Credit Union Membership Access Act in 1998, replacing the current formula with a flat rate of 20 percent of the total assets of a credit union. We support revising the definition of a member business loan by giving NCUA authority to exclude loans of $100,000 or less from counting against the cap.

There is a lot of rhetoric out there on this issue, but I must note that a 2001 Treasury Department study entitled ″Credit Union Member Business Lending″ concluded that credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions.

Finally, we urge the subcommittee to also include language that would address the strain that could be placed on merging credit unions when FASB changes merger accounting rules from the pooling method to the purchase method. This subcommittee held a hearing on April 13 of this year, and legislation to address this

issue in the form of the Net Worth Amendment for Credit Unions Act is moving through the House. We thank you for your leadership on this issue, Mr. Chairman, and we hope that this issue will also be included in any regulatory relief package.

In conclusion, 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 to ease the regulatory burden on credit unions as we move forward in the 21st century financial services marketplace. NAFCU urges the subcommittee to consider the important credit union provisions we have outlined in this testimony for inclusion in any regulatory relief bill.

We look forward to working with you on this important matter and would welcome your comments or questions, and we appreciate the opportunity to testify at today's hearing.

Thank you.

[The prepared statement of Robert Marquette can be found on page 208 in the appendix.]

Chairman BACHUS. Thank you, Mr. Marquette.

Mr. Ensweiler?

**STATEMENT OF RICHARD L. ENSWEILER, PRESIDENT, TEXAS CREDIT UNION LEAGUE, ON BEHALF OF CREDIT UNION NATIONAL ASSOCIATION**

Mr. ENSWEILER. Chairman Bachus, Ranking Member Sanders, and members of the subcommittee, on behalf of the Credit Union National Association, I appreciate this opportunity to express the association's view on legislation to help alleviate the regulatory burden under which all financial institutions operate today. I am Richard Ensweiler, president and CEO of the Texas Credit Union League and chairman of the Credit Union National Association.

According to the U.S. Treasury Department, credit unions are clearly distinguishable from other depository institutions in their structure and operational characteristics and have more limited powers than national banks and Federal savings associations. Given the limited time available, I will devote my statement to describing a few exceptionally important issues for these credit unions. Most of these are addressed in the recently introduced H.R. 2317, the Credit Union Regulatory Improvement Act of 2005, or CURIA.

We are very grateful to Representatives Royce and Kanjorski, as well as Representatives LaTourette, Sanders, Maloney, and other cosponsors for reintroducing this important bill. As part of our mission, credit unions are devoted to providing affordable financial services to all our members, including those of modest means. One provision that this committee and the House have already passed, thanks to Representatives Gerlach and Sherman, would better enable us to meet the goal. I am referring to H.R. 749, legislation to permit credit unions to provide broader check-cashing and remittance services.

Accomplishing our mission can also be greatly enhanced by revisiting two major components of the 1998-passed Credit Union Membership Access Act. With 7 years of experience, we have learned that what was thought to be good policy at the time has actually

created new problems that need to be resolved to assure that credit unions can continue to meet their mission.

The first of these is the current cap on member business lending. There was no safety or soundness reason to impose these limits as the historical record is clear that such loans are even safer than other types of credit union loans. In fact, public policy argues strongly in favor of eliminating altogether or increasing the limits that credit unions can lend to their small business members from the current 12.25 percent of total assets to the 20 percent suggested in CURIA.

Small business is the backbone of our economy and is responsible for the vast majority of new jobs in America. Yet recent SBA and 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. Although few credit unions are currently bumping up against the cap, in a few years that is likely to change.

Then there is the case of many small credit unions. Investing in the expertise required to run a member business lending operation is a very expensive proposition. With the 12.25 percent of assets cap, they could not make up the costs necessary to engage in such an operation. Their members want the credit union option for this service, too.

Furthermore, the National Credit Union Administration should be given the authority to increase the $50,000 threshold as proposed in CURIA to $100,000. This would be especially helpful to small credit unions as they would then be able to provide the smallest of these loans without the expense of setting up a formal program.

Another critical issue addressed in CURIA is prompt corrective action regulations governing credit unions. Credit unions have higher statutory capital requirements than banks, but credit unions's cooperative structure creates a systemic incentive against excessive risk-taking, so since there is no profit motive to take excessive risks, there may be actually less capital required to meet potential losses than at other depository institutions.

And because of their conservative management style, credit unions generally seek to always be classified as well, rather than adequately, capitalized. To do so, they must maintain a significant cushion above the 7 percent of assets reserve level. CUNA believes that the best way to reform PCA would be to transform the system in to one that is much more explicitly based on risk measurement as outlined in CURIA. It would place much greater emphasis on ensuring that adequate net worth in relation to risk at a particular credit union as it undertakes this operation.

At the same time, CUNA believes credit union PCA could incorporate a meaningful leverage requirement comparable to that in effect for other federally insured institutions. CUNA strongly supports CURIA's new rigorous safety and soundness regulatory regime for credit unions, which is anchored by meaningful net worth requirements and are at least comparable to bank PCA.

And credit unions agree that any credit union with net worth ratios well below those required to be adequately capitalized should

be subject to prompt and stringent corrective action. There is no desire to shield credit unions from PCA. They are indeed the appropriate targets of PCA. Because of the cooperative funding structure of the national credit union share insurance fund, credit unions are keenly aware that it is they who pay when a credit union fails.

Reforming PCA along these lines would preserve and strengthen the fund. It would more closely tie a credit union's net worth requirements to its risk exposure. It would also free up more capital for making loans to members and putting resources into the economy.

Finally, we thank you, Chairman Bachus and others for introducing and moving H.R. 1042 to address a pending issue before FASB that would cause undue hardship to credit unions by forcing them to change from the pooling method of accounting for reserves in the event of mergers.

In summary, Mr. Chairman, we are grateful to the subcommittee for holding this important hearing. We strongly urge the subcommittee to act on this very important issue this year and to make sure that CURIA is a part of any congressional action to provide financial institutions regulatory relief. CURIA is our future. Without CURIA, more credit unions will feel forced to consider converting to a thrift or a bank, and millions of Americans will be deprived of a not-for-profit, member-owned financial cooperative, or a credit union, as an option to respond to their financial needs.

Thank you for this opportunity this morning.

[The prepared statement of Richard L. Ensweiler can be found on page 51 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Keeling?

**STATEMENT OF J. MICHAEL KEELING, PRESIDENT, THE ESOP ASSOCIATION**

Mr. KEELING. Chairman Bachus, Ranking Member Sanders, members of the subcommittee, my name is J. Michael Keeling. I am president of the ESOP Association. Our primary members are U.S. corporations that are owned by their employees through an employee stock ownership plan, or ESOP.

Approximately 97 percent of our 1,400 ESOP company members are private, small-to mid-size businesses. Our member demographics pretty much represent business as a whole in America. I have served as the chief staff officer of the Association since April 1991 and first began work with the ESOP group in early 1982, shortly after leaving a position as Chief of Staff for 10 years with former Congressman J. J. Pickle.

You may wonder what someone who works for companies that are employee-owned through ESOP has to say to you as you examine ways to ease and improve the regulation of our nation's financial institutions. Before I finish, I would hope that you would conclude that discussions of creating employee ownership should be before your full committee and your subcommittee more so than the tax and labor committees of Congress.

Let me explain. An ESOP is similar to any other defined contribution plan such as a 401(k) plan, except for two statutory distinguishing characteristics. Unlike other defined contribution

plans, an ESOP must be primarily invested in employer stock and may borrow money to obtain its asset, the stock of the plan sponsor. Attachment A summarizes the research that ESOPs are good for America, for the ESOP companies, and the employee-owners in the vast majority of instances. Note the words I used, ″borrow money,″ which clearly means you should have an interest in the approximately 11,000 ESOP companies in America.

But let's dig a little deeper. First, a big picture statement as to why your subcommittee should be involved with ESOPs as you work with your primary concern, our Nation's financial institutions. Ninety percent of ownership is created in a free enterprise society by financing. The idea that one can work hard and save a few pennies and then start their own business and succeed, but never be financed, is a Pollyanna pipedream. Entrepreneurs get financed, and as they pay off their debts or line of credit, they own more and as what they own grows, they become wealthier.

ESOPs borrow money to enable average-paid persons, the employees, to be owners. The ESOP method of financing cuts the employees in on the ownership of what makes people truly financially secure in a capitalistic system: productive assets. The sources of ESOP financing are generally from the institutions you oversee. So ESOPs are intertwined with financial institutions in economic theory and in practicality.

Let's climb down from the skies a bit. As Mr. Sanders mentioned, yesterday he introduced H.R. 2547 and was joined by his colleagues Manzullo, Rohrabacher, Maloney, and Lee. Last Congress, Mr. Sanders introduced H.R. 2969, which would have established a lending program in the United States Treasury to facilitate employees buying their plants under conditions and to operate them as ESOP companies or employee-owned cooperatives, or EWOCs, as they are called.

In today's climate of tight budgets, it will take more work by the employee ownership community to make the case to you that you and your colleagues should move forward the H.R. 2969 package.

But as ESOP experts reviewed H.R. 2969, one provision of Mr. Sanders's bill jumped off the page as a modest but meaningful first step in accomplishing several worthy goals. This was the provision that is now H.R. 2547.

H.R. 2547 provides that the appropriate Federal financial supervisory agency assessing a financial institution's record of meeting the credit needs of its entire community should also include as a factor the institution's capital investment loans to support or enable manufacturing employees to establish ESOPs or EWOCs that are at least 51 percent owners of the companies where they work.

Please note the language of H.R. 2547 is very modest. It does not automatically mean that the agency gives a CRA. The loan has to be for employees of a manufacturing facility that ends up with at least 51 percent ownership. In the real world, we are looking at about 100 to 150 situations like this. In 2003, Congressman Sanders had hearings on H.R. 2969 and we learned of many plants where the union and management, or nonunion employees and management could, make a good case that the plant could succeed as an employee owned company, but yet they did not get financing.

Still today, too many banks and lending institutions do not understand the mechanisms in how employee-owned companies work. I think of Mrs. Maloney in the 1980s and the work she was doing for her people in the Bronx. Perhaps we would have saved that Bronx Brass facility, Mrs. Maloney, if we had had this provision in law.

We come to the win-win situation here. What Mr. Sanders is saying is, listen, banks, help expand employee ownership and you will get a little easing of your regulatory burden. So it is a modest step. Indulge me one thought, and I quote a speech: ″In America's idea of freedom, citizens find the dignity and security of economic independence instead of laboring on the edge of subsistence. This is the broader definition of liberty that motivated the Homestead Act.″

″To give every American a stake in the promise and future, we will build an ownership society. We will widen the ownership of homes and businesses, retirement savings and health insurance, preparing our people for the challenges of life in a free society. By making every citizen an agenda of his or her own destiny, we will give our fellow Americans greater freedom from want and fear and make our society more prosperous and just and equal.″ President George W. Bush, inauguration speech, January 20, 2005.

Mr. Chairman and subcommittee, there should be legitimate debate over the specifics of how to build a more prosperous, just, and equal society, but I submit H.R. 2547 can be a small, meaningful, reasonable specific step that will move us towards an ownership society, while at the same time easing a regulatory burden for the financial institutions.

I appreciate your invitation to be here today.

[The prepared statement of J. Michael Keeling can be found on page 109 in the appendix.]

Chairman BACHUS. I thank you, Mr. Keeling.

At this time, I am going to yield my time to Mr. Pearce for questions.

Mr. PEARCE. Thank you, Mr. Chairman, for that yielding of your time.

Many years ago, I read a statement that I still have yet to find fault with that said there are really no Third World economies, there are just overregulated economies, and ours appears to be moving that way very fast.

The district that I represent is built of small communities, small businesses, and small banks. Some of our communities have, Ms. Jorde, as their economic development plan the hope to get to the size of the community that you are in, maybe the third stage up from where we are. The community I grew up in actually had no post office. It did have a crossroads. The crossroads are still there and the post office is still not. So I am like you, from a very small area. We depend on the small banks, so I appreciate the quandary that we find ourselves in.

Mr. Rock, you were pretty definitive on some of your regulatory suggestions. Do we run any risk in many of the regulations if we back them out first of all? And secondly, is there any reason that the regulators just cannot go in and begin to take pages of regulations out that no longer mean anything? Is it technically possible, even if it is not probable?

Mr. ROCK. Well, let me respond to the first part. Certainly the purposes of many of these regulations, for example the Bank Secrecy Act, they are laudable purposes. Banks want to help identify terrorists and any terrorist financing. But we think that the way that these are being done by the regulators amounts to overreaching. I think that the regulators can make some changes and I think we are moving in that direction. We have had some discussions with folks from FinCEN. We have had discussions with the folks from Treasury, for example, on bank secrecy.

We think that they have communicated through their examination process that they have a zero tolerance level. The problem is that banks then take on a posture where they are trying to defend themselves, and they file defensively. And they file then reams of paper in order to not be penalized by the regulators. As Mrs. Maloney referred to earlier, it is really very counterproductive to the process. I think it not only hurt banks, but I think it hurts all of us.

I have a bank secrecy officer in my bank who has 30 years of experience at identifying what suspicious activity is. If the regulators weren't to push us so hard to file everything, then she would file fewer and she would file not whenever anything comes to her attention that might even be remotely at risk.

Mr. PEARCE. Do you ever get any follow-up? Do you ever get follow-up?

Mr. ROCK. No, we have never.

Mr. PEARCE. So no one ever calls back. You send in the reports and no one ever calls back and says, could you call that person up and see if they are really valid.

Mr. ROCK. We have never had any follow-up. I will say that we have never had any follow-up to situations that we have considered serious. We have had to go out of our way to make the call to law enforcement to try to have them pull that one out of the pile.

Mr. PEARCE. Did anything happen when you made those calls?

Mr. ROCK. Yes. I think after we made that call, law enforcement did pull it out of the pile and follow up.

Mr. PEARCE. Which if you were not filing piles of paperwork, you probably would have made that call anyway and you probably would have gotten the same results.

Mr. ROCK. That is right. I reckon that we would have only filed that one suspicious activity report.

Mr. PEARCE. Mr. Keeling, you mention on page five about the failure of ESOPs to get financing. Do you think that is systemic or do you think that that may reflect risk and sometimes lack of management expertise in some of the ESOPs? In other words, do you think that ESOPs are targeted or is it a risk-reward-type question that the institutions are asking that causes some ESOPs not to get funded?

Mr. KEELING. I think it is 50-50.

Mr. PEARCE. Okay.

Mr. KEELING. I think that there are examples, and this came out in the hearing last year, where you can make a good case that the plant, like the one in Baltimore that I refer to in the testimony in an attachment where Governor Ehrlich played a major role in sav-

ing those 300 inner-city jobs and made a very strong feasibility case. The state of Maryland had to step in to finance it.

Mr. PEARCE. What percent of ESOPs would you say go belly up during a period of time?

Mr. KEELING. About 2 percent, 1 percent. Keep in mind, we are dealing with a subset of ESOP companies when we talk about the ones that Mr. Sanders is targeting. The vast majority of ESOP companies involve an exiting shareholder. Here, we are discussing specifically manufacturing plants. And let me say in defense of U.S. corporation, many times they slate a business or firm for shutdown. It is not because it was not profitable. It just did not fit into the picture with that corporation.

Mr. PEARCE. I understand.

Thank you, Mr. Chairman, my time has expired.

Mr. HENSARLING. [Presiding.] The time of the gentleman has expired.

Clearly, I am not Chairman Bachus. He had to excuse himself to deliver a speech, but he wanted to thank each and every one of the panelists and share his view that he thought the testimony was incredibly valuable.

At this time, the Chair will recognize the ranking minority member, the gentleman from Vermont, Mr. Sanders.

Mr. SANDERS. Thank you, Mr. Chair.

Let me mention to all of our guests today that I understand all of the issues out there are important, but I would like to focus a little bit on the ESOP issue with Mr. Keeling. Mr. Keeling, I had a wonderful experience, and I wanted to mention it to the members of this committee. Just a few months ago, I went to a company in the southern part of the State of Vermont in a town called Bellows Falls, which has had some economic difficulties.

There is a company there called Chroma. I do not know, Mr. Keeling, if you are familiar with the Chroma Company. It is a worker-owned industry. The spirit of the people there was just extraordinary. It is a high-tech company. They make lenses for microscopes. Wages are high. The whole decision-making process is very cooperative. People feel involved. There is almost no turnover. People get that job; they do not want to leave. It was just an amazing and wonderful thing to see.

Mr. Keeling, let me ask you this. I know that in Vermont, and I expect all over this country, there are a lot of people, businessmen who have started companies, worked to see those companies grow for 30 years, are fond of their employees, but probably do not have the information available or the resources available to be able to say to those workers, look, thank you for 20 years of work for me; I want to see you and your fellow workers own this company, and so forth and so on.

Do you think that there is a general lack of information out there to those types of people? Often we see the headlines, companies shut down; workers look to worker-ownership. And sometimes, it is too late to move in that direction. But I have the feeling that there are probably thousands of businessmen out there, if they knew the options, if it was financially feasible, would love to see their employees own and control the work that they had done. Do you believe that is true?

Mr. KEELING. I believe that you are generally correct. Oddly enough, when you get up in years of experience I have had around employee ownership, you start looking at the glass being half full when it is half empty. It is so much better than it was in the 1970s and the early 1980s. But having said that, we still find that the primary advisers to small-and mid-businesses, which is more often than not someone who is an accountant because small businesses need to keep their books, the advisor is not familiar with the advantages and the plusses of creating employee ownership. And thus that business owner's head is often turned in another direction where he or she may not hear about this opportunity.

There are some systematic issues, too, in terms of the price that can be paid for ESOP shares that might not be attractive to the owner. So I agree with you that the glass, at best, is half empty, but, of course, I can say it is half full.

Mr. SANDERS. Might that also be true of a lot of banks who simply may not be making those loans, not because they are prejudiced, but because simply of it is a new idea. It is a concept that they are not familiar with.

Mr. KEELING. I agree with you, and I particularly agree with that with the smaller lending institutions, that would be not staffed in a manner to be up to speed on all the different methods of financing an exiting shareholder or a company that might be viable with an ESOP loan. Keep in mind, no one is asking that an unviable economic unit be financed and kept in business. They have to meet the underwriting standards.

Mr. SANDERS. I gather that what you are saying is that it would be a very positive idea to provide a CRA credit to financial institutions which provide assistance to employees in order to establish ESOPs or EWOCs.

Mr. KEELING. I endorse that 100 percent and I am going to make one little statement. If you could save 200 jobs, 100 jobs, and that was the extent of the advantage; if we had saved the factory in Mrs. Maloney's city council district, it would have made it worthwhile because I do not see the downside for the financial institutions.

Mr. SANDERS. Well, I just want to thank, Mr. Bachus is not here right now, but he just indicated to me that he wants to come on board this bill. We have Mr. Rohrabacher on board and Mr. Manzullo, who is chairman of the Small Business Committee. We are going to make this a real tripartisan effort and I hope that we can move this important legislation this year.

I want to thank you, Mr. Keeling for your support, and I would hope that our other panelists will join in support of this concept.

Thank you very much, Mr. Chair.

Mr. HENSARLING. The Chair now recognizes the gentleman from Kansas, Mr. Ryun.

Mr. RYUN. Mr. Chairman, thank you very much.

First of all, let me thank all the panelists for coming today, and then make a point of personal privilege, if I may. Prior to entering office 9 years ago, as a small businessman, two things that frustrated me were the ever-increasing taxes and the number of unnecessary regulations that it caused in terms of compliance. It was one of those things that drove me to run for office.

Having said that, I would like to address a question, if I may, to Mr. Rock and Mr. Macomber. I have countless of your members in my district who helped in the drafting of H.R. 2061. I am not necessarily asking for an endorsement, although that would be nice, of my bill, but rather for you to make an observation of what provisions in that particular bill that you feel you could strongly support.

Mr. MACOMBER. Well, certainly elements of it. I am not sure of all the details on it, but certainly anything that results in regulatory relief for small banks is a very, very positive thing. I am not sure that particular act as it is currently drafted, while excellently drafted, is the bill we would support 100 percent, but there are certainly things in that act that I think all the banking agencies, the trade groups would support.

Regulation is crushing banks. Small banks are going out of business. They are withdrawing from public ownership. They are merging themselves out of existence. In Rhode Island, there is a bank that is merging for the main reason being an inability to maintain the regulatory burden. One of the primary reasons that I formed a holding company with another bank was so we could share the costs of regulatory burden, which are extraordinary.

If we had a more reasonable burden of regulations, we feel we could probably open another branch or two without spending any more. It would certainly enhance the services to the communities that depend on us. So anything that would help in reducing regulatory burden and in some areas expanding the powers of banks is certainly in our best interest.

Mr. RYUN. Mr. Rock?

Mr. ROCK. Yes. We think that many of the provisions of that bill are very worthwhile and would provide significant regulatory relief for smaller banks. If the committee would like to move in the direction as put forth in that bill, we would certainly work with you in that regard.

Mr. RYUN. If I may, I have a little more time. I want to have a little bit of a follow-up question which I could address to anyone that is actually willing to respond to it, especially regarding the banking industry.

The record profitability has caused a lot of people to say there is not a need for regulatory relief, and yet if I am correct at what is called return on assets, small bank profitability has lagged significantly behind larger banks, which could be possibly attributable to the difficulty that small institutions have in handling the sheer volume of regulatory mandates.

Any comment any of you would like to make on that?

Mr. ROCK. Well, I think it is true, Congressman, that smaller banks carry a disproportionate burden because of the amount of the cost. A larger bank can spread the cost of compliance with some of these regulations over a larger income base, over a larger asset base. So I think it is true that smaller banks carry a disproportionate amount of the regulatory burden, and I think that is why it is reflected in those ROA numbers that you have quoted.

Ms. JORDE. I would just add to that and to echo Mr. Rock and his comments earlier that a lot of times in a smaller bank the most senior level of managers are the ones that are also responsible for

compliance because of the very large stick that lack of compliance carries. So it is not only that it is a disproportionate impact, but it also takes the key employees of the bank to deal with those issues, and that takes them away from their probably more important responsibilities of planning for the future, growing the bank, coming up with new customer initiatives. All of that affects the bank's ability to grow and to return profitability on their assets.

Mr. MACOMBER. I would just add that regulatory burden is involved in every decision we make in our bank, at my level on down to the newest teller we have. The regulations we work under have an impact on every individual in that bank, and it is a very, very significant burden.

Mr. RYUN. A final observation, if I may. I know one of the charges I have and we have as Members of Congress is to serve our constituents, which we do and enjoy that opportunity. One of your obligations or one of your purposes is to serve your customers. I am hoping that we can continue to push forward with good regulatory relief so you will have fewer responsibilities and better opportunities to serve.

I return my balance of time.

Mr. HENSARLING. The Chair now recognizes the gentlelady from New York, Ms. Maloney.

Mrs. MALONEY. Thank you.

And I want to thank all of the panelists for your excellent testimony and to give a special welcome to Mr. Keeling with whom I have worked in trying to save manufacturing jobs in the district I am honored to represent. Truly, if we had gotten access to capital, maybe we could have saved those jobs. So I am a strong supporter of the bill and any effort to get capital into our communities.

This country lost 2.7 million manufacturing jobs in the past four years. That is an astonishing number. Possibly, if we had been able to inspire our employees and help them with the financing of it, we might have been able to save those companies. I agree with Mr. Ryun. Our first priority is to serve our constituents. Therefore, I am very sympathetic to credit unions.

I used to represent one of the poorest neighborhoods in the entire United States. Literally, it was rated the poorest neighborhood on the census tract at East Harlem and South Bronx. Many of the financial institutions left. I respect their opportunity in a free market system to move, but the credit unions stayed and continued to provide services to the people in the community. I am very, very appreciative.

I have a question on the overburden of regulation. I would like to address it to Ms. Jorde of the Independent Bankers, Mr. Rock of the American Bankers, and Mr. Macomber of the Community Bankers, if any of you would like to comment on it. Recently, the Public Company Accounting Oversight Board suggested that auditors should exercise more discretion in reviewing compliance with Sarbanes-Oxley standards. I hear from my constituents, small businesses, financial institutions, that the standards are just overpowering.

That is, they can use a ″reasonableness″ standard that considers such things as the size of the entity and other factors. Does this help your institutions? And do you think auditors will start exer-

cising judgment as the PCAOB has advised? Because particularly for smaller institutions, I would say for large institutions, the standards have been very heavy. Would any of the three of you representing the industry like to reply?

Mr. ROCK. Well, I think that the guidance that the PCAOB put out on Monday, May 16, I think it is very, very useful. We met with them about 30 days ago ourselves, and representatives of other groups met with them to try to talk about what we thought some of the remedies could be that would not necessarily have to be included in legislation. They listened to us, and I think that the May 16 guidance is—

Mrs. MALONEY. What were some of those remedies?

Mr. ROCK. For example, the audit standard number two issued by the PCAOB said that independent auditors must use primary evidence in finding that the internal controls of the company are sufficient. The independent auditors tell us that they were afraid. What independent auditors would typically do is they would selectively test various internal controls and if they were satisfied with the selective testing, then they would give a clean opinion.

The auditors said that they were afraid that this standard of primary evidence said that they could not selectively test. They could not use the work papers of the internal auditors and the bank's management testing, that they had to do all of the testing all over again themselves. And that is the kind of thing that resulted in massive duplication of testing of internal controls and hugely increased costs for banks of all sizes.

The PCAOB listened to that. Mr. McDonough, the Chairman of the PCAOB, said that that was not the intention and that that would be included in guidance and that is one of the items in the May 16 guidance that we think will be very helpful for independent audit firms and also for banks of all sizes, and especially smaller banks.

Mrs. MALONEY. Would anyone else like to comment?

Mr. MACOMBER. I think the real concern, and I certainly agree that the May 16 statement was very helpful conceptually. The issue is the implementation and how audit firms in the field will react to it. If you talk to people at the OTS or FDIC about some of their regulations, BSA being one of them and the Patriot Act, their statements are a lot more reasonable than when it is being interpreted in the field. I think that is a real danger, that accounting firms themselves will be very afraid to go too far with that judgment standard because they may be second-guessed down the road. So it is an implementation issue.

Mrs. MALONEY. I would like to also go to the CTRs that some of you spoke about. How do you think we could change that?

One of you mentioned that that law went into effect 35 years ago. It is so broad. No one is looking at it.

How would you create a standard that would, as you said earlier, Mr. Rock, you have an experienced person who can really figure out what is going on. It would be helpful to the Treasury Department, too, because they are almost overwhelmed with all the paper coming at them.

How do you think the CTR could be more useful in helping Treasury find these terrorists and the whole purpose of it, as op-

posed to having absolutely every document? What is it, over $5,000 or over $10,000?

Mr. ROCK. Over $10,000.

Mrs. MALONEY. Over $10,000.

Mr. ROCK. But because of the restructuring requirements, there are many that are filed for cash transactions under $10,000 also.

Mrs. MALONEY. So that is a huge filing.

Mr. ROCK. A huge filing.

Mrs. MALONEY. It is monumental.

Mr. ROCK. For absolutely ordinary businesses like pizza parlors in New York, if you do business with pizza parlors, you have to file CTRs for them all the time because they deal in large amount of cash. I think that the answer would be to eliminate the requirement of filing CTRs for seasoned customers.

If you have customers that you have been doing business with for a long period of time, in the ordinary course of business you should not have to file CTRs for them anymore. I would point out that 35 years ago when the CTR requirement was adopted, we did not have the extensive SAR reporting, suspicious activity reporting, that we have now.

I think that rather than file reams of paper for absolutely ordinary activity by pizza parlors and delis and flower shops, I think what we should do is for seasoned customers, the CTR requirement should be eliminated and we should focus more upon the suspicious activity reporting. I think that that would be a large step in the right direction.

Ms. JORDE. I would maybe add to that that if you were to adjust the $10,000 for inflation, that would be $50,000 in today's terms. So we have proposed that that threshold level be increased to $30,000.

Mr. HENSARLING. The time of the gentlelady has expired.

The Chair will now recognize himself.

Recently, Federal banking and financial institution regulators have increased the threshold for a streamlined CRA exam. I sponsored legislation in the last Congress to raise that threshold to $1 billion. It became a moot point once the regulators chose to do that on their own. There are those who believe, though, that this somehow will imperil future community lending.

My question, first to you, Mr. Jorde, and perhaps your bank was not subject to the more extensive CRA exam, but certainly some of your members may be. If you were not making loans in Cando, North Dakota, and the surrounding area and serving that community, would your bank be viable?

Ms. JORDE. Absolutely not. That was the reason that we were chartered by local shareholders within the community is that they needed a bank that was going to lend to the community. If it were not for our loans to the community, our community would not exist and we would not either.

I would just add to that, although we are under the streamlined CRA exam, we have a CRA exam. It is a true exam, and we spend the better part of a week with one examiner just going through the process of determining our loan-to-deposit ratios, our lending in the community, our assessment areas, our complaint file, which there

weren't any. So it is not that we are exempt from CRA and we very much do go through a CRA exam.

Mr. HENSARLING. Mr. Rock, simply because I like your name, I would like to ask you the same question. In a slight wrinkle, I suppose, and that is can a streamlined CRA actually enhance a bank's ability to serve its community?

Mr. ROCK. I think so, and I think my bank is a good example of that and a good example of what the problem is. My bank has $750 million in assets, so we fall between that $250 million number and the $1 billion number. Yet when my bank is examined pursuant to the big bank CRA standards, which is what has happened for us in the recent past, we get irrational results.

We have in my community a small builder who is a Native American. He builds small homes on small lots that are less than one-quarter acre. He then sells those homes at modest prices in a low-to moderate-income area. He sells them mostly to minority buyers who are mostly black and Hispanic. We are the only bank in our area which funds that activity for this Native American builder, and yet we get no CRA credit for it and we never have. It is because when the big bank rules are applied to banks that are my company's size, we get irrational results.

We do not at all want to be exempted from CRA. We just want to have a set of rules applied to us that make more sense for our circumstances.

Mr. HENSARLING. A follow-up question: I heard you say in your testimony, and I guess this is somewhat anecdotal, that a number of bank CEOs, I believe you said this, are now spending over half of their time on regulatory compliance.

I find that to be a staggering figure and certainly can make a prima facie case that when you are spending more time working for the Government than you are yourself, that that is a significant loss of freedom.

You mentioned that the regulatory burden is reduced by only 20 percent.

Mr. ROCK. Yes.

Mr. HENSARLING. My time is starting to draw to a close, but do you have any idea how many new small businesses and jobs might be launched with that additional capitalization?

Mr. ROCK. Well, we have never tried to have our economic staff count the number of businesses because it would depend upon the size of each business, but we think that it would be a huge positive impact for the economy if those funds were freed up and allowed to be used as capital to support additional small business lending.

Mr. HENSARLING. Mr. Ensweiler, let's turn to you. I would like the record to show that you, although not a native Texan, I know that you got there as soon as you could, and we appreciate that.

[Laughter.]

In your testimony, you spoke about two recent credit union conversions in Texas. I would like for you to elaborate upon what you see as the reasons for those conversions. What could be done to ensure that financial institutions's consumers continue to have the option of credit unions?

Mr. ENSWEILER. The two cases are ones that I am very familiar with. They are both located in the Dallas-Fort Worth metroplex

area. They are both in fast growing communities. In both cases, the credit unions have enormous opportunity, opportunities that cause them to generate enough business that they are outgrowing their capital requirements. With credit unions being so heavily capitalized by law, they find that it would be much less restrictive if they could convert to a mutual savings bank.

So in our testimony today, we talked about the opportunity to make our requirements more risk-rated and more in line with other depository financial institutions. If that were the case, that would take a big step towards helping credit unions stay within their charter.

One other point that both of these institutions point to is the fact that they have an opportunity to serve small businesses. They are bumping up against the cap in both cases. They are looking for relief so that they can stay credit unions and help their members as their members have small business needs. So those two provisions would go a long way to keeping credit unions within their charter.

Mr. HENSARLING. My time is expired.

Mr. Keeling, I was going to ask you the question of why I do not see a small green lapel pin pickle knowing that you had worked for a Texas legend and a great man, but I am sure there is a reason that pickle lapel pin is not here today.

Mr. KEELING. I would have brought several squeaky, but I also would let the record show I grew up in Kilgore, Texas, and was under Friday night lights many times in Athens, Texas.

[Laughter.]

Mr. HENSARLING. My time having expired, the Chair now recognizes the gentleman from Texas, Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Mr. Chairman.

I want to also thank all the members of this distinguished panel for your testimony. It has been very informative, and we appreciate very much that you would come and share with us your thoughts.

I have a comment to make and then would ask two of today's witnesses to respond to a proposal that I am going to mention. Mr. Ensweiler, I want to extend a warm welcome to you as a fellow Texan. I hope you enjoy your stay here in Washington. As you are likely aware, the National Community Reinvestment Coalition is releasing a comprehensive study today that appears to have found that large mainstream credit unions fail in their mission to serve people of modest means. You mentioned some of that in your remarks.

The study finds that credit unions make a lower portion of their home loans and more loan denials than banks make to minorities, women, and low-and moderate-income borrowers. NCRC is now asking that the Community Reinvestment Act be applied to these larger credit unions to ensure and to enforce their original commitment to serve people of lower means. I would like to have your response to that.

Mr. ENSWEILER. Thank you, Congressman.

We just became aware that they were going to have that press conference today to indicate their feelings. We certainly disagree with that.

Credit unions are still member-owned. They only serve the people in their community. That is the only opportunity they have.

They do not send money to money centers in other cities and take the money out of a community and use it for investments or loans in other communities. Credit unions have always only been able to serve their members, so they are serving everybody in their own community.

We also find that some of the methodology to that study might be flawed, at least in our view. So I would like to file with the committee our response to that report today because we do not think that it measures up to what credit unions really do.

Mr. HINOJOSA. Could you give us your response in writing?

Mr. ENSWEILER. Yes.

Mr. HINOJOSA. Okay. I would like to have the response by the Independent Community Bankers of America representative, the President and CEO of CountryBank, Terry Jorde. May I have your response?

Ms. JORDE. Sure, I would be glad to. Obviously the study that you have seen, we have seen also and we agree with that. In response to Mr. Ensweiler's comment, credit unions continue to serve their members because the membership base continues to grow. In North Dakota, we have mostly community-based credit unions and the one that is in my town covers about a 90-to 100-mile radius. So as long as the membership base continues to grow and the geographic restrictions continue to be lifted, then credit unions are going to continue to have more members. Obviously, they are serving more members because the pie is getting bigger.

We feel very strongly that small credit unions, people that are serving those of modest means, that they should continue to be supported and regulatory relief is certainly important for them. But we are very much opposed to expanding powers to credit unions, multi-billion dollar credit unions that are using their tax-favored advantages to grow and to continue to grow profits, which increase their capital levels and is part of the reason why they have capital issues right now.

Mr. HINOJOSA. I appreciate your response and would ask you if you would put that in writing also and let us have it.

Ms. JORDE. Certainly.

Mr. HINOJOSA. Mr. Chairman, I am going to yield back the balance of my time because the vote has already started, and I do not want to make anybody late. With that, I yield back.

Mr. HENSARLING. The Chair now recognizes the gentleman from North Carolina, Mr. Jones.

Mr. JONES. Mr. Chairman, thank you.

Mr. Ensweiler, I think you wanted to respond to that previous statement. I will yield you 1 minute of my time because I only have 3. So if you want to respond?

Mr. ENSWEILER. Thank you very much, Congressman.

I just wanted to say that in the information we will file, it shows that in 2003, credit unions approved 72.2 percent of home mortgage loans to low-income borrowers. By contrast, non-credit union lenders approved only 47.8 percent. Our denial rates were 15.6 percent compared to non-credit union lenders of 27.7 percent. So we really are reaching out and serving mortgage opportunities in low-income areas. Thank you.

Mr. JONES. Well, I want Ms. Jorde to know I was just being fair. I have not made my mind up on this issue yet.

But, Ms. Jorde, let me ask you, and I am very serious when I ask you this question. I first want to say that we are here today because we do want to reduce the regulatory burden on you so you can better serve the consumers and the customers that are in your banks and credit unions and ESOPs.

I am very serious when I ask you this question. In Cando, North Dakota, you have a unique situation, a small community, what would you say is the biggest concern of the customers who come into your bank? I am not talking just about credit cards. What do they tell you they are concerned about in America?

Ms. JORDE. I would say the biggest concern of my customers and people in my community is economic growth, is the viability of rural communities and our ability to retain young people who are educated in our State and in our communities. We need to continue to have ways to bring capital into those communities so that we can invest in businesses and offer good paying jobs that are competitive with what the larger cities are offering.

Mr. JONES. I appreciate that.

Mr. Chairman, I am going to make a statement, then I am going to close.

I am very impressed with this panel. I look forward to studying in detail what you have said today so I can be better informed and make my decisions.

This is my last point. I am not sure I want anybody to answer, but I am a conservative who is concerned about the debt and the deficit of this Nation, which will eventually impact on your business. This country right now is over $7.9 trillion in debt. You cannot operate in debt. The deficit is about $418 billion. Foreign governments own 30 percent of the U.S. public debt.

I share that with you because you are so important to the economic future of this country. I hope you will watch carefully what we are doing here in Washington because you will not be able to operate if this country continues to go down the road it is going right now.

With that, Mr. Chairman, I yield back the balance of my time.

Mr. HENSARLING. The Chair would observe that there are approximately 10 minutes left in this series of votes that have been called. So if members either wish to be brief or submit their questions for the record, they certainly have that option.

Otherwise, the Chair will yield to the gentleman from Texas, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

Thank you, members of the panel, for coming in.

Mr. Chairman, I will try to be as pithy and concise as possible. I will make every effort to cause the panelists not to be superfluous, nor will I try to cause them to be redundant in any way, given that we have 10 minutes left.

Members of the panel, I am concerned about the CRA. While there are always reasons to challenge studies, one of the things that I have found to be consistent in all of these studies is that they all show that when minorities attempt to make loans, and this is with testing, this is not a circumstance where you have persons

who some have higher education, some have more money, some are better qualified, but when you have capable, competent and qualified minorities who apply for loans. You have capable, competent, qualified persons who are not minorities to apply, and every single test indicates that the minority persons do not get the loans to the same extent that the others do.

Now, this is no disrespect to you. I believe you all to be honorable people. But that CRA, the Community Reinvestment Act, was put there to give us empirical data so that we could come to some intelligent conclusion as to what is happening in the business. If we start to limit the CRA for some banks, I am not sure where it ends. I have great consternation about changing the formula as it relates to reporting these lending patterns and habits.

With that said, I will welcome anyone to give me a terse and laconic response.

Mr. MACOMBER. No one here is looking to drop CRA. We just want to have a more reasonable approach to the regulation. We have two banks in our holding company. One is about $270 million. My bank is about $175 million. We fall under different CRA regulations under the FDIC, and yet there is certainly no less commitment by my bank to the community on the CRA basis than by my sister bank in the holding company.

CRA is what we do. The CRA exam that we do go through reviews all the statistics you are talking about, so that is all laid out. And we are concerned about what the burden is on smaller companies. Again, two banks, same holding company, two different ways of doing CRA.

Mr. GREEN. I want to thank you for your response because the chairman has indicated that our time is limited.

Mr. HENSARLING. Mr. Green, without objection, the rest of the panelists could insert their answers to the record.

At this time, the Chair would recognize the gentlelady from New York, Ms. Kelly.

Mrs. KELLY. Thank you, Mr. Chairman.

I have questions for this panel. Next week, I am holding a panel in my own subcommittee on the effect of the Bank Secrecy Act. I would like to have my questions answered by this panel as soon as possible, so perhaps they would be of influence in what we do with my own hearing next week.

Thank you very much for holding the hearing, Mr. Chairman.

Mr. HENSARLING. With approximately between 6 and 7 minutes left in this vote, the Chair now recognizes the gentlelady from Wisconsin, Ms. Moore.

Ms. MOORE OF WISCONSIN. Thank you, Mr. Chair.

I will reserve the right to make inquiries of this panel in writing, in respect to our time.

I certainly think that there has got to be a balance between regulatory reform and really providing services to the community. The home mortgage loan disclosures are extremely telling about the persistent lack of opportunity for women and minorities in lending.

Of course, homeownership is one of the most stabilizing economic decisions that people can make. In a time when we are faced with terrorism and money laundering, I think we have to be very careful about how we make those balances.

I would yield back.

Mr. HENSARLING. The Chair wishes to thank all of the panelists for their insightful testimony. We hate to question and run, but unfortunately we must.

The Chair notes that some members may have additional questions for the panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and place their responses in the record.

The hearing is adjourned.

[Whereupon, at 11:51 a.m., the subcommittee was adjourned.]

# A P P E N D I X

May 19, 2005

**OPENING STATEMENT OF**
**CHAIRMAN SPENCER BACHUS**
**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT**
**"FINANCIAL SERVICES REGULATORY RELIEF: PRIVATE SECTOR PERSPECTIVES"**
**MAY 19, 2005**

Good morning. Today's hearing on regulatory relief will provide representatives of the financial services industry with an opportunity to identify regulations that they consider outdated or not cost-effective. In addition, the witnesses will have a chance to offer their recommendations for alleviating the burdens imposed by those regulations.

The banking industry estimates that it spends somewhere in the neighborhood of $36 billion annually to comply with regulatory requirements imposed at the Federal and State levels. A large portion of that regulatory burden is justified by the need to ensure the safety and soundness of our banking institutions; enforce compliance with various consumer protection statutes; and combat money laundering and other financial crimes.

However, not all regulatory mandates that emanate from Washington, D.C. or other state capitals across the country are created equal. Some are overly burdensome, unnecessarily costly, or largely duplicative of other legal requirements. Where

examples of such regulatory overkill can be identified, Congress should act to eliminate them.

Under Chairman Oxley's leadership, this Committee has been dedicated to freeing depository institutions from unduly burdensome regulations as a way of both improving their productivity and enhancing their ability to meet the credit needs of their communities. In 2001, the Chairman requested that Federal and State financial regulators and financial services industry trade associations recommend legislative items that would provide regulatory relief for insured depository institutions. The goal was to reduce regulatory burden and improve productivity, as well as make needed technical corrections to current statutes. The initiative was also intended to counterbalance the significant compliance responsibilities placed on insured depository institutions by the USA PATRIOT Act as part of the government's effort to thwart terrorist financing. The Committee ultimately produced a comprehensive regulatory relief bill (H.R. 1375) that passed the House during the 108th Congress by a margin of 392-25.

While the Senate took no action on H.R. 1375, Mr. Hensarling and Mr. Moore, two Members of the Subcommittee, have indicated their intention to draft comprehensive regulatory relief legislation in this Congress that draws from the provisions of that bill. Other Members of the Subcommittee have introduced

legislation to afford regulatory relief to specific sectors of the financial services industry. On May 3, 2005, Mr. Ryun introduced H.R. 2061, the "Community Banks Serving Their Communities First Act," which contains regulatory and tax relief proposals targeted at small community banks.

Last week, Mr. Royce and Mr. Kanjorski introduced H.R. 2317, the "Credit Union Regulatory Improvements Act" (CURIA), which would modify credit union capital requirements and make other changes to credit union powers, governance, and regulatory oversight. I applaud the goals of these bills which would allow banks and credit unions to devote more resources to the business of lending to consumers and less to the bureaucratic maze of compliance with outdated and unneeded regulations.

I am now pleased to recognize the Ranking Member, Mr. Sanders, for an opening statement.

**Opening Statement**

## Congressman Paul E. Gillmor (R-OH)

**Subcommittee on Financial Institutions and Consumer Credit**

**May 19, 2005**

***Hearing entitled:*** *"Financial Services Regulatory Relief: Private Sector Perspectives."*

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I want to thank Chairman Bachus for calling this hearing today. There is no doubt that our regulatory structure has contributed to the United States becoming the model for the world when it comes to financial services, but without constant attention to the burdens of outdated regulation, the markets can be dragged down by unnecessary costs. Last Congress, the House passed H.R. 1375 with bipartisan support and I hope that this Congress, our Committee will again pass measures that provide regulatory relief to our banks, thrifts and credit unions.

Much of the problem with the current regulatory structure is that small banks are treated as large banks in a "one-size-fits-all" approach. Whether it is provisions of the USA-Patriot Act or Sarbanes-Oxley, small banks have faced enormous new cost in complying with regulations that may not have much benefit to our banking system.

I look forward to working with Chairman Oxley and Chairman Bachus in again passing regulatory relief measures so that our depository institutions may remain the most efficient in the world.

**05-19-05 Financial Services Committee Hearing on Regulatory Relief**

**HENSARLING:** Thank you, Mr. Chairman. Thank you for holding this important hearing. Thank you for your leadership in trying to help us reduce the regulatory burden on our nation's financial institutions.

When laws are passed and regulations are promulgated, we just cannot walk away from them, not unlike a ship that picks up barnacles, it has to be cleaned from time to time. The same is true of regulations. Many have costs that are passed on to the consumer in one form or fashion. Many outlive their purposes. Many have unintended consequences. The bottom line is that excessive and redundant and costly regulations can make credit more expensive and less accessible. They can keep Americans from purchasing their first home; buying a second automobile to go to work; financing their child's education; or maybe launching a small business that creates new jobs in a small town.

I believe with thoughtful regulatory relief, we can free up more capital for these valuable purposes without undermining safety and soundness. I think, Mr. Chairman, that we all know that the federal regulatory burden particularly falls disproportionately on our smaller banks and credit unions. These are institutions that typically have branches that are located in rural and more scarcely populated areas.

Let's look at just banks for a moment. Assuming that $1 billion in assets is the dividing line between small and medium-to-large banks, the total number of small banks has declined from roughly 12,000 at year's end in 1993 to a little over 8,000 at the end of 2003, in other words, a decline of almost one-third in just a decade. Now, I am sure there are a number of reasons for the mergers and consolidations that led to this decline, but from talking to folks in my home state of Texas, I am convinced that the cost and burden of federal regulation certainly ranks among the top reasons, and really one of the top challenges to their continued profitability and viability.

This is very worrisome because our smaller financial institutions are often the economic lifeblood of these small communities. Let me give you one example in my district. First State Bank of Athens, Texas, they make almost 100 charitable contributions a year to groups like the American Heart Association, Meals on Wheels, Disabled Veterans. They have funded close to $3 million for a 36-unit low- income housing unit for seniors. They fund Texas Ragtime, a key employer with 90 employees; Nelson's Henderson County Door, Futurematrix Medical Devices, creating hundreds of jobs in Henderson County, Texas.

But every dollar they spend on regulatory compliance is a dollar they cannot spend on Meals on Wheels or to fund capital improvements at Ragtime to create new jobs. The fact is that this one bank in Athens, Texas spends close to $500,000 annually on BSA compliance, Reg B, Reg E, Reg D, CRA, HMDA, HOPA, Reg O, and the list goes on and on and on.

We must ensure that the banking system, the financial system and the people of Henderson County, Texas are at least receiving $500,000 in value for the regulatory burden. I fear this may not be the case. For that reason, Mr. Chairman, I applaud you for holding this hearing. I thank you for doing it. I look forward to working with members of this committee, especially my colleague from Kansas, Mr. Moore, to draft a comprehensive bill that will put more resources into the hands of those on the frontlines of community lending and enable more American families to realize their dreams. I yield back.

**OPENING REMARKS OF THE HONORABLE RUBEN HINOJOSA**
**COMMITTEE ON FINANCIAL SERVICES**
**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT**
**"FINANCIAL SERVICES REGULATORY RELIEF:**
**PRIVATE SECTOR PERSPECTIVES"**
**MAY 19, 2005**

Thank you Mr. Chairman, I will be very brief. I am pleased that the Subcommittee is proceeding with the first in what I imagine will be a number of hearings on regulatory relief. I imagine these hearings are a precursor to an eventual markup of legislation Congressman Hensarling and Congressman Moore intend to draft that will cull from previous regulatory relief bills this Committee and Congress have considered and passed.

I am aware that Congressman Ryun introduced H.R. 2061, the "Community Banks Serving Their Communities First Act." I am reviewing the provisions of this legislation very carefully to decide whether to cosponsor this very comprehensive legislation. I am also reviewing H.R. 2317, the "Credit Union Regulatory Improvements Act (CURIA)," that Congressman Royce and Congressman Kanjorski introduced last week, especially the bill's provisions that differ from the CURIA legislation introduced in the 108th Congress.

I am paying particular attention to the provisions in the bill that would increase credit unions' commercial lending limit from 12.5 percent to 20 percent.

Mr. Chairman, I recognize that it is our community banks and credit unions that allow the small businesses and constituents in my District to enter into the financial system and generate economic wealth, create jobs, and raise the standard of living for everyone.

I am very interested in helping to craft legislation that is both fair to consumers and that reduces the regulatory burden imposed on the financial services sector. Reducing certain regulatory burdens imposed on our financial institutions will, in fact, boost our economy. However, I fear that passing legislation that were to contain provisions giving one part of the financial services sector an advantage over the others must be avoided at all cost.

I look forward to hearing the testimony of our witnesses today, and I look forward to working with my colleagues on comprehensive regulatory reform legislation in the near future.

Having said that, Mr. Chairman, I yield back the balance of my time.

Opening Statement
Rep. Carolyn Maloney
Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
"Financial Service Regulatory Relief: Private Sector Perspectives"
Thrusday, May 19, 2005

Thank you Chairman Bachus and Ranking Member Sanders and I welcome the witnesses. As a representative of New York City, the financial center of the United States, I am particularly concerned about the burdens that regulation and reporting requirements impose on our financial institutions, particularly those that are not mega-institutions but are mid-size and smaller. I know the vast majority of my colleagues on both sides of the aisle share this concern.

Last year, we passed a regulatory relief bill by an overwhelming majority in the House but it died in the other body. I voted for that bill, although I thought it could use some improvement and this bill is improved by the addition of several provisions dealing with issues that were of special concern to me, such as the extraordinary burdens of compliance with the new Bank Secrecy Act provisions.

Wherever I go in my district, smaller financial institutions tell me how hard and costly it is to comply with the requirements of the Bank Secrecy Act to file CTRs [Currency Transaction Reports] and SARs [Suspicious Activity Reports] and to comply with the Patriot Act Know Your Customer requirements. The burdens are particularly heavy on the smaller institutions for whom the costs of compliance are a much higher proportion of their resources.

This bill includes a new section that addresses these concerns. It is not perfect but it is a first step in the right direction. Similarly, this bill contains some of the provisions of HR 2317, the Credit Union Regulatory Improvement Act, which I have cosponsored and vigorously supported in several incarnations. I hope we can also move forward to pass the remaining portions of CURIA, especially the reforms to the Prompt Corrective Action system, and the conversion provisions. I look forward to the testimony.

Rep. Dennis Moore
Opening Statement
Regulatory Relief Hearing
May 19, 2005

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- I would like to thank my good friend, Chairman Bachus, for scheduling today's hearing on regulatory relief measures for depository institutions in this country.

- I look forward to working on legislation in this area with Congressman Hensarling in the weeks and months ahead, and look forward to hearing suggestions from our witnesses today on how we can reduce the regulatory burden on financial institutions.

- This subcommittee and the full committee both passed the reg. relief bill by voice vote during the 108th Congress, and the House passed it one year ago by a wide margin [392-25].

- I hope that we can continue the broad bipartisan cooperation on this legislation that we have enjoyed in the past.

- Regulatory relief should not be about Republicans and Democrats, it should be about doing the right thing for the lenders in our communities who have played such an important role in expanding home ownership and creating opportunities for businesses and consumers.

- Thank you again Mr. Chairman, and I look forward to hearing from the witnesses.

**Opening Statement**
**Rep. Ed Royce (CA-40)**
**19 May 2005**
**Regulatory Relief Hearing**

Mr. Chairman, thank you for holding this hearing to address the issue of regulatory relief for the financial services industry, a measure that I believe is constructive, well-reasoned and long overdue. For far too long, Congress has burdened our country's federally-chartered banks, thrifts and credit unions with well-intentioned but onerous and often outdated rules and regulations, preventing them from operating as efficiently and competing as effectively as they could. I support the efforts of this Subcommittee to reduce these unnecessary burdens.

One week ago Rep. Paul Kanjorski and I introduced H.R. 2317, the Credit Union Regulatory Improvements Act or "CURIA," which is an updated version of legislation we first offered in the 108th Congress. As of this morning, I am pleased to announce we already have garnered the support of 27 cosponsors from members of both parties.

CURIA in the 109th Congress contains significant modifications regarding the applicable prompt corrective action (PCA) standards and net worth requirements for credit unions. The most important changes replace the capital reform language contained in Title III of H.R. 3579 with the more comprehensive and robust capital provisions incorporated into Title I of the new CURIA. Title I of the new CURIA now contains the PCA capital reforms recently recommended by the National Credit Union Administration (NCUA), which oversees federally chartered credit unions and administers the National Credit Union Share Insurance Fund. The new PCA provisions in CURIA are modeled after FDIC capital standards applicable to banks and thrifts.

I am pleased to see that the testimony of one of our witnesses today will lay-out more specifics on our legislation -- so in the interest of time -- I would just ask that as this Committee addresses regulatory relief provisions for financial institutions, I hope that the Chairman and other members strongly consider the needed reforms Mr. Kanjorski and I have put forward for credit unions.

I would like to thank the Chairman for the opportunity to speak on behalf of my legislation. I look forward to the testimony of our witnesses today and yield back.

Opening Statement
Rep. Jim Ryun
May 19, 2005

Thank you, Mr. Chairman. I appreciate you holding this hearing on regulatory relief for our financial institutions. I believe that institutions across the spectrum of the financial services industry do a remarkable job of serving our communities and making our financial services infrastructure the envy of the world.

I believe that virtually all segments of the industry are in need of some form of regulatory relief, which is why I am pleased to see this effort begin to again move forward. I am grateful to my colleagues on this committee for spearheading the debate, and specifically to Mr. Hensarling and Mr. Moore for making this issue a priority.

I am pleased to make a contribution to this debate by sponsoring HR 2061, the Communities First Act, which will provide targeted regulatory relief for community banks and their customers.

I wholeheartedly supported HR 1375 in the last Congress. HR 1375 was a comprehensive regulatory relief bill, and provides us a good starting point as we again address the issue. However, I believe there are additional measures that should be added to assist our community banks in their service to small towns and rural communities in America.

The Community First Act is intended to call attention to the needs of customers who use these community banks. Specifically, I believe that it is important to identify areas where resources could be better used for serving customers than for compliance with burdensome or unnecessary regulations. As

this broader regulatory relief effort moves forward, I encourage this committee to have a similar focus on serving the needs of the consumer.

I also want to say that my intent for introducing HR 2061 is to supplement the debate that we are having today. I have some concerns that I believe should be addressed and will work to have those concerns included in a comprehensive package that moves forward. I am certainly supportive of the broader effort, as I believe that a comprehensive approach is appropriate and needed. I look forward to participating in this debate and helping my colleagues craft the best bill possible.

Today, I look forward to hearing from our distinguished panel. I have had the opportunity to work with all of the organizations represented, and I thank each of you for joining us today to provide your advice and insight as we continue this process. I am confident that we will be able to address many of the concerns that each of your organizations have.

Thank you again, Mr. Chairman, and I yield back.

## STATEMENT BY REP. BERNARD SANDERS AT THE REGULATORY RELIEF HEARING (ALSO FOCUSING ON ESOPS) THURSDAY, MAY 19, 2005 AT 10AM IN 2128 RHOB

Mr. Chairman, thank you for holding this important hearing. I would also like to welcome our witnesses today.

The focus of this hearing is on providing regulatory relief to financial institutions which this Committee has tried on several occasions to accomplish.

Mr. Chairman, let me begin by saying that I do believe credit unions are one of the most highly regulated and restricted of all depository institutions in this country. To ease these regulatory burdens and help credit unions succeed in the 21st century, I am pleased to be an original co-sponsor of the Credit Union Regulatory Improvement Act (CURIA) introduced by Congressmen Ed Royce and Paul Kanjorski, and the Credit Union Net Worth Amendment Act introduced by the Chairman. Among other things, CURIA will expand credit union investments in small businesses and create decent-paying jobs. The Credit Union Net Worth Amendment Act will also update statutory language to conform to new accounting practices for mergers of credit unions. I look forward to working with everyone on this Committee to advance these bills.

But, Mr. Chairman, I do not understand why large banks that have been making record breaking profits for the past 5 consecutive years need further regulatory relief; while consumers who are over $2 trillion in debt, also a record, are far too often left out of the mix.

Having said that, Mr. Chairman, I would be pleased to work with you on regulatory relief legislation, if we can also include a provision to expand employee ownership in this country.

Let me give you an example of what I am talking about. Last night, I introduced the Employee Ownership Opportunity Act with Representatives Don Manzullo, Carolyn Maloney, Dana Rohrabacher, and Barbara Lee. This legislation would provide a Community Reinvestment Act credit to financial institutions that offer assistance to employees to establish Employee Stock Ownership Plans (ESOPs) or Eligible Worker Owned Cooperatives (EWOCs).

Mr. Chairman, providing a CRA credit for the expansion of employee ownership is, I believe, a win-win. It will be good for banks looking for new ways to fulfill their CRA requirements, and it will be good for workers who would like to own their own businesses. In addition, Mr. Chairman, workers who are also owners will not ship their own jobs overseas in search of cheap labor. And, importantly, this bill will not cost taxpayers one dime.

Mr. Chairman, when we are talking about employee ownership we are talking about protecting and creating decent-paying jobs in this country.

Over the past 4 years, the United States has lost more than 2.7 million manufacturing jobs and one million high tech jobs. In addition, according to Forrester Research, "Over the next 15 years, 3.3 million U.S. service industry jobs and $136 billion in wages will move offshore to countries like India, Russia, China and the Philippines."

Mr. Chairman, many of these jobs could be saved by giving employees the tools they need to own their own businesses through employee stock ownership plans (ESOPs) and eligible worker owned cooperatives.

Broad-based employee ownership has been proven to increase employment, increase productivity, increase sales, and increase wages in the United States. According to a Rutgers University study, broad based employee ownership boosts company productivity by 4%, shareholder return by 2% and profits by 14%. Similar studies have shown that ESOP companies paid their hourly workers between 5 to 12 percent better than non-ESOP companies.

Mr. Chairman, last Congress, I thought that one of the most interesting hearings in our Subcommittee dealt with the issue of employee ownership, and I was delighted that we were able to work together on that hearing.

Another person who remembers that hearing well is also here with us again today on the witness panel: Michael Keeling with the ESOP Association. Mr. Keeling also testified at our last employee ownership hearing and we look forward to his testimony.

So, Mr. Chairman, when we are talking about introducing broader regulatory relief to the financial services industry, I hope we can also include expanding employee ownership as an essential component of this bill. I thank the Chairman, and I look forward to hearing from our witnesses.

**CUNA & Affiliates**

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**WRITTEN TESTIMONY**
**OF**
**RICHARD ENSWEILER**
**PRESIDENT & CEO, TEXAS CREDIT UNION LEAGE**
**AND**
**CHAIRMAN, CREDIT UNION NATIONAL ASSOCIATION**
**ON BEHALF OF THE**
**CREDIT UNION NATIONAL ASSOCIATION**
**ON**
**"FINANCIAL SERVICES REGULATORY RELIEF:**
**PRIVATE SECTOR PERSPECTIVES"**
**BEFORE THE**
**HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS**
**AND CONSUMER CREDIT**

**May 19, 2005**

**WRITTEN TESTIMONY**
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**AND CONSUMER CREDIT**

**May 19, 2005**

Chairman Bachus, Ranking Member Sanders, and other members of the Subcommittee, on behalf of the Credit Union National Association (CUNA), I appreciate this opportunity to come before you and express the association's views on legislation to help alleviate the regulatory burden under which all insured financial institutions operate today.

CUNA is the largest credit union advocacy organization, representing over 90% of our nation's approximately 9,000 state and federal credit unions and their 86 million members.

I am Richard Ensweiler, President & CEO of the Texas Credit Union League, and Chairman of CUNA. The Texas Credit Union League represents over 600 credit unions throughout the state.

CUNA is especially pleased that the Subcommittee is continuing its efforts to provide regulatory relief of unneeded and costly burdens. Some might suggest that the Credit Union Membership Access of 1998[1] (CUMAA) was the credit union version of regulatory relief. While that law did provide relief from an onerous Supreme Court decision, it also imposed several new, stringent regulations on credit unions, which, in spite of assertions to the contrary, are the most stringently regulated of insured financial institutions.

**Credit Unions Are Distinct Financial Institutions**

Among its numerous provisions, the CUMAA required 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 study, "Comparing Credit Unions with Other Depository Institutions," found that while "credit unions have certain characteristics in common with banks and thrifts, (e.g., the intermediation function), they are clearly distinguishable from these other depository institutions in their structure and operational characteristics."

[1] Pub. L. No. 105-219 Sec. 401; 112 Stat. 913 (1998); 12 USC 1752a note and 1757a note

These qualities, catalogued by the U.S. Treasury in its 2001 study, had been previously incorporated into the congressional findings of the Federal Credit Union Act[2] when CUMAA was adopted in 1998.

Recognition and appreciation of such attributes is critical to the understanding of credit unions, as Congress made it clear when it amended the Federal Credit Union Act in 1998 that it is these characteristics that form the foundation on which the federal tax exemption for credit unions rests. As Congress determined when it passed CUMAA:

"Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are:

1. member-owned,
2. democratically operated,
3. not-for profit organizations,
4. generally managed by volunteer boards of directors, and
5. because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means."

While other institutions, such as mutual thrifts, may meet one or two of these standards or display some of these differences, other credit union distinctions listed here do not necessarily apply. As Treasury noted in its study, "Many banks or thrifts exhibit one or more of ...(these) characteristics, but only credit unions exhibit all five together." [3]

Other 1998 congressional findings in the Federal Credit Union Act 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.

Since their inception, credit unions continue to share these unique attributes, separating them from other depository institutions. Despite the frequent attempts of detractors to present credit unions in a false light and label them as other types of institutions, the distinct characteristics of credit unions have been recognized in statute and in analytical reports from the U.S. Treasury and others. Further, despite repeated attempts, legal challenges brought by banking groups against the National Credit Union Administration's (NCUA) field of membership policies under CUMAA have not proved fruitful.

As unique institutions, credit unions today stand distinctly in need of regulatory relief.

**Credit Unions' Regulatory Burden Is *Real* And Relief Is Imperative**

As cooperative financial institutions, credit unions have not been shielded from the mounting regulatory responsibilities facing insured depositories in this country.

[2] P. L. 105-219, Sec. 2, 112 Stat. 913

[3] U.S. Dept. of the Treasury, *Comparing Credit Unions with Other Depository Institutions, (Wash. DC: 2001.)*

Last year, Federal Deposit Insurance Corporation (FDIC) Vice Chairman John M. Reich said in testimony before the House Subcommittee on Financial Institutions and Consumer Credit, "regulatory burden is a problem for all banks." His statement is accurate as far as it goes.

Regulatory burden is an issue for all financial institutions generally, and credit unions in particular. Indeed, credit unions **are the most heavily regulated of all financial institutions.** This dubious distinction is the result of several factors, which include:

- Credit unions operate under virtually the same consumer protection rules, such as Truth-Lending, Equal Credit Opportunity, Home Mortgage Disclosure, Real Estate Settlement Procedures Act, Truth-in-Savings, Expedited Funds Availability Act, USA Patriot Act, Bank Secrecy, safety and soundness including prompt corrective action (PCA) regulations reviewed by Treasury, and other rules that apply to banks. Credit unions will also have to comply with developing rules under the Fair and Accurate Credit Transactions (FACT) Act and the Check 21 statutory requirements. A list of the 137 rules that federal credit unions must follow is attached.

  In addition:

  (1) Credit unions are the only type of financial institution that have restrictions on whom they may serve;
  (2) Credit unions are the only group of financial institutions that must comply with a federal usury ceiling;
  (3) Credit unions may not raise capital in the marketplace but must rely on retained earnings to build equity;
  (4) Credit unions are the only group of financial institutions that must meet statutory net worth requirements;
  (5) Credit unions face severe limitations on member business lending;
  (6) Credit unions have limitations on loan maturities;
  (7) Credit unions have stringent limitations on investments;
  (8) Credit unions have not been granted new statutory powers, as banks have under Gramm-Leach Bliley; and
  (9) Credit unions' operations and governance are inflexible because many aspects are fixed in statute.

Most importantly for credit unions, time and other resources spent on meeting regulatory requirements are resources that would otherwise be devoted to serving their members – which is, after all, their primary objective.

**With Few Exceptions, Credit Unions Must Comply with Virtually All Bank Rules**

Despite unfounded banker charges to the contrary, federally insured credit unions bear an extraordinary regulatory burden that is comparable to that of banks in most areas and much more restrictive in others.

As the Treasury's 2001 study comparing credit unions with other institutions concluded, "Significant differences (in the general safety and soundness regulation of banks and credit unions,

parenthesis added) have existed in the past, but have been gradually disappearing." The Treasury study cited PCA and net worth requirements for credit unions as a major regulatory difference that was removed in 1998.

Treasury further noted that their "relative small size and restricted fields of membership" notwithstanding, "federally insured credit unions operate under bank statutes and rules virtually identical to those applicable to banks and thrifts."

**Credit Unions Must Comply With Substantial Requirements Banks Don't Have to Follow**

In addition to following rules applicable to the banking industry, credit unions operate under considerable statutory and regulatory requirements that do not apply to other types of financial institutions.

As Treasury's study pointed out, credit union statutory net worth requirements direct federally insured credit unions to maintain a minimum of 6% 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% net worth ratio. "(T)his exceeds the 4% Tier 1 level ratio applicable for banks and thrifts (and is statutory as opposed to regulatory)," Treasury stated. Complex credit unions have additional net worth requirements.

Treasury's analysis also 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. In addition, a usury ceiling prevents them from charging more than 18% on any loan, and the term of many types of loans may not extend beyond twelve years."

Credit unions also have statutory and regulatory restrictions as to whom they may serve. Federal credit unions' fields of membership must meet the common bond requirements that apply to an associational, occupational, multi-group or community credit union. Thus, unlike banks and thrifts, which may serve anyone regardless of where they live or work, a credit union may only offer its services to individuals within its field of membership.

Credit unions operate under heavily constrained investment authority as well. A federal credit union may invest in government securities and other investments only as provided under the Federal Credit Union Act and authorized by NCUA.

Credit unions also must comply with limitations on lending, including member business lending. A federal credit unions' member business loan (MBL) 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% of their total assets in commercial loans.

It is useful to note that there are other limitations on credit unions' member business lending that do not apply to commercial banks. A credit union's MBLs must generally meet 12-year maturity limits and can only be made to members. Credit union MBLs have significant collateral and while not required, often carry the personal guarantee of the borrower.

Commercial banks have a variety of mechanisms through which they can raise funds, including through deposit-taking or borrowing funds in the capital markets. In marked contrast, credit unions may only build equity by retaining earnings. A credit union's retained earnings are collectively owned by all of the credit unions' members, as opposed to a bank that is owned by a limited number of stockholders or in some cases, by a finite number of individuals or family members.

Thus, a major distinction between credit unions and commercial banks is that credit unions operate under a number of specific, operational regulations that do not apply to banks. Bank trade associations attempt to mislead Congress when they erroneously argue that credit unions have evolved into banks. The restrictions on credit union operations and the limitations on their activities drive a stake into the heart of that argument.

**Unlike Banks, Credit Unions Have Not Received New Statutory Powers**

Not only have credit unions not received new statutory powers as banks have, severe regulatory constraints on member business lending and under PCA have been imposed on credit unions for the last several years.

An important study regarding the regulation of credit unions was published in 2003 under the auspices of the Filene Research Institute and addresses the regulatory advantages banks have over credit unions.

Authored by Associate Professor of Economics William E. Jackson, III, Kenan-Flagler Business School, University of North Carolina at Chapel Hill and entitled, "The Future of Credit Unions: Public Policy Issues,"[4] the study 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.

For example, 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 this sweeping, statutory expansion of bank powers. However, while they received neither benefits nor new powers under the Gramm-Leach-Bliley Act, credit unions 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.

[4] Jackson, III, William E., University of North Carolina-Chapel Hill. ***The Future of Credit Unions: Public Policy Issues, 2003.***

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.

**Pending Credit Union Regulatory Improvements Legislation That CUNA Supports**
CUNA strongly supports H.R. 2371, the Credit Union Regulatory Improvements Act (CURIA), which was recently introduced by Representatives Royce and Kanjorski. In the 108th Congress, CUNA had also endorsed the House-passed Regulatory Relief Act, which was approved by the House of Representatives on March 18, 2004, by a vote of 392-25.

You may have heard of the recent conversions of two of our credit unions in Texas to mutual banks. Credit unions, as democratically controlled financial institutions, have the right to change their charter if voted on favorably by the membership. However, we believe if most of the provisions in CURIA, including PCA reform and changes to member business lending limitations, were currently in effect, the conversions would not have been necessary.

In our view, these bills provide an excellent starting point for the House Financial Institutions Subcommittee as it considers real reforms that will provide regulatory relief to credit unions and other institutions.

While CUNA also supports other statutory changes, we first want to focus on amendments to the Federal Credit Union Act--all of which CUNA has endorsed--that are contained in the newly introduced H.R. 2371.

**H.R. 2371—The Credit Union Regulatory Improvements Act**
Although this legislation goes beyond what was included in the Regulatory Relief measure that passed the House last year, it nevertheless provides a sound foundation for this Subcommittee's consideration of some fundamental problems facing credit unions today and we ask you to take a close look at these proposed changes as incorporated in CURIA. This portion of my testimony will describe the different sections of CURIA, followed by an explanation of why CUNA strongly supports the proposed and necessary changes.

**H.R. 2371, THE CREDIT UNION REGULATORY IMPROVEMENTS ACT OF 2005--SECTION-BY-SECTION DESCRIPTION**

**TITLE I: CAPITAL REFORM**

CUNA strongly supports this title, which reforms the system of PCA 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.

**Section 101. Amendments to 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. This section would continue to specify net worth requirements, but at levels more appropriate for credit unions and comparable to those currently in effect for banking institutions.

**Section 102. Amendments Relating to Risk-Based Net Worth Categories**
Currently, federally insured credit unions that are considered "complex" must meet a risk-based net worth requirement. This section would require all credit unions to meet a risk-based net worth requirement, and directs 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.

**Section 103. Treatment Based on Other 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 of Section 102 deal only with credit risk. This section would permit delegation 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.

**Section 104. 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 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. This section addresses that anomaly and defines net worth for purposes of PCA to include the new component for post-merger credit unions.

It was our understanding that FASB intended to apply the standard to credit unions beginning in early 2006, following a comment period, but now may be putting application of the standard off until the beginning of 2007. Such a change, we believe, 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. Senior legal staff at FASB have indicated support for a legislative approach, and we urge the Subcommittee to likewise support such an effort, well in advance of the effective date so credit unions will have certainty regarding the accounting treatment of mergers.

Legislation was introduced by Representative Bachus to address this issue in H.R. 1042, the "Net Worth Amendment of Credit Unions Act," which received a hearing from this Subcommittee on April 13, 2005, and is pending further action. We are grateful to Chairman Bachus and members of the Full Committee for recognizing the importance and urgency of this matter. The correction of this issue is identical in H.R. 1042 and H.R. 2371.

Also in this section, the definition of secondary capital for low-income credit unions is expanded to include certain limitations on its use by those credit unions. The definition of the net worth ratio is

modified to exclude a credit union's share insurance fund deposit from the numerator and denominator of the ratio, and the ratio of net worth to risk-assets is defined, also to exclude a credit union's share insurance fund deposit from the numerator.

**Section 105. Amendments Relating to Net Worth Restoration Plans**
Section 105 would provide the NCUA Board with 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.

This section would also modify the required actions of the Board in the case of critically undercapitalized credit unions in several ways. First, it would authorize the Board to issue an order to a critically undercapitalized credit union. Second, the timing of the period before appointment of a liquidating agent could be shortened. Third, the section would clarify the coordination requirement with state officials in the case of state-chartered credit unions.

The following is a detailed discussion of the need for and logic of PCA reform.

**HISTORY OF CREDIT UNION PCA**

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 Section 1790d (PCA) of the Act 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 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. Chief among these is that 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. Further, the levels of the net worth ratio for a credit union to be classified "well" or "adequately" capitalized are two percentage points (200 basis points) above those currently in place for banks and thrifts, even though credit unions' activities are far more circumscribed that those of banks. In addition, 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 is instead dealt with through examination and supervision.

**NEED FOR REFORM OF CREDIT UNION PCA**

Net worth requirements were not the original purpose of the CUMAA. The genesis of the Act was the Supreme Court's field of membership decision of 1998 that prohibited NCUA from approving

credit union fields of membership comprising more than one group. Since its adoption seven 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.

There are two basic problems with the current PCA system.

- **HIGH BASIC CREDIT UNION CAPITAL REQUIREMENTS.** Credit unions have significantly higher capital requirements than do banks, even though the credit union 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.

- **RISK BASED 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 unartful system weakens the measurement of the NCUSIF's exposure to risk, and provides blurred incentives to credit unions on how to arrange their balance sheets so as to minimize risk. A Basel-type method of applying different weights to asset types based on the asset's risk profile would permit a more precise accounting for risk than does the current credit union 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 net worth ratios 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 that drive the credit union system's PCA requirements.

Under the current system of PCA, there are many credit unions that have more than enough capital to operate in a safe and sound manner, but that feel constrained in serving their members because potential reductions in their net worth category can result from growth in member deposits, even when uninduced by the credit union. The current law stipulates that a credit union with a 6% 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% is more than adequate net worth. However, 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% 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.

We are not here describing credit unions that aggressively and imprudently go after growth, just for growth's sake. Rather, 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). The resulting cautionary deposit building or flight to safely 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% in 2000 to over 15% in 2001 despite the fact that credit unions lowered deposit interest 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 September 11th.

Credit union concern about the impact of uninduced growth on net worth ratios goes far beyond those credit unions that are close to the 6% cutoff for being considered adequately capitalized. Again, because of the conservative management style that is the product of their cooperative structure, most credit unions wish always to be classified as "well" rather than "adequately" capitalized. In order to do that, they must maintain a significant cushion above the 7% level required to be "well" capitalized so as not to fall below 7% after a period of rapid growth. A typical target is to have a 200 basis point cushion above the 7% standard. Thus, in effect, the PCA regulation, which was intended to ensure that credit unions maintain a 6% adequately capitalized ratio, has created powerful incentives to induce credit unions to hold net worth ratios roughly 50% 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 these 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. CUNA believes that credit unions should have greater access to such secondary capital. However, this bill does not provide access to secondary capital.

The other solution is reform of PCA requirements themselves. Reform of PCA 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, a reformed PCA 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.

H.R. 2317 would reform 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.

Under H.R. 2317, 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. The tables below show the ratio cutoff points for the various net worth classifications. 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% |
| Signif. Undercapitalized | 2% to < 3% | < 6% |
| Critically Undercapitalized | <2% | NA |

The net worth cutoff points specified in H.R. 2317 are substantially similar to those currently in effect for FDIC insured institutions, yet, 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 is included in the numerator of the ratio; the NCUSIF deposit is first 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.

H.R. 2317 would require NCUA 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 when 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 when Basel II lowers net worth requirements for the very large institutions. Thus, it will be the modified version of Basel I in place for smaller banks that will be the standard under which NCUA will construct a risk weighting system for credit unions. Since it will be Basel based, it will focus on credit risk, leaving the treatment of interest rate risk to the supervisory process. The new credit union risk-based system will provide a much more precise measure of balance sheet risk than the current risk-based net worth requirement.

H.R. 2317 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:

1. One of the original justifications for higher credit union PCA net worth requirements (higher than for banks) was the 1% NCUSIF deposit. While FASB and NCUA have both affirmed that the 1% NCUSIF deposit is an asset and thus part of net worth, as a result of the unique funding mechanism of the NCUSIF (it has been funded solely by credit unions), the 1% deposit appears on the books of both the NCUSIF and insured credit unions. H.R. 2317 has addressed this issue by defining the net worth ratio as net worth less the 1% NCUSIF deposit divided by assets less the 1% deposit. Thus, to be adequately capitalized, a credit union must hold net worth equal to about 5.7% (on average) of its assets to meet the 5% net worth requirement. This means that the discretionary and mandatory supervisory actions of PCA will be applied at higher levels of individual credit union capitalization than for similarly situated banks and thrifts.

2. Another reason given for credit unions' higher net worth requirements is their lack of access to capital markets. Credit unions' only source of net worth is the retention of earnings, which is a time consuming process. The idea was that since credit unions cannot access capital markets, they 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.

3. The other reason that a credit union's net worth ratio might fall – rapid asset growth – does not require higher net worth requirements for credit unions either. Asset growth (which comes from savings deposits) can 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 which would not occur had dividend rates been lowered. H.R. 2317 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.[5] 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

[5] See *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers*, Edward J. Kane and Robert Hendershott, Journal of Banking and Finance, Volume 20, September 1996, pp.1305-1327. Kane and Hendershott summarize their paper as "the paper analyzes how differences in incentive structure constrain the attractiveness of interest-rate speculation and other risk-taking opportunities to managers and regulators of credit unions." See also *Differences in Bank and Credit Union Capital Needs,* David M. Smith and Stephen A. Woodbury (Filene Research Institute, Madison, WI. 2001) Smith and Woodbury find that credit unions have lower loan delinquencies and net-charge off rates than do banks, and that charge-offs at credit unions are only two-thirds as sensitive to macroeconomic shocks as they are at banks. They also explain that because of the governance structure in credit unions "economic theory predicts that credit unions would take less risk than banks." (p. 5)

comparable statistics for banks and thrifts. Similarly, the equity ratio of the NCUSIF has been remarkably stable, between 1.2% and 1.3%, 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 provided in H.R. 2317 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.

**TITLE II: ECONOMIC GROWTH**

**Section 201. Limits on Member Business Loans**
This section eliminates the current asset limit on MBLs 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 and replaces it with a flat rate of 20 percent of the total assets of a credit union. This provision therefore facilitates member business lending without jeopardizing safety and soundness at participating credit unions.

**Section 202. Definition of Member Business Loans**
This section would amend the current definition of a MBL to facilitate such loans by giving the NCUA the authority to exclude loans of $100,000 or less as de minimus, rather than the current limit of $50,000.

**Section 203. Restrictions on Member Business Loans**
This section would modify language in the Federal Credit Union Act that currently prohibits a credit union from making any new MBLs if its net worth falls below 6 percent. This change will permit the NCUA to determine if such a policy is appropriate and to oversee all MBLs granted by an undercapitalized institution.

**Section 204. Member business loan exclusion for loans to non-profit religious organizations**
This section excludes loans or loan participations by federal credit unions to non-profit religious organizations from the MBL limit contained in the Federal Credit Union Act, which is 12.25% of the credit union's total assets. This amendment would offer some relief in this area by allowing federal credit unions to make MBLs to religious-based organizations without concern about the statutory limit that now covers such loans. While the limit would be eliminated, such loans would still be subject to other regulatory requirements, such as those relating to safety and soundness.

We believe that this is really a technical amendment designed to correct an oversight during passage of CUMAA. The law currently provides exceptions to the MBL caps for credit unions with a history of primarily making such loans. Congress simply overlooked other credit unions that purchase parts of these loans, or participate in them. This provision would clarify that oversight and ensure that these organizations can continue meeting the needs of their members and the greater community at large and ensuring that loans are available for religious buildings as well as their relief efforts.

**Section 205. Credit Unions Authorized to Lease Space in Buildings with Credit Union Offices in Underserved Areas**

This section enhances the ability of credit unions to assist distressed communities with their economic revitalization efforts. It would allow a credit union to lease space in a building or on property in an underserved area on 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, then lease out excess space in that building.

Having described briefly how CURIA would address credit union member business lending concerns, I would like to provide the Subcommittee with a detailed rationale for these needed changes.

**HELPING SMALL BUSINESS**

Title II, Section 203 of CUMAA established limits on credit union MBL activity. There were no statutory limits on credit union member business lending prior to 1998. 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 (i.e., 7%) can be counted. Hence the limit is (1.75 x .07) or 12.25% of assets.

**NEED FOR REFORM OF CREDIT UNION MBL LIMITS**

Small businesses are the engine of economic growth – accounting for about one-half of private non-farm economic activity in the U.S. annually. Their ability to access capital is paramount. But this access is seriously constrained by the double-whammy of banking industry consolidation and the CUMAA-imposed limitations on credit union MBLs. 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 held by the largest banks. FDIC statistics show that the largest 100 banking institutions now control nearly two-thirds of banking industry assets nationally. In 1992 the largest 100 banking institutions held just 45% of banking industry assets. Thus, CUMAA severely restricts small business access to credit outside the banking industry at a time when small firms are finding increasing difficulty in accessing credit within the banking industry.

Basic problems with the current MBL limits are:

- **THE LIMITS ARE ARBITRARY AND UNNECESSARILY RESTRICTIVE.** Insured commercial banks have no comparable business lending portfolio concentration limitations. Other financial institutions, savings and loans, for example, have portfolio concentration limitations, but those limitations are substantially less restrictive than the limits placed on credit unions in CUMAA.

- **THE 12.25% LIMIT DISCOURAGES ENTRY INTO THE MBL BUSINESS.** Even though very few credit unions are approaching the 12.25% ceiling, the very existence of that ceiling discourages credit unions from entering the field of member business lending. 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% 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 (e.g., data processing systems, furniture and equipment, printing, postage, telephone, occupancy, credit reports and other operating expenses) make member business lending unviable at most credit unions given the current 12.25% limitation. In fact, assuming credit unions could carry salary expense of 2% of portfolio, 76% of CUs couldn't afford to be active member business lenders even if they had portfolios that were equal in size to the current 12.25% of asset maximum. Alternatively, assuming credit unions could carry salary expense of 4% of portfolio, 63% of CUs couldn't afford to be active member business lenders even if they had portfolios that were equal in size to the current 12.25% of asset maximum.

- **THE LIMITS ARE NOT BASED ON SAFETY AND SOUNDENSS CONSIDERATIONS.** There is no safety and soundness reason that net worth above 7% cannot also support business lending. If all net worth could be counted, the actual limit would average between 18% and 19% of total assets rather than 12.25% of total assets.

- **THE MBL DEFINITIONS CREATE DISINCENTIVES THAT HURT SMALL BUSINESSES.** The current $50,000 cutoff for defining an MBL is too low and creates a disincentive for credit unions to make loans to smaller businesses. Permitting the cutoff to rise to $100,000 would open up a significant source of credit to small businesses. These "small" business purpose loans are so small as to be unattractive to many larger lenders. Simply inflation adjusting the $50,000 cutoff, which was initially established in 1993 and hasn't been adjusted since that time, would result in an approximate 33% increase in the cutoff to over $65,000.

While some bankers call credit union member business lending "mission creep" this is simply a preposterous fiction. Credit union member business lending is not new -- 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 U.S. Treasury Department study, credit union business lending is more regulated than commercial lending at other financial institutions. In addition, the Treasury found that "member business loans are generally less risky than commercial loans made by banks and thrifts because they generally require the personal guarantee of the borrower and the loans generally must be fully collateralized. Ongoing delinquencies – for credit unions, loans more than 60 days past due, and for banks and thrifts, loans more than 90 days past due – are lower for credit unions than for banks and thrifts. Credit unions' mid-year 2000 loan charge-off rate of 0.03 percent was much lower than that for either commercial banks (0.60 percent) or savings institutions (0.58 percent)."

Not surprisingly, the Treasury also concluded that MBL "does not pose material risk to the" National Credit Union Share Insurance Fund.

Updated statistics from full-year 2000 through 2003 indicate that the favorable relative performance of MBLs reported in the Treasury study has continued in recent years. Credit union MBL net chargeoffs have averaged just 0.08% over the four-year period since the Treasury study, while the comparable average net chargeoff rate at commercial banks was 1.28% and at savings institutions it was 1.11%. MBLs have even lower loss rates than other types of credit union lending, which themselves have relatively low loss experience.

Credit union member business lending represents a small fraction of total commercial loan activity in the United States. At mid-year 2004, the dollar amount of MBLs was less than one-half of one percent of the total commercial loans held by U.S. depositories. Credit union MBLs represent just 3.1% of the total of credit union loans outstanding and only 17.9% of U.S. credit unions offer MBLs. According to credit union call report data collected by the NCUA, the median size of credit union MBLs granted in the first six months of 2004 was $140,641.

Currently, only 90 credit unions in Texas offer MBLs, totaling just under 2,200 loans made in 2004. The average MBL in 2004 was $126,000.

Adjusting credit union MBL limits from 12.25% to 20% of assets, which is the equivalent to the business lending limit for savings institutions, would not cause these numbers to change dramatically.

This adjustment would help small business. As noted earlier, small businesses are the backbone of the US economy. The vast majority of employment growth occurs at small businesses. And small businesses account for roughly half of private non-farm gross domestic product in the U.S. each year.

An example of a MBL at a credit union in Texas involves a woman who joined San Antonio Teachers Credit Union, as a teacher, in the early 1970s. Several years after she joined, the credit union member decided she would like to open her own floral business. She only needed a $2,000 loan to start her business; however, she either was turned down by "every bank in town" or was asked to use her home as collateral. San Antonio Teachers Credit Union agreed to provide her with a signature loan for $2,000 (without collateral), as long as she maintained some form of income. Using the start-up money to provide floral arrangements for weddings etc., her business flourished, and in two years she opened her own shop in Austin, Texas. The credit she had established with San Antonio Teachers Credit Union enabled her to qualify for a lease on the property. The credit union member has now been in business for 25 years, because of the MBL provided to her through San Antonio Teachers Credit Union. She is now a member of another credit union, the Florist Credit Union in Austin, and has served as Chairman of their Board.

Small businesses are in need of loans of <u>all</u> sizes, including those of less than $100,000, which many have said banks are less willing to make.

Moreover, large banks tend to devote a smaller portion of their assets to loans to small businesses. The continuing consolidation of the banking industry is leaving fewer smaller banks in many markets. In fact, the largest 100 banking institutions accounted for 42% of banking industry assets in 1992. By year-end 2003, the largest 100 banking institutions accounted for 65% of banking industry assets – a 23-percentage point increase in market share in just eleven years.

This trend and its implications for small business credit availability are detailed in a recently released Small Business Administration paper. 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."

In reforming credit union MBL limits, Congress will help to ensure a greater number of available sources of credit to small business. 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.

**TITLE III: REGULATORY MODERNIZATION**

**Section 301. Leases of land on federal facilities for credit unions**
This provision would permit military and civilian authorities responsible for buildings 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. 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 lease arrangements to enable the credit union to channel more funds into lending programs and favorable savings rates for its members.

**Section 302. Investments in securities by federal credit unions**
The Federal Credit Union Act limitations on the investment authority of federal credit unions are anachronistic and curtail the ability of a credit union to respond to the needs of its members. The amendment provides additional investment authority to purchase for the credit union's own account certain investment securities. The total amount of the investment securities of any one obligor or maker could not exceed 10 percent of the credit union's unimpaired capital and surplus. The NCUA Board would 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.

**Section 303. Increase in general 12-year limitation of term of 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 limited exceptions. This section would allow loan maturities up to 15 years, or longer terms as permitted by the NCUA Board.

All Federal credit unions must comply with this limitation. We are very concerned that credit union members seeking to purchase certain consumer items, such as a mobile home, may seek financing elsewhere in which they could repay the loan over a longer period of time than 12 years. While we would prefer for NCUA to have 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 and benefit credit unions as well as their members.

**Section 304. Increase in one-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 aggregate no more than 1% of its shares and undivided earnings in these organizations, commonly known as credit union service organizations or CUSOs. The amendment raises the limit to 3% percent.

CUSOs provide a range of services to credit unions and allow them to offer products to their members that they might not otherwise be able to do, such as check clearing, financial planning and retirement planning. 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, as federal credit union participation in CUSOs is fully regulated by NCUA, the agency has access to the books and records of the CUSO in addition to its extensive supervisory role over credit unions.

The current limit on CUSO investments by federal credit unions is out-dated and limits the ability of credit unions to participate with these organizations to meet the range of members' needs for financial services. It requires credit unions to arbitrarily forego certain activities that would benefit members or use outside vendors in which the credit union has no institutional stake. While we feel the 1% limit should be eliminated or set by NCUA through the regulatory process, we appreciate that the increase to 3% will provide credit unions more options to investment in CUSOs to enhance their ability to serve their members.

CUNA also would support raising the borrowing limitation that currently restricts loans from credit unions to CUSOs to 1 percent. We believe the limit should be on par with the investment limit, which under this bill would be raised to 3 percent.

**Section 305. Check-cashing and money-transfer services offered within the field of membership**

Federal credit unions are currently authorized to provide check-cashing services to members and have limited authority to provide wire transfer services to individuals in the field of membership under certain conditions. The amendment would allow federal credit unions to provide check-cashing services to anyone eligible to become a member.

This amendment is fully consistent with President Bush's and Congressional initiatives to reach out to other underserved communities in this country, such as some Hispanic neighborhoods. 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 one day, deposit their necessary share balance and come in the very next day and withdraw because they need the money. This is not mismanagement on their part. They just do not have another source of funds. And sometimes, a $5.00 withdrawal means the difference between eating or not.

If we are able to cash checks and sell negotiable checks such as travelers checks, 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 the potential member so that when they are financially capable of establishing an account, they will look to the credit union, which will also provide financial education and other support services. Take the example of one of our credit unions in Pueblo, which attracts migrant workers who live in that area for several months each year, many who return year after year. It is well known that this particular group is taken advantage of because of the language barrier. The Pueblo credit union has developed a group of bi-lingual members who are willing to act as translators when needed and several successful membership relationships have resulted.

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 pursue this provision and is grateful for the extensive interest by Committee members, and particularly wish to thank Representatives Gerlach, Sherman, and the entire House for passing H.R. 749.

**Section 306. 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 arbitrarily limits the ability of two healthy multiple common bond federal credit unions from honing their financial resources to serve their members better.

The amendment is a big step forward in facilitating voluntary mergers, as other financial institutions are permitted to do. It provides that the numerical limitation does not apply in voluntary mergers.

**Section 307. Conversions involving common bond credit unions**
This section allows a multiple common bond credit union converting to or merging with a community charter credit union to retain all groups in its membership field prior to the conversion or merger. 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 credit union. The amendment would allow the new or continuing community credit union to provide service to all members of groups previously served.

**Section 308. Credit union governance**
This section gives federal credit union boards 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. Federal credit unions are authorized to limit the length of service of their boards of directors to ensure broader representation from the membership. Finally, this section allows federal credit unions to reimburse board of director volunteers for wages they would otherwise forfeit by participating in credit union affairs.

There has been more than one occasion when some credit unions would have liked to have had the ability to expel a member for just cause. It is relatively rare that things occur that would cause credit unions to use such a provision. However, the safety of credit union personnel may be at stake. One instance I know of involved a credit union member who seemed to have a fixation on an employee and had made inappropriate comments. Another involved an older member who refused to take no for an answer from a young teller whom he persistently asked to date. We have heard of an example at another credit union when one member actually told one of the tellers he would punch her if he ever saw her out in public. Most cases are not quite that extreme; however, we have had other reports from credit unions of unruly members who seem to enjoy causing a ruckus.

Credit unions should have the right to limit the length of service of their boards of directors as a means to ensure broader representation from the membership. Credit unions, rather than the federal government, should determine term limits for board members. Providing credit unions with this right does not raise supervisory concerns and should not, therefore, be denied by the federal government.

Credit unions are directed and operated by committed volunteers. Given the pressures of today's economy on many workers and the legal liability attendant to governing positions at credit unions, it is increasingly difficult to attract and maintain such individuals. Rather than needlessly discourage volunteer participation through artificial constraints, the Federal Credit Union Act should encourage such involvement by allowing volunteers to recoup wages they would otherwise forfeit by participating in credit union affairs.

Whether or not a volunteer attends a training session or conference is sometimes determined by whether or not that volunteer will have to miss work and not be paid.

**Section 309. Providing NCUA with greater flexibility in responding to market conditions**
Under this section, in determining whether to lift the usury ceiling for federal credit unions, NCUA will consider rising interest rates or whether prevailing interest rate levels threaten the safety and soundness of individual credit unions.

**Section 310. Credit Union Conversion Voting Requirements**
This section would change the Federal Credit Union Act from permitting conversions after only after a majority of those members voting approve a conversion, to requiring a majority vote of at least 20 percent of the membership to approve a conversion.

Time and time again, Congress has made clear its support for credit unions, in order to assure consumers have viable choices in the financial marketplace. Yet, banking trade groups and other credit union detractors have indicated they would like to encourage credit union conversions, particularly those involving larger credit unions, in order that they may control the market, thereby limiting consumers' financial options.

Last year, the NCUA adopted new regulatory provisions to require credit unions seeking to change their ownership structure to provide additional disclosures to their members to insure they are adequately informed regarding the potential change and are fully aware of the consequences of such action. CUNA strongly supported this action because we feel members should know that their rights and ownership interests would change, particularly if the institution converts to a bank. In such a situation the institution would "morph" from one in which the members own and control its operations to an institution owned by a limited number of stockholders.

CUNA likewise supports the agency's ongoing efforts to ensure members are provided sufficient disclosures and opportunities to present opposing views in relation to a possible conversion.

Congress addressed conversions in CUMAA and reinforced that a credit union board which desires to convert must allow its members to vote on its conversion plan. CURIA would require a minimum level of participation in the vote -- at least 20% of the members -- for a conversion election to be valid. Currently, there is a requirement that only a majority of those voting approve

the conversion. The legislation would prevent situations in which only a very small number of an institution's membership could successfully authorize such a conversion.

Last year, CUNA's Governmental Affairs Committee developed a resolution that was adopted by our Board relating to credit union ownership, and we want to share its provisions with the Committee.

- The credit union charter presents the best vehicle for serving the financial needs of consumers;
- Credit unions considering changing ownership structure to a bank or thrift charter should decide solely on the basis of what is best for the members of the credit union--not for the management or directors;
- The credit union system should identify and recommend ways to keep the credit union's net worth in the hands of its members;
- Credit unions should provide plain language, full disclosure of all relevant information--including the pros and cons--of a change in the ownership and governance of the credit unions;
- Ensure that credit union senior management and directors are not unjustly enriched, and that appropriate penalties will be imposed for noncompliance with disclosure and other requirements designed to protect the interests of the members; and
- CUNA is rededicated to the improvement of the credit union charter.
- CUNA will continue to look for ways, working with Congress and regulators, to insure a credit union's membership is fully aware of the consequences of a conversion prior to any membership vote.

**Section 311. Exemption from pre-merger notification requirement of the Clayton Act**
This section gives all federally insured credit unions the same exemption as banks and thrift institutions already have from pre-merger notification requirements and fees of the Federal Trade Commission.

**Section 312. Treatment of credit unions as depository institutions under securities laws**
This section gives federally insured credit unions exceptions, similar to those provided to banks, from broker-dealer and investment adviser registration requirements.

**108th Congress: H.R. 1375—Financial Services Regulatory Relief Act (Credit Union Provisions)**

Most of the provisions of H.R. 2317, as outlined above, were also included in last Congress's H.R. 1375. The single exception is the following section.

**Section 301. Privately insured credit unions authorized to become members of a Federal Home Loan Bank**
CUNA supports this section which permits privately insured credit unions to apply to become members of a Federal Home Loan Bank. Currently, only federally insured credit unions may become members. The state regulator of a privately insured credit union applying for Federal Home Loan Bank membership would have to certify that the credit union meets the eligibility requirements for federal deposit insurance before it would qualify for membership in the Federal Home Loan Bank system.

**Additional Legislative Amendments CUNA Supports**

None of the following provisions have been included in CURIA, nor past versions of regulatory relief legislation, yet represent legitimate burdens faced by credit unions that are deserving of relief. We encourage the Subcommittee to consider including them in any future legislation.

- **Allow community credit unions to continue adding members from groups that were part of the field of membership (FOM) before the credit union converted to a community charter but are now outside the community**

Prior to the adoption of amendments to the Federal Credit Union Act in 1998, community credit unions were able to add new members from groups that they had previously served but are outside of the community area the credit union serves. Currently, the credit union may serve members of record but not include additional members from those groups. CUNA supports legislation that would restore that capacity to credit unions.

- **Allow credit unions to serve underserved areas with an ATM**

The legislative history to the CUMAA indicates that federal credit unions should establish a brick and mortar branch or other facility rather than establishing an ATM to serve an underserved area. This directive makes it far less affordable for a number of credit unions to reach out even more to underserved areas. While credit unions serving underserved areas through an ATM should be as committed to the area as a credit union with another type of facility, this change would facilitate increased service to underserved areas.

- **Eliminate the requirement that only one NCUA Board member can have credit union experience**

Currently, only one member of the NCUA Board may have credit union experience. Such a limit does not apply to any of the other federal regulatory agencies and denies the NCUA Board and credit unions the experience that can greatly enhance their regulation. At a minimum, the law should be changed to permit **at least one** person with credit union experience on the NCUA Board.

- **Accounting Treatment of Loan Participations as Sales**

Many of our members currently engage in loan participations, either as the originating institution or as an investor, and FASB's project to review FASB Statement (FAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, is of great concern to us. Other financial institution groups, as well as federal financial regulators, have likewise raised serious questions about the need for and advisability of the proposed guidance.

For a variety of reasons, participations can be important financial and asset liability management tools. They are used increasingly by credit unions, as well as by other institutions, to control interest rate risk, credit risk, balance sheet growth, and maintain net worth ratios. Participations enable credit unions to utilize assets to make more credit available to their membership than they would be able to do without the use of loan participations.

FASB states that it is concerned that in a loan participation in which the borrower has shares or deposits at the originating institution, if that institution is liquidated, the participating institution would not be able to recover its pro rata portion of the members' shares/deposits within the originating institution that are "claimed" by the originating institution to setoff the portion of the debt owed to it. This outcome is highly unlikely and we are not aware that it has ever occurred in a credit union.

Nonetheless, FASB is considering amendments to Statement of Financial Accounting Standard 140 that would expressly state that because the right of setoff between the originating institution and the member/depositor/borrower exists (setting up the potential that the participating institution would not have any claim against the member/depositors' funds in the originating institution) the loan transaction does not meet the isolation requirements of FAS 140. Because of this concern, instead of transferring the portion of the loan participated off of its books as a sale, it is our understanding that the transaction would be reflected on the originating credit union's financial statements and records as a secured borrowing.

In order for participations to continue being treated as sales for accounting purposes, the amendments would further change the existing accounting standards by requiring an institution to transfer participations through a qualified special purpose entity (QSPE), if the transaction did not meet 'True-Sale-At-Law" test. This is a needless and costly expense that would make it difficult for credit unions to use participation loans as a management tool. Further, it would drastically limit the ability of credit unions to provide low-cost, economical financing for their membership through loan participations.

There are sufficient safeguards already in place that address FASB's concerns about isolating the loan participation asset from the reach of the originating credit union and its creditors in liquidation, without the need for changes to FAS 140 of the nature FASB is contemplating.

**Conclusion**

In summary, Mr. Chairman, we are grateful to the Subcommittee for holding this important hearing. We strongly urge the Subcommittee to act on this very important issue this year. And, we strongly urge the Subcommittee to make sure that CURIA is a part of any Congressional action to provide financial institutions regulatory relief. We strongly believe that CURIA is our future. Without CURIA, more credit unions will feel forced to consider converting to a thrift or bank, and millions of Americans will be deprived of a credit union able to respond to their needs.

**CUNA & Affiliates**

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# THE REGULATORY BURDEN OF CREDIT UNIONS

**List of Rules Credit Unions Follow**
**Compiled by the**
**Credit Union National Association**

**May 2005**

# CREDIT UNIONS AS FINANCIAL INSTITUTIONS

| **National Credit Union Administration**<br>*NCUA is an independent federal agency that supervises and insures all federal credit union and insures most state-chartered credit union. It is entirely funded by credit unions and received no tax dollars* | | | |
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| **Subject** | **Description** | **Statute** | **Regulation** |
| Advertising | Prescribes requirements on using the official federal share insurance sign and the official insurance statement and the accuracy of advertisements. | *12 USC 1785(a)* | *12 CFR 740* |
| Appraisals | Sets forth the real estate appraisal requirements for federally insured credit unions. | *12 USC 3341* | *12 CFR 722, 741.3(b)* |
| Audits and Verification | Sets for the responsibilities of federally insured credit unions concerning the review of credit union records and reports as well as the policies and control procedures to safeguard against error, carelessness, and fraud. | *12 USC 1761d, 1782(a)(6)* | *12 CFR 715* |
| Board of Director Changes | Sets forth conditions under which a federally insured credit union must notify NCUA in writing of any proposed changes in its board, committees, or executive staff. | *12 USC 1790a* | *12 CFR 701.14* |
| Borrowed Funds | Sets forth the limitations of federally insured credit unions to borrow from any source and regulatory conditions on borrowing from natural persons. | *12 USC 1757(9)* | *12 CFR 701.38, 741.5* |
| Capital Reserves | Establishes the amount of reserves that must be accumulated and maintained by federally insured credit unions. | *12 USC 1762* | *12 CFR 700.1, 702, 741.9* |

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| Catastrophic Act Report | Requires federally insured credit unions to notify NCUA within five days of any natural disaster that affects the credit union's operations. | *12 USC 1766* | *12 CFR 748* |
| Community Development Revolving Loan Program | Implements a special loan program for low-income credit unions. | *42 USC 9812, 12 USC 17726-1* | *12 CFR 705* |
| Compensation of Officials and Indemnification | Sets forth the restrictions on the volunteer members of the federal credit union board receiving compensation and sets limits on their indemnification. | *12 USC 1761(c)* | *12 CFR 701.33* |
| Conversion of Insured Credit Unions | Establishes procedures for an insured credit union to convert to a mutual savings bank. | *12 USC 1785(b)(2)* | *12 CFR 708a* |
| Corporate Credit Unions | Establishes special rules for all credit unions organized to serve other credit unions. | *12 USC 1757* | *12 CFR 704* |
| Credit Practices | Defines unfair credit practices and unfair or deceptive cosigner practices for federal credit unions. | *15 USC 57a(f)* | *12 CFR 706* |
| Credit Union Service Organizations | Sets limits on federal credit unions' investments in and loans to organizations providing services to them and their members. | *12 USC 1757(5)(D), (7)(I)* | *12 CFR 712* |
| Criminal Referral report | Required federally insured credit unions to notify NCUA, the U.S. Attorney, and the FBI within seven business days when crimes or suspected crimes have occurred. Required credit unions to comply with record keeping and reporting requirements to help identify and prosecute money laundering. | *12 USC 1786(q)* | *12 CFR 748 31 CFR 5311,5313* |
| Discrimination in Real Estate Lending | Prohibits a federal credit union from discouraging a real estate loan application based on race, color, origin, religion, sex, disability, or familial status. | *42 USC 3605* | *12 CFR 701.31* |
| Dividends/Interest | Requires federal credit unions to make transfers to reserves | *12 USC 1763* | |

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| Reporting | before declaring dividends. | | |
| Employee Protection | Prohibits federally insured credit unions from discharging or discriminating against any employee who provides information to the federal government of any possible violation of a law or regulation. | *12 USC 1790b* | |
| Examinations | Requires federally insured credit unions to make periodic financial reports and be subject to regular examinations. | *12 USC 1756, 1784, 1789(8)* | *12 CFR 741.1, 741.6* |
| Fidelity Bond and Insurance Coverage | Requires federally insured credit unions to maintain fidelity bonds for employees and officials, and insurance to cover losses due to theft, vandalism, ect. | *12 USC 1761b* | *12 CFR 713* |
| Field of Membership and Chartering | Sets forth the practices and procedures concerning federal credit union chartering and field of membership modifications. Sets forth criteria for multiple common-bond credit unions and community credit unions. | *12 USC 1759* | *12 CFR 701.1, IRPS 99-1* |
| Fixed Assets | Sets forth the limitations on federal credit unions in regard to ownership of fixed assets. | *12 USC 1757(4)* | *12 CFR 701.36* |
| Flood Insurance | Sets forth guidelines for federally insured credit unions regarding flood insurance. | *42 USC 4012a, 4106* | *12 CFR 760* |
| Foreign Branching | Establishes the requirements for federally insured credit unions to branch outside the U.S. | *12 USC 1757, 1781* | *12 CFR 741.11* |
| Incidental Powers | Provides federal credit unions incidental powers necessary to carry out their business. | *12 USC 1757(17)* | *12 CFR 721* |
| Insurance and Group Purchasing Activities | Permits federal credit unions to make insurance and group purchasing plans involving outside vendors available to their membership under specified conditions. | *12 USC 1757(17)* | *12 CFR 721* |
| Investment and Deposit Activities | Sets forth the securities, deposits, and other obligations in which federal credit unions may invest. | *12 USC 1757(7), (8)* | *12 CFR 703* |
| Lending (General) | Sets forth the general requirements and limitations on loans to federal credit union members. | *12 USC 1757(5)* | *12 CFR 701.21* |
| Loan Limits to One | Restricts the amount of federal credit union funds that can be | *12 USC* | *12 CFR* |

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| Borrower | loaned to one member to no more than 10% of a credit union's unimpaired shares and surplus. | *1757(5)(A)(x)* | *701.21(c)(5)* |
| Loan Participations | Establishes procedures a federal credit union must follow to participate in making loans with eligible organizations. | *12 USC 1757(5)(E)* | *12 CFR 701.22* |
| Loans to Directors and Committee Members | Sets forth the restrictions on loans and lines of credit to any member of the federal credit union board of directors, credit committee, or supervisory committee. | *12 USC 1757(5)(A)(iv)* | *12 CFR 701.21(d)* |
| Management Interlocks | Prohibits a management official of a credit union from also serving as a management official of another credit union if the credit unions are not affiliated and the credit unions exceed certain asset sizes or are located in the same local area. | *12 USC 3201 et seq.* | *12 CFR 711* |
| Member Business Loans | Defines "member business loan" and sets forth the requirements a federally insured credit union must meet to make such loans. | *12 USC 1757(5), 1757a* | *12 CFR 701.21, 741.3 12 CFR 723* |
| Mergers/Conversions | Prescribes the procedures for merging a federally insured credit union and the procedures and notice requirements for termination of, or conversions from, federal insurance. | *12 USC 1785, 1786* | *12 CFR 708b IRPS 99-1* |
| NCUA Board Membership | Establishes qualification for NCUA Board members. | *12 USC 1752(b)* | |
| Privacy | Requires credit unions to deliver privacy notices to members, outlines the procedures that credit unions must use when providing members with the right to opt out of certain information disclosures to third parties, and requires credit unions to establish safeguards for protecting the security of member information. | *15 USC 6801 et seq.* | *12 CFR 716, 741,748* |
| Prompt Corrective Action/Risk Based Net Worth Requirement | Establishes capital standards for credit unions, imposes consequences based on capitalization levels, and if necessary, authorizes supervisory action based on capital levels. | *12 USC 1790d, 1787(a)* | *12 CFR 702* |
| Public Unit and | Sets forth the limitations on federally insured credit unions | *12 USC 1757(6)* | *12 CFR* |

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| Non-member Accounts | receiving funds from federal, state, and local governments and non-members. | | *701.32, 741.6* |
| Purchase, Sale, and Pledge of Obligations | Sets forth procedures a federal credit union must follow to purchase, sell, or pledge assets. | *12 USC 1757(13), (14)* | *12 CFR 701.23* |
| Real Estate Lending | Sets for the rules for long-term mortgage lending by federal credit unions. | *12 USC 1757(5)(A)(i)* | *12 CFR 701.21(g)* |
| Records Preservation Program | Requires federally insured credit unions to maintain records preservation programs to identify, store, and reconstruct vital records. | *12 USC 1766, 1789* | *12 CFR 749* |
| Refunds of Loan Interest Payments | Sets forth the provisions under which a federal credit union may refund interest paid on loans. | *12 USC 1761b(9)* | *12 CFR 701.24* |
| Retirement Benefits | Establishes procedures a federal credit union must follow to provide reasonable retirement benefits for its employees and officers. | *12 USC 1761b* | *12 CFR 701.19* |
| Reg Flex | Provides regulatory flexibility to federal credit unions that maintain strong financial position. | *12 USC 1766(a)* | *General Rulemaking* |
| Service Contracts | Establishes the procedures a federal credit union must follow when entering into a contractual agreement with one or more credit unions or other organizations. | *12 USC 1757(1)* | *12 CFR 701.26* |
| Service Providers | Establishes that a credit union service provider is subject to regulation and examination by NCUA. | *12 USC 1786a* | |
| Share Insurance Coverage of Accounts | Describes the insurance coverage of various types of federally insured member accounts. | *12 USC 1787(k)* | *12 CFR 745* |
| Share Insurance Eligibility, Payments, and Responsibilities | Prescribes requirements of federal share insurance, the payment of insurance premiums and capitalization deposits, and enforcement sanctions. | *12 USC 1781 et seq.* | *12 CFR 741* |
| Trustees and | Sets forth the procedures for a federal credit union to act as | *26 USC 408* | *12 CFR 724* |

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| Custodians of Certain Pension Plans | trustee or custodian of 401(k) pension plans and individual retirement accounts. | | |
| Truth-in-Savings | Requires credit unions to disclose how dividends are calculated and what fees are assessed on savings accounts. | *12 USC 4301 et seq.* | *12 CFR 707* |
| Usury Limit | Limits the amount of interest a federal credit union can charge on a loan. | *12 USC 1757(5)(vi)* | *12 CFR 701.21(c)(7)* |
| Voluntary Liquidation | Prescribes the procedures a federal credit union must follow to voluntarily liquidate. | *12 USC 1766* | *12 CFR 710* |

| **Federal Reserve System**<br>*The Federal Reserve System is an independent federal agency that executes monetary policy, oversees the national payments system, provides payment services, and implements major federal consumer protection laws.* | | | |
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| Check-Holds/Check Collection | Governs check-hold policies and sets endorsement standards to expedite the check-clearing process. | *12 USC 4001 et seq.* | *12 CFR 229 (Regulation CC)* |
| Check Clearing in the 21st Century Act | Establishes the rules and guidelines for substitute checks. | *12 USC 5001* | *12 CFR 229 (Regulation C)* |
| Commercial Payments via Automated Clearinghouses | Governs financial institutions' transaction and receipt of commercial ACH transaction through Federal Reserve Banks. | *15 USC 1693(b)* | *12 CFR 205, 210 Fed. Reserve Op. Cir. #4* |
| Consumer Lending | Governs the disclosure and advertising requirements when leasing property to consumers. | *15 USC 1601 et seq.* | *12 CFR 213 (Regulation M)* |
| Credit by Brokers and Dealers | Regulates certain stock purchase plans when a credit union assists its members in purchasing stock of the sponsor corporation. | *15 USC 78a et seq.* | *12 CFR 220 (Regulation T)* |
| Credit Secured by Negotiable Securities | Limits the amount of credit that credit unions can extend when the loan purpose is to purchase or carry securities and when the loan is secured by margin securities. | *15 USC 78a et seq.* | *12 CFR 221 (Regulation U)* |
| Discount Window | Establishes rules under which Federal Reserve Banks may extend credit to depository institutions and others. | *12 USC 347a, b* | *12 CFR 201 (Regulation A)* |
| Electronic Funds Transfer | Establishes the basic rights, liabilities, and responsibilities of consumers who use electronic money transfer services and of the credit unions that offer these services. | *15 USC 1693 et seq.* | *12 CFR 205 (Regulation E)* |

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| Equal Credit Opportunity | Prohibits discrimination with respect to any credit transaction on the basis of sex, marital status, race, color, religion, national origin, and receipt of public assistance income. | *15 USC 1601 et seq., 1691* | *12 CFR 202 (Regulation B)* |
| Home Mortgage Disclosure | Requires credit unions to collect, report, and disclose data regarding home mortgage and home improvement loans, including the geographic location of where mortgage loans have been granted and denied. | *12 USC 2801 et seq.* | *12 CFR 203 (Regulation C)* |
| Payments Systems | Governs the collection of checks and other cash and non-cash items and the handling of returned checks by Federal Reserve Banks. | *12 USC 342, 360*<br>*12 USC 4001 et seq.* | *12 CFR 210 (Regulation J)* |
| Reserve Requirements | Sets monetary reserve requirements that covered credit unions must maintain at the Federal Reserve. | *12 USC 461 et seq.* | *12 CFR 204 (Regulation D)* |
| Truth-in-Lending | Requires credit unions to disclose terms and costs of consumer credit. | *15 USC 1601 et seq.* | *12 CFR 226 (Regulation Z)* |

| **Internal Revenue Service**<br>*The IRS is a federal agency within the U.S. Treasury Department that administers and enforces the tax laws that include extensive information reporting.* | | | |
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| Backup Withholding | Requires credit unions to obtain certified taxpayer identification numbers on W-9 forms or obtain W-8 form, and imposes backup withholding of 31% of an interest or dividend payment of a member under certain conditions. | *26 USC 3406* | *26 CFR 35a.3406-2 et seq.* |
| Depositing Funds Withheld | Governs how credit unions are to deposit funds with the U.S. government that are withheld due to backup withholding. | *26 USC 7805* | *26 CFR 31.6302-3* |
| Depositing Employee Finds Withheld | Governs how credit unions are to deposit income and other taxes withheld from employees' earning. | *26 USC 7805* | *26 CFR 31.6302.1* |
| Discharge of Indebtedness | Requires credit unions to file Form 1099-C to report the discharge of indebtedness for amounts of $600 or more in a calendar year. | *26 USC 6050P* | *26 CFR 1.6050P-1* |
| Dividend/Interest Reporting | Requires credit unions to file a 1099-INT information return with members and with the IRS when making a payment of dividends of $10 or more on an account. | *26 USC 7805* | *26 CFR 1.6042-1* |
| Employee Withholding | Requires employers to file Form W-2 to report wages paid to employees. | *26 USC 7805, 6051* | *26 CFR 1.6041-2* |
| Federal Insurance Contribution Act | Establishes the rates and computation of the FICA taxes than an employer must collect from each employee. | *26 USC 3101 et seq.* | *26 CFR 31.3101 et seq.* |
| Federal Unemployment Tax | Establishes the tax rates and computation of the unemployment tax. | *26 USC 7805* | *26 CFR 31.3301 et seq.* |
| Foreclosures and Abandonment of Security | Requires credit unions to file a Form 1099-A when acquiring an interest in any property that is security for a debt due to foreclosure or abandonment. | *26 USC 7805* | *26 CFR 106050J-IT* |
| Income Tax | Requires state-chartered credit unions to file a Form 990 annually. | *26 USC 6104,* | *26 CFR* |

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| Return for Tax-Exempt Organizations | | *6033* | *1.6033-1* |
| Individual Retirement Accounts | Prescribes rules relating to filing annually the Form 5498 and for handling distribution for IRAs. Establishes new "Roth" IRA. | *26 USC 408, 408A* | *26 CFR 1.408, 1.408A* |
| Magnetic Medic Reporting | Requires the general use of magnetic media for submitting Forms 1098 and the 1099 series to the IRS. | *26 USC 6011(e)* | *26 CFR 301.6011-2* |
| Mortgage Interest Reporting | Requires a credit union that receives at least $600 of interest on most mortgages to file a Form 1098- information return annually. | *26 USC 7805* | *26 CFR 1.6050H* |
| Original Issue Discount Reporting | Requires credit unions, in certain cases where a certificate extends beyond one-year to file a Form 1099-OID information return in place of a 1099-INT return. | *26 USC 1272* | *26 CFR 1.6049-1, 1.6050* |
| Property Subject to Levy | Governs how credit union are to surrender funds to the IRS upon the receipt of a notice of levy. | *26 USC 7805* | *26 CFR 301.6332* |
| Real Estate Transaction Reporting | Generally requires credit unions to make a 1099-S information return with respect to a real estate transaction if no agent is involved with the sale. | *26 USC 6045* | *26 CFR 1.6045-4* |
| Record keeping Requirements for Employment Taxes | Sets forth the record keeping and return requirements for employers. | *26 USC 7805* | *26 CFR 31.6001* |

| **U.S. Department Of The Treasury**<br>*The Department of the Treasury is a cabinet level agency responsible for formulating and executing domestic and international financial, economic, and tax policies* | | | |
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| Bank Secrecy Act, including USA PATRIOT Act | Sets forth the record keeping and reporting responsibilities for credit unions and other financial institutions to assist in the effort to combat money laundering, terrorism, tax evasion, and other criminal activity. Includes: Currency transaction reporting for each deposit, withdrawal, exchange of currency or other payment or transfer than involves a transaction in currency of more than $10,000; Suspicious activity reporting for suspected money laundering activity, suspected structuring activity or other suspicious activity; Regulations issued to implement the USA PATRIOT Acts provisions regarding (1) identification and verification of any person who opens an account at a financial institution and (2) sharing of information between the government as well as among financial institutions themselves. | *31 USC 5311-5322*<br>*12 USC 1786(q)*<br>*12 USC 1829b*<br>*12 USC 1951-1959* | *31 CFR 103*<br>*12 CFR 748* |
| Book entry Transactions Involving Treasury Securities | Governs the purchase and sale of Treasury bonds, notes, and bills by individuals through financial institutions. | *31 USC 3101 et seq.*<br>*12 USC 391* | *31 CFR 357* |
| Counterfeit and Mutilates Currency | Governs the handling of counterfeit obligations presented at the credit union and the exchange of mutilated coin and paper currency. | *18 USC 492*<br>*31 USC 321* | *31 CFR 403, 100 et seq* |
| Federal Payments via Automated Clearinghouse | Governs the payment of federal government benefit and non-benefit proceeds made by the ACH method through the Federal Reserve to recipients who maintain accounts at financial institutions. | *12 USC 391*<br>*31 USC 321* | *31 CFR 210* |
| Fiscal Agents and Treasury | Governs the contractual terms of the agreement between a credit union and the Treasury Department in order to be designated to hold | *12 USC 1767*<br>*31 USC 3122* | *12 CFR 701.37* |

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| Tax Loan Depositories | government tax funds. | | *31 CFR 203, 312* |
| Savings Bonds | Governs the manner in which an organization may qualify and act as a paying agent and issuing agent of Series EE US savings bonds. | *31 USC 3105* | *31 CFR 317* |
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| **Federal Trade Commission**<br>*The FTC is an independent federal agency with the primary responsibility to eliminate unfair or deceptive acts or practices affecting consumers* | | | |
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| Credit Practices | Defines what constitutes unfair credit practices for state-chartered credit unions. | *15 USC 57a* | *16 CFR 444* |
| Fair Credit Reporting | Requires consumer-reporting agencies to provide information fairly and equitably to consumers with regard to the confidentiality, accuracy, and proper use of such information. Includes the Fair and Accurate Credit Transactions Act that includes identity theft protections and restrictions on information sharing. | *15 USC 1681 et seq.* | *16 CFR 600* |
| Fair Debt Collection | Prohibits a credit union that is collecting a debt for someone else from using any deceptive representation or deceptive means to collect or attempt to collect debts. | *15 USC 1692* | *16 CFR 901* |
| Holder-in-Due-Course | Restricts enforcement of contract terms when there is a business relationship between a seller of goods and services and a creditor financing the purchase. | *15 USC 41 et seq.* | *16 CFR 443* |

| **NACHA – The Electronic Payments Association**<br>*NACHA is a private, non-profit association that writes the rules for the Automated Clearing House (ACH) system, which are known as the NACHA Operating Rules. These Operating Rules apply to all credit union that use the ACH system. Credit union that are capable of receiving ACH items into the accounts of their members are receiving depository financial institutions (RDFIs) and those that are capable of originating an ACH item are originating depository financial institutions (ODFIs). This section provides a reference to some provisions of the Operating Rules that affect credit unions participating in the ACH system. NACHA has Guidelines that supplement these "Operating Rules," a NACHA publication.* | | |
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| Affidavits | The Operating Rules require a credit union to obtain an affidavit from a member before they re-credit a member's account for an ACH item that the member alleges is unauthorized or improperly originated. IN those cases, when the credit union returns the ACH item to the ODFI, it warrants that the credit union has already obtained a signed affidavit. | *Operating Rules Article Seven, subsection 7.6.1-7.6.4, 7.7.1, 7.7.2* |
| Audits and Verification | The Operating Rules require credit unions in the ACH network and their ACH service providers to conduct annual audits of compliance with the Operating Rules. These requirements differ for ODFIs and RDFIs. The audits must be kept and available at NACHA's request for six years from the date of the audit. | *Operating Rules Article One, subsection 1.2.1. Appendix Eight Guidelines Section II, subsection L, Guidelines Section II, Chapter IV RDFIs, subsection G* |
| Availability of Funds | Establishes when a RDFI must post ACH entries and make the funds from those entries available to members based on when entries are available to an RDFI. | *Operating Rules, Article Four, sections 4.3 and 4.4 Guidelines Section II, Chapter I, subsection J-2* |
| Returns | The ACH network allows the return of ACH entries and allows an ODFI to dishonor and contest a return. | *Operating Rules Article Five, section 5.1 and 5.2 Operating Rules Article Nine, section 9.3* |

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| | | *Operating Rules Appendix Five Guidelines Section II, Chapter I, subsection J-2 Guidelines Section II, Chapter I, subsection J-3 Section III, Chapter III* |

| Other Federal Agencies Affecting Credit Union Operations | | | |
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| Americans with Disabilities Act- U.S. Department of Justice | Prohibits discrimination on the basis of disability, requires constructions of new buildings in compliance with the accessibility standards, and requires removal of physical barriers in existing facilities of alteration is readily available. | *42 USC 12181* | *28 CFR 36* |
| Anti-Discrimination Data Collection- U.S. Department of Housing and Urban Development | Requires credit unions participating in the HUD mortgage insurance programs, home improvement loan programs, GNMA mortgage purchase programs, or special mortgage assistance programs to maintain data on race, religion, nationality, and sex. | *42 USC 3535(d)* | *24 CFR 107* |
| Bankruptcy | Sets forth the requirements and procedures credit unions must follow when a member has filed bankruptcy including the automatic stay, proof of claim, and reaffirmation agreements. | *11 USC 501 et seq* | |
| Child Support Enforcement | Establishes responsibility for financial institutions to use data matches to provide states with the social security number, tax payer identification number and financial account information for parents who owe child support arrearages. | *42 USC 666(a)(17)* | |
| Credit Unions on Military Bases – U.S. Department of Defense | Provides general operating policies and procedures for credit unions operating on DOD installations. | *10 USC 136* | *32 CFR 231a* |
| Environmental Lender Liability | Sets forth guidelines under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) concerning responsibility for environmental cleanup of a foreclosed property. | *42 USC 9601 et seq.* | *40 CFR 300 Subpart L* |
| Electronic Records and Signatures | Establishes that electronic records and signatures may not be denied effect solely because they are not written. Provides default rules for electronic consumer disclosures and validated electronic records for checks that are used for record keeping | *15 USC 7001 et seq.* | |

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| | and proof of payment, but not as payments instruments. | | |
| Electronic Transfer Accounts | Establishes electronic transfer account that allows government benefit recipient to electronically receive benefits in credit union accounts. | *31 USC 3332* | *31 CFR 208 et seq.* |
| Food Stamps – U.S. Department of Agriculture | Establishes the criteria and procedures for the redemption of food stamps by qualified credit unions. | *7 USC 2001 et seq.* | *7 CFR 278.5* |
| Guarenteed Student Loans/PLUS Programs – U.S. Department of Education | Requires a credit union to disclosed certain information to a borrower either before or at the time of the first disbursement of the student loan. | *20 USC 1078-2* | *34 CFR 682.205* |
| Privacy – Access by Various Federal Agencies to Credit Union Records | Governs the procedures that the Department of Treasury, U.S. Postal Service, and the Department of Defense must follow to gain access to credit union records. | *12 USC 3401 et seq* | *31 CFR 14*<br>*29 CFR 19*<br>*32 CFR 504*<br>*39 CFR 233* |
| Real Estate Settlement Procedures Act (RESPA/regulation X) – U.S. Department of Housing and Urban Development | Requires credit unions receiving loan applications for federally related mortgage loans to provide a cope of the special information booklet and an estimate of closing costs for settlement; requires loan originators and servicing organizations to disclose information on their practices of selling loan servicing; and requires disclosures relating to escrow accounts. | *12 USC 2601 et seq.* | *24 CFR 3500* |
| Signature Guarantees – Securities Exchange Commission | Provides the standard by which a credit union's signature guarantee regarding a stock transfer must be accepted by the stock transfer agent. | *15 USC 77c* | *17 CFR 240, 17Ad-15* |
| Soldiers' and Sailors' Civil Relief Act – U.S. Department of | Requires credit unions to reduce the interest rate on pre-existing loans of certain individuals upon entering military service, during their period of active duty. | *50 USC Appx 526* | |

| Defense | | | |
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| Title I Property Improvement and Manufactures Home Loans – U.S. Department if Housing and Urban Development | Sets forth the requirements for participation in this programs insuring certain loans. | *12 USC 1701 et seq. 42 USC 3535(d)* | *24 CFR 201, 202* |

| **Equal Employment Opportunity Commission**<br>*The EEOC is a federal agency that provides guidance and technical assistance to employees who suspect discrimination and to employers on equal employment laws.* | | | |
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| Age Discrimination in Employment Act | Prohibits age discrimination in employment and requires credit union to keep records necessary for the administration of this law. | *29 USC 621 et seq.* | *29 CFR 1627* |
| Americans with Disabilities Act | Prohibits employers from discriminating against persons with disabilities who are otherwise qualified for employment, and requires employers to make reasonable accommodations to known disabilities. | *42 USC 12101 et seq* | *29 CFR 1602, 1630* |
| Equal Employment Opportunities – Civil Rights | Requires equal employment opportunity without regard to race, color, religion, sex, familial status, national origin, age, or disability. | *42 USC 2000e* | *29 CFR 1601 et seq.* |

| **U.S. Department of Labor**<br>*The Department of Labor is a federal agency that promotes and develops policies relating to working conditions and employment opportunities for the benefit of U.S. wage earners* | | | |
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| Affirmative Action Plans | Requires credit unions with more than 50 employees that are federal contractors to comply with affirmative action rules | *29 USC 793, 794* | *41 CFR 60-741* |
| Employee Retirement Income Security Act (ERISA) | Protects employees' rights to receive welfare and pension benefits, and includes detailed reporting, filing, and disclosure requirements. | *29 USC 1001 et seq.* | *29 CFR 2509 et seq.* |
| Employment Practices Record Keeping | Requires employers to make, keep, and preserve personnel records of employees, including wages, hours, and other conditions of employment. | *29 USC 211* | *29 CRR 516* |
| Family and Medical Leave | Requires employers with 50 or more employees to provide up to 12 weeks per year of unpaid, job-protected leave to eligible employees for family medical emergencies or to care for an infant. | *29 USC 2601 et seq.* | *29 CFR 825* |
| Group Health Plans | Requires employers to provide continuous group health coverage to certain individuals due to termination of employment. | *29 USC 1161 et seq.* | |
| Minimum Wage/Overtime | Establishes the minimum permissible wage per hour, and the maximum number of hours above which an employer must pay an employee not less than 1 ½ times regular wages. | *29 USC 206, 207* | *29 CFR 500 et seq.* |
| Occupational Safety and Health | Requires employers to provide employees a safe and non hazardous environment in which to work, and requires employers to keep records regarding activities relating to occupations safely and health as well as to report workplace injuries and illnesses. | *29 USC 651 et seq.* | *29 CFR 1900 et seq.* |
| Polygraph Protection | Prohibits employers from requiring an employee or prospective employee to take a lie detector test (with limited exceptions). | *29 USC 2001 et seq.* | *29 CFR 801* |

| Other Federal Employment Rules | | | |
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| Bankruptcy Protection – U.S. Bankruptcy Code | Prohibits employe4ers from discriminating against an employee/debtor with respect to employment. | *11 USC 525(b)* | |
| Employment of Aliens – U.S. Department of Justice/Immigration and Naturalization Service | Requires employers to verify employment eligibility of prospective employees by examining documentation and completing Form I-9. | *8 USC 1324a* | *8 CFR 274a* |
| Veteran's Reemployment Rights Act – U.S. Office of Personnel Management | Sets forth the rights and obligations of employees on connection with leaves of absence or restoration to duty following military duty. | *28 USC 4301 et seq.* | *5 CFR 353* |

**Testimony**
**by**
**Terry Jorde**
**President/CEO**
**CountryBank USA**
**Cando, ND**
**&**
**Chairman-Elect**
**Independent Community Bankers of America**
**Washington, DC**

# "Financial Services Regulatory Relief: Private Sector Perspectives"

**United States House of Representatives**
**Financial Services Committee, Subcommittee on**
**Financial Institutions and Consumer Credit**

**May 19, 2005**

Mr. Chairman, Ranking member Sanders 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 27 full time employees and $39 million in assets. We are a small, but diversified organization with nine of my employees working in our insurance agency, two employees devoted to retail sales of non-deposit 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 proposals to reduce the regulatory burden on banks, thrifts and credit unions, a topic this committee has addressed repeatedly. We are especially pleased that the committee is apparently open to expand on previously passed regulatory relief bills, such as H.R. 1375, since those bills included little true relief for community banks.

That is one reason that ICBA worked closely with Rep. Jim Ryun on his Community Banks Serving Their Communities First Act. The Communities First Act (H.R. 2061) includes regulatory and tax relief that is critical to community banks and their customers. It includes additional provisions that apply to all banks and bank customers. Virtually all of the regulatory provisions in the bill were also endorsed by other financial groups that have been working with FDIC Vice Chairman John Reich on the regulatory burden reduction project mandated by the Economic Growth and Paperwork Reduction Act of 1996 (EGRPRA). ICBA hopes that Rep. Hensarling will include many items from H.R. 2061 in the bill he is developing for this committee.[2]

Our testimony will focus on the specific proposals in the Communities First Act and explain why they should be included in this committee's new regulatory relief bill. Before that, I will briefly explain why regulatory relief is so important to community banks, their customers, and the communities they serve.

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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] In a similar vein, ICBA plans to work with the Ways and Means Committee on the tax relief components of H.R. 2061.

## Community Banks Need Regulatory Relief

Since 1992, the market share of community banks with less than $1 billion in assets has dropped from about 20 percent of banking assets to 13 percent. And the market share of large banks with more than $25 billion in assets has grown from about 50 percent to 70 percent. Community bank profitability also lags large banks. Obviously part of the reason is due to economies of scale that community banks have always accepted as a fact of life. However, in recent years, the disproportionate impact of the ever-mounting regulatory burden is significantly impacting community bank profitability. I agree with FDIC Vice-Chairman Reich that it is a leading cause of consolidation in our industry.

At the same time credit unions, with their unfair tax-exempt advantages and favorable legislation loosening membership restrictions, have made inroads into small banks' market segments. Credit union assets have more than tripled since 1984, from $194 billion to $611 billion, whereas total small bank assets (less than $1 billion) have decreased.

An analysis of these trends conducted by two economists at the Federal Reserve Bank of Dallas concluded that the competitive position and future viability of small banks is questionable.[3] The authors suggest that the regulatory environment has evolved to the point of placing small banks at an artificial disadvantage to the detriment of their primary customers—small business, consumers and the agricultural community.

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 to comply, 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 originated 58 real estate loans last year for sale on the secondary market, she sits on our audit and technology committee, she regularly teaches home-buyer education courses at our community college, and she baby sits my 14-year-old son at times like this when I'm begging for relief. Unlike larger institutions, we can't just add a new person and pass the costs on to our customers.

It's not just smaller community banks like mine that are feeling the pain. Larger community banks as well are drowning in paperwork and regulatory burden. They are hiring 2 or 3 full-time employees to do *nothing* but Bank Secrecy Act compliance. They have had to expend hundreds of thousands of dollars for Sarbanes-Oxley Act compliance.

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[3] Gunther and Moore, "Small Banks' Competitors Loom Large," *Southwest Economy,* Federal Reserve Bank of Dallas, Jan./Feb. 2004.

This is not just about numbers and costs. I assure you we are not crying "wolf." If we don't get meaningful relief *soon*, more and more community banks will throw up their hands, and give up their independence.

Why should policy makers care about community banks? First, community banks play a strong role in consumer financing and an especially vital role in small business lending. Commercial banks are the leading suppliers of credit to small business, and community banks account for a disproportionate share of total bank lending to small business, the primary job-creating engine of our economy. Banks with less than $1 billion in assets make 37 percent of bank small business loans, more than twice their share (13%) of bank industry assets. And they account for 64 percent of total bank lending to farms.

Second, community banks that fund local businesses are particularly attuned to the needs of their communities and are uniquely equipped to facilitate the local economic development process, which can be time-consuming and resource intensive. Community bankers provide tremendous leadership in their communities, which is critical to economic development and community revitalization.

For example, in a recent week I spent 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 depends on the economic vitality of my community. I have a very real incentive to work to assure the success of Cando. Branches of large mega banks do *not* provide this same commitment to the community.

## Bank Secrecy Act Compliance

While our testimony today does not include legislative recommendations for changes in the Bank Secrecy Act, this certainly does not mean that community bankers do not have serious concerns about how the act is being enforced. In fact, it is topic 1A when bankers discuss the regulatory burden. However, we believe the agencies have authority to address most of the problems. These center around whether or not there is a "zero tolerance" examination climate, as well as uncertainty about what the agencies expect from banks.

ICBA has just filed a comment letter with the banking agencies under the EGRPRA process with a number of recommendations regarding BSA compliance, including:

- **Bank Secrecy Act Administration**. Issue additional guidelines and provide reference tools for compliance so that bankers *and* examiners know what is expected. (The anticipated June 30, 2005 revised examination procedures and outreach programs for bankers *and* examiners should help, but balance is clearly needed.)
- **BSA Currency Transaction Reporting**. Increase the filing threshold from $10,000 to $30,000 to eliminate unnecessary filing. Improve the CTR exemption process so banks use it.
- **Suspicious Activity Reporting.** Simplify the filing process and issue easily accessible guidance on when banks should report.

At this point, ICBA strongly urges this committee to engage in thorough oversight to ensure that BSA compliance does not impose an unreasonable and unproductive burden on the economy and truly achieves its important goals.

## The Credit Union Bill is Not Like the Communities First Act

Last week the credit union industry had introduced what it is calling a regulatory relief bill. Some representatives of that industry compared their bill (H.R. 2317) with the Communities First Act. The bills are not at all comparable. The credit union bill is a charter enhancement proposal, while the Communities First Act includes no new powers for anyone. It is strictly designed to lift the regulatory and tax burden for community banks and help level the playing field. ICBA is unalterably opposed to H.R. 2317, which, among other things, would substantially increase the ability of credit unions to make loans to businesses. Congress should eliminate the credit unions' unfair tax and regulatory advantages over community banks, not give them even more new powers.

## Industrial Loan Companies

The regulatory relief bill that the House passed in the last Congress, H.R. 1375, included provisions permitting *de novo* interstate branching and permitting banks to pay interest on business checking accounts. The branching provision included the Gillmor/Frank compromise that would prohibit predominantly commercial firms from buying or establishing an industrial loan company and using the new branching authority. ICBA is pleased that this committee has added the Gillmor/Frank language to the business-checking bill now pending before the House. While we believe that the best way to deal with and eliminate the mixing of banking and commerce made possible by the ILC loophole is to close it by bringing ILCs under the Bank Holding Company Act, the Gillmor/Frank language is a reasonable compromise that should be included in any proposal to relax branch restrictions or permit interest on business checking.

## Specific Legislative Recommendations

ICBA strongly supports the bank regulatory reduction project mandated by the Economic Growth and Paperwork Reduction Act of 1996 (EGRPRA) and commends the EGRPRA task force, led by FDIC Vice Chairman John Reich, for the excellent job it has done to identify those banking regulations that are outdated, unnecessary or unduly burdensome. Through the public comment process, banker outreach meetings and the EGRPRA website, the project has generated a large number of recommendations for reducing the regulatory burden on banks. 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 hard-wired into federal statute.

The Communities First Act includes a variety of legislative proposals to reduce the burden of regulation on community banks.[4] Many of the following legislative changes from H.R. 2061 build on the concept of a tiered regulatory and supervision system recommended by Vice Chairman Reich by targeting relief to institutions based on their size. Others 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.

***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[5] in assets to $250 million. While this may appear to be a 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% 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

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[4] 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.

[5] 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.

of Metropolitan Statistical Area for HMDA purposes, instead of using Census Bureau definition created for entirely different reasons. This would avoid covering certain rural banks that are close enough to metropolitan areas to be included by the Census Bureau. Current law requires the use of the Census Bureau definition, so certain areas that are truly rural are 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.

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 five 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's request.

***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 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 reverse the repeated increases in the reporting burden imposed when agency economists and financial analysts seek to add "just one more" item to the call reports. While many of these items provide interesting information, we question whether private companies – banks – should have to provide non-essential information under threat of government sanction.

The current call report instructions and schedules consist of 458 pages. The fourth highest paid employee in my bank spends the better part of April, July, October, and January working on this report. She never takes a vacation during these months and God help us if she would get sick during these months for any extended period of time.

While extensive and time consuming to produce, these quarterly filings by community banks are not essential to the agencies. The fact is that in banks like mine, the world just doesn't change that dramatically between March 31st and June 30th of each year. The FDIC will not lose track of us if we file a short form every other quarter instead of the extensive report every 90 days and Mr.

Greenspan 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 non-banking 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, non-complex, holding companies, while maintaining the Federal Reserve's ability to obtain holding company information for larger institutions.

Again, the banking industry has included each of these recommendations as consensus items on the list for Senator Crapo.

***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 Section 404. Section103 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 banks under $500 million in assets. Congress imposed these requirements on banks after the crises of the 1980s. 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. Companies like Enron and WorldCom were not regulated the same way. Not only is this burden redundant and unnecessary for community banks, it is 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.

***Director Interlocks and Loans to Officers***

Section 105 of the Communities First Act increases the size of bank 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.[6] This limit has not been adjusted for over ten years, 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.

My bank was one of those affected after September 11th when MJK Clearing failed and I discovered to my great surprise that the local North Dakota nursing home bonds that I thought I owned were not really safe kept, but in fact were used to cover a multi-million dollar securities trade that failed to settle. Up until then, my biggest worry was whether the nursing home would be able to make its semi-annual payments. Instead, $100,000 of my bank's assets were frozen for more than a year during MJK Clearing's bankruptcy proceedings. I had little reason to think of SIPC prior to 9-11, but I quickly learned that SIPC was one of those agencies that protects innocent victims and credit unions, but not 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 institutions for their brokerage account assets under the SIPA.

This is included in the banking industry's consensus recommendations to Senator Crapo.

***Examination Schedules***

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[6] 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

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.[7]

Both of these changes would help strong, well-run community banks focus on service to their communities rather than responding to unnecessarily frequent examinations.

***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 annoyed when they hear they have to wait an additional three days for their funds.

Subsection (b) addresses another source of annoyance for consumers, the fact that borrowers have to wait three 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 three days or longer. On the other hand, consumers who need immediate access to their line of credit should have it.

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[7] 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.

The banking industry has included the provisions of section 201 in its consensus recommendations.

***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 an interim 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 mail carriers would also be grateful.

Like virtually all of the regulatory provisions of the Communities First Act, this section is a banking industry consensus item.

***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.

## Conclusion

ICBA greatly appreciates this opportunity to testify on this important issue. In a major way, the future of community banking depends on what you do. The banking industry is united on the need for regulatory burden relief. Indeed, virtually all the proposals in Rep. Ryun's Communities First Act are included in the industry's recommendations to Senator Crapo. The bill simply highlights those provisions that are important to community banks. We strongly urge Rep. Hensarling to include them in his broader regulatory relief bill. That would provide real benefits to community banks and the communities and customers that they serve.

**Written Testimony of J. Michael Keeling, President of The ESOP Association, to the Subcommittee on Financial Institutions and Consumer Credit, of the Committee on Financial Services, on "Financial Services Regulatory Relief: Private Sector Perspectives"**

**May 19, 2005**
**2128 Rayburn House**
**Office Building**

Written Testimony of J. Michael Keeling

Chairman Bachus, ranking member Sanders, members of the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services, and guests of the Subcommittee, my name is J. Michael Keeling, and I am the President of The ESOP Association, or descriptively, the Chief Staff Officer. The ESOP Association is a trade association, governed by the Internal Revenue Code Section 501(c)(6). Our primary members are U.S. corporations that sponsor employee stock ownership plans, or ESOPs, which are tax qualified deferred compensation arrangements where employees are the beneficial owners of the corporation sponsoring the ESOP. Secondary members of the Association are individuals who provide a variety of services to ESOP companies, search as legal, administrative, valuation, lending, among other things.

Approximately 97% of our 1,400 ESOP companies' members are private, small to mid-sized businesses. Our member demographics are thus similar to businesses as a whole.

I have served as the chief staff officer of the Association since April 1991, and first began work with the group as general counsel in early 1982, shortly after leaving a position as chief staff officer to former Congressman J. J. "Jake" Pickle for nearly 10 years.

You may wonder what someone who works for the companies that are employee-owned through ESOPs has to say to you, as you examine ways to ease, and improve, the regulation of our nation's financial institution? Before I finish, I would hope that you would conclude that

discussions of creating employee ownership should be before your full committee, and your subcommittee more so than the tax and labor committees of Congress.

Let me explain. An ESOP is similar to any other defined contribution plan such as a 401(k) plan except for two statutory, distinguishing characteristics. Unlike other defined contributions plans, an ESOP must be primarily invested in employer stock, and may borrow money to obtain its primary asset, stock of the plan sponsor. Attachment A summarizes the research that ESOPs are good for America, the ESOP companies, and employee-owners in the vast majority of instances.

Note the words "borrow money", which clearly means you should have an interest in the approximately 11,000 ESOP companies.

But let's dig a little deeper.

First, a big picture statement as to why your subcommittee should be involved with ESOPs as you work with your primary concern, our nation's financial institutions. 90% of ownership is created in a free enterprise society by financing. The idea that one can work hard on a salaried job, save a few pennies, and then start and own a business that succeeds, but never be financed, is a "Pollyanna" pipe dream. Entrepreneurs get financed, and as they pay off their debt, or line of credit, what they own becomes more valuable.

ESOPs borrow money to enable average pay persons, the employees, to be owners. The ESOP method of financing cuts the employees in on the ownership of what makes people truly financial secure in a capitalistic system—productive assets.

The sources of ESOP financing are generally from the institutions you oversee.

So ESOPs are intertwined with financial institutions in economic theory, and in practicality.

Now let's climb down from the skies a bit.

In the 108th Congress, the Subcommittee's ranking member, Mr. Sanders, introduced H.R. 2969, and before the close of the Congress he was joined by 17 of his colleagues, including members of the committee Manzullo, Maloney, Carson, and Lee, plus members such as Rohrabacher and Goode. The entire package Mr. Sanders put forward was to create a method to fill a gap in financing the saving of American manufacturing jobs.

His proposal was to establish a lending program in the U.S. Treasury to provide loan guarantees, feasibility grants, and even in some instances direct loans to permit employees to buy their plants under certain condition and operate them as ESOP companies, or employee-owned co-operatives, which are called EWOCS.

In today's climate of tight budgets, and the general leeriness of many towards Federally sponsored loan programs, it will take more work by the employee ownership community to make the case to you and your colleagues that the entire H.R. 2969 package should move forward. We will continue to try to make that case, as it does not matter whether one is Republican, Democrat, or Independent, all are troubled to see American jobs lost, when there may be reasonable and sensible ways to preserve those jobs through employee ownership.

But, as ESOP experts reviewed H.R. 2969, one provision of Mr. Sanders et al bill jumped off the page as a modest, but meaningful first step in accomplishing several worthy goals.

The provision is Section 6 of H.R. 2969. Section 6 provides that the appropriate Federal financial supervisory agency assessing a financial institution's record of meeting the credit needs of its entire community should also include as a factor the institution's capital investments, loans, loan participation, technical assistance, financial advice, grants, and other ventures undertaken by the institution to support or enable manufacturing employees to establish employee stock ownership plans or eligible worker owned cooperatives that are at least 51% employee-owned plans or cooperatives.

Mr. Chairman, please note the precise language of Section 6. It is very modest. It does not automatically mean the Federal supervisory agency will mindlessly give a bank community reinvestment credit for making a loan to establish or expand an ESOP or an EWOC. It only makes it a factor. The loan also has to be for employees of a manufacturing facility that end up with at least 51% ownership.

In the real world, what kind of ESOP transaction are we talking about? We are talking about, under current ESOP laws and practices, about 150 to 200 new ESOP companies a year. Because of the 51% requirement, I would state that Section 6 would currently cover 80 to 100 ESOP transactions a year. These are companies that represent prior to the ESOP transaction a division, or a subsidiary of a much bigger company, that has decided, for whatever reason, to close the division down, or to sell it. Attachment B is a news article form the *Baltimore Sun* describing the typical situation I am talking about as a Belgium company sought to close a manufacturing facility in inner city Baltimore, but with the State of Maryland's help, the employees saved their jobs with a 100% ESOP buyout.

When this subcommittee had hearings on the entire H.R. 2969 on June 10, 2003, it heard stories of companies that were shut down, or about to be shut down, even though the union and management of the plant, and sometimes non-union employees and management, could make a strong case that as owners they could make the plant thrive in our global, extremely competitive market place.

But they often could not get the financing, as it is a fact that many regional, local, and even big national banks, do not understand employee ownership, much less understood how to finance employee ownership. So the jobs went down the tube.

Now, we come to a win-win situation: Financial institutions have the burden, and it can be easily justified, to comply with the Community Reinvestment Act of 1977. Congressman Sanders, in H.R. 2969, with Section 6, has proposed, "Here banks, help Americans, expand

ownership, and it will be easier for you to comply with the Community Reinvestment Act of 1977."

So here is a little step, easing a bit a regulatory requirement on financial institutions, and at the same time providing an incentive for more financial institutions to learn about making ESOP and EWOC loans to save jobs, and to expand ownership.

So Mr. Chairman, and subcommittee members, this is why I am here today.

Indulge me to put one more thought on the table. I quote a speech,

*In America's idea of freedom, citizens find the dignity and security of economic independence, instead of laboring on the edge of subsistence. This is the broader definition of liberty that motivated the Homestead Act.*

*To give every American a stake in the promise and future...we will...build an ownership society. We will widen the ownership of homes and businesses, retirement savings, and health insurance—preparing our people for the challenges of life in a free society.*

*By making every citizen an agenda of his or her own destiny, we will give our fellow Americans greater freedom from want and fear and make our society more prosperous and just and equal.* President George W. Bush, Inauguration Speech, January 20, 2005.

Mr. Chairman, and members of the subcommittee, there should be legitimate debate over the specifics of how to build a more prosperous, just, and equal society through ownership. But I submit that Section 6 of H.R. 2969 can be one small, but meaningful, specific step that will move us towards that ownership society, while at the same time, potentially easing a regulatory burden faced by those you oversee.

I appreciate your time and invitation to be here today.

Attachments

ATTACHMENT A

**J. Michael Keeling's May 19, 2005 Testimony**

# Employee Ownership and Corporate Performance

1. In 2004, the Employee Ownership Foundation, conducting its 13th Annual Economic Performance Survey, found that a very high percentage of companies, 88%, declared that creating employee ownership through an ESOP (employee stockownership plan) was "a good decision that has helped the company." In addition, the EPS asked companies to indicate their performance in 2003, relative to 2002. Approximately 65% of respondents indicated a better performance in 2003 than 2002, 12% indicated a nearly identical performance, and 23% indicated a worse performance. Around 70% indicated that revenue increased while 30% indicated revenue did not increase. In terms of profitability, 64% indicated that profitability did increase and 36% indicated that profitability did not increase in 2003. This survey was conducted in the summer of 2004 among corporate members of The ESOP Association.

2. The most comprehensive and significant study to date of ESOP performance in closely held companies was conducted by Dr. Joseph R. Blasi and Dr. Douglas L. Kruse, professors at the School of Management and Labor Relations at Rutgers University, and funded in part by the Employee Ownership Foundation. The study, which paired *1,100 ESOP companies* with *1,100 comparable non-ESOP companies* and followed the businesses for *over a decade*, reported overwhelmingly positive and remarkable results indicating that ESOPs appear to increase sales, employment, and sales/employee by about 2.3% to 2.4% over what would have been anticipated, absent an ESOP. In addition, Drs. Blasi and Kruse examined whether ESOP companies stayed in business longer than non-ESOP companies and found that 77.9% of the ESOP companies followed as part of the survey survived as compared to 62.3% of the comparable non-ESOP companies. According to Drs. Blasi and Kruse, ESOP companies are also more likely to continue operating as independent companies over the course of several years. Also, it is substantially more probable that ESOP companies have other retirement-oriented benefit plans than comparable non-ESOP companies, such as defined benefit plans, 401(k) plans, and profit sharing plans.

3. Research done by the Washington State Department of Community, Trade and Economic Development of over 100 Washington not publicly-traded ESOP companies compared to 500 not publicly-traded non-ESOP companies showed that the ESOP companies paid better benefits, had twice the retirement income for employees, and paid higher wages than their non-ESOP counterparts. Wealth and Income Consequences of Employee Ownership: A Comparative Study from Washington State, Kardas, Peter A., Scharf, Adria L., Keogh, Jim, November, 1998.

4. Research conducted by Professor Hamid Mehran, while he served on the faculty of the J.L. Kellogg Graduate School of Management, Northwestern University, of nearly 400 publicly traded companies with significant ESOPs both before and after the adoption of the ESOP, compared to non-ESOP companies in similar lines of businesses, showed that the rate of return for the ESOP companies was 2.7% higher, 60% of the ESOP companies experienced share price increases upon announcement of the ESOP program, and 82% indicated that the ESOP had a positive impact on business results.

5. In 1995, Douglas Kruse of Rutgers University examined several different studies between ESOPs and productivity growth. Kruse found through an analysis of all studies that "positive and significant coefficients [are found] much more often than would be expected if there were no true relation between ESOPs and productivity." Kruse concludes that "the average estimated productivity difference between ESOP and non-ESOP firms is 5.3%, while the average estimated pre/post-adoption difference is 4.4% and the post-adoption growth rate is 0.6% higher in ESOP firms. Kruse cites two studies as part of his

research: Kumbhakar and Dunbar's 1993 study of 123 public firms and Mitchell's 1990 study of 495 U.S. business units in public firms. Both reports found significant positive effects of greater productivity and profitability in the first few years after a company adopted an ESOP.

6. In 1995, the U.S. Department of Labor released a study entitled "The Financial and Non-Financial Returns to Innovative Workplace Practices: A Critical Review." This study found that companies that seek employee participation, give employees company stock, and train employees, can positively affect American corporations' bottom lines. In addition, the report cited three studies that analyzed "the market reaction to announcements of ESOPs which found significant positive returns to firms which implemented ESOPs as part of a broader employee benefit or wage concession plan." The three studies are: Chang's 1990 "Employee Stock Ownership Plans and Shareholder Wealth: An Empirical Investigation"; Dhillon and Ramirez' 1994 "Employee Stock Ownership and Corporate Control"; and Gordon and Pound's 1990 "ESOPs and Corporate Control." citation at (202) 293-2971 or E-mail: esop@csopassocation.org.

*For additional information about ESOP or The ESOP Association, visit the website at www.esopassociation.org, call 1-866-366-3832, or email esop@esopassociation.org.*

J. Michael Keeling's May 19, 2005 Testimony

http://www.baltimoresun.com/business/bal-te.bz.hedwin21feb21,1,2014466.story

# Workers get the business

## Purchase: Faced with possibly losing their jobs, Baltimore employees of a container factory join to buy the company.

By Stacey Hirsh
Sun Staff

February 21, 2004

As a machine operator at Hedwin Corp. in Baltimore, Grace Heughan spent yesterday afternoon opening plastic cubes and hanging them on hooks at the factory.

Her factory.

Heughan, a five-year employee, is among about 300 workers at the maker of industrial plastic containers who have bought Hedwin in an effort to keep their jobs from moving out of Maryland.

About 100 Hedwin employees from outside the state also participated in the purchase.

"I was grateful that they did it because a lot of people would have been out of jobs - including me," said Heughan, 44, who works on the line assembling "cubitainers" used to store liquids, from medical chemicals to Japanese saki for restaurants.

Hedwin, which was founded in Baltimore in 1946, was up for sale last year by its parent company, Solvay S.A. of Belgium.

A potential buyer signaled that it might move jobs out of the state and cut employee benefits.

So the workers bought Hedwin, through an employee stock ownership plan, with the help of a state loan guarantee.

The Maryland Industrial Development Financing Authority, which offers incentives to encourage private economic development projects, agreed to insure $2.5 million of an $8.2 million loan to help keep the plant running, the state announced yesterday.

"Many, if not all, of the jobs here in Baltimore were in jeopardy over the short term and the long term," said company President David E. Rubley.

### Political element

The move was considered such a success story, and political coup, that Gov. Robert L. Ehrlich Jr. and Lt. Gov. Michael S. Steele attended yesterday's ceremony at the plant, near Hampden.

With the shift of manufacturing work overseas emerging as an issue in presidential politics, the governor seemed pleased to have a more creative, favorable outcome to announce.

The number of manufacturing positions in the country has fallen by more than 2 million in the past decade, the result of lower-wage jobs overseas and technological advances, even as overall employment has increased by nearly 20 million during that period.

"At one time, we were part of the great manufacturing business in this country," Ehrlich told the Hedwin workers during a visit to the plant yesterday, adding that many of those jobs have gone.

Steele added, "What we're about ... is promoting a climate of change that facilitates rather than hinders the growth of business in this city."

### Grateful employees

The announcement that the state was helping to save a plant in Baltimore City - the turf of a possible competitor in the 2006 gubernatorial election, Democratic Mayor Martin O'Malley - was a smart political move for the Republican governor, said Matthew Crenson, a Johns Hopkins University political science professor.

"I think the people who stood in danger of losing their jobs and seeing the plant move away are probably very grateful," Crenson said.

"And a lot of them are probably traditional Democratic voters."

Crenson pointed out that Ehrlich's visit to the plant came on the same day that U.S. Sen. John Edwards of North Carolina, a Democratic presidential candidate, briefly visited the state with his message of creating better jobs for the middle class.

Aris Melissaratos, secretary of the Maryland Department of Business and Economic Development - who worked at Hedwin briefly during the summer of 1963 - called the employee purchase "a new beginning for Maryland's manufacturing."

Company officials said that they couldn't have done the deal without the state backing.

Hedwin employees bought the plant with an $8.2 million machinery and equipment loan from LaSalle Business Credit, LLC.

But the purchase price of the company exceeded what the bank could give Hedwin, the company said.

Without the guarantee for an additional $2.5 million from the state, the sale wouldn't have gone through. The deal closed Jan. 30.

### Government incentives

Employee purchases of their companies typically come with state and local incentives because it is less expensive for the government to help them save their company than to pay unemployment benefits, said Charles Craver, a labor law professor at George Washington University Law School.

Many of the factory workers at the Hedwin plant never believed they would own their own company.

Having a stake in their business, they said, would motivate them to work even harder.

Frank Sponheimer, a mechanic who has worked at Hedwin for more than 20 years, said:

"It's a big incentive for everybody to do the best they can."

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**Testimony of**

**America's Community Bankers**

**on**

**Financial Services Regulatory Relief: Private Sector Perspectives**

**before the**

**Subcommittee on Financial Institutions and Consumer Credit**

**of the**

**Committee on Financial Services**

**of the**

**United States House of Representatives**

**on**

**May 19, 2005**

**Mark E. Macomber**
**President and CEO**
**Litchfield Bancorp**
**Litchfield, Connecticut**

**and**

**Second Vice Chairman**
**Board of Directors**
**America's Community Bankers**
**Washington, DC**

Chairman Bachus, Congressman Sanders and Members of the Committee, I am Mark Macomber, President and CEO of Litchfield Bancorp in Litchfield, Connecticut. Litchfield Bancorp is a $175 million state chartered community bank, part of a two bank mutual holding company. I also serve as CEO of the holding company.

I am here this morning representing America's Community Bankers. I am the Second Vice Chairman of ACB's Board of Directors. I want to thank Chairman Bachus, Congressman Hensarling and Congressman Moore of Kansas for their leadership in addressing 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. Many of ACB's specific recommendations for regulatory relief have been included in regulatory relief legislation adopted by the Financial Services Committee and the House, including the Financial Services Regulatory Relief Act of 2004 (H.R. 1375). The House adopted H.R. 1375 by an overwhelming bipartisan vote of 392 to 25. We greatly appreciate the past support of the Financial Institutions Subcommittee and the Financial Services Committee for these proposals, and we hope the Members of the Committee will support those provisions and others that we will discuss today.

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 meaningful reduction of regulatory burden.

This hearing and this topic are important and timely. Community banks operate under a regulatory scheme that becomes more and more burdensome every year. Ten years ago there were 12,000 banks in the US. Today, there are only 9,000 left. ACB is concerned that community banks are becoming less and less able to compete with financial services conglomerates and unregulated companies that offer similar products and services without the same degree of regulation and oversight 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 for my small mutual community bank 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.

Bankers are not the only ones concerned about the impact of the increasing layers of regulation on community banks. According to FDIC Vice Chairman John Reich, the bank and savings association regulatory agencies have promulgated over 800 regulations since 1989. In the opinion of the Vice Chairman, although most of the rule changes were put in place for good, sound reasons, over 800 changes in 15 years are a lot for banks to digest, particularly smaller community banks with very limited staff. Vice Chairman Reich believes that regulatory burden will play an increasingly significant role in the viability of community banks in the future. I agree.

Before turning to specific recommendations for legislative changes, I would like to discuss two areas where the implementation of laws by the regulators has been carried out in a fashion that creates unnecessary uncertainty and burden on community banks, namely, anti-money laundering and corporate governance.

Community bankers fully support the goals of the anti-money laundering laws, and we are prepared to do our part in the fight against crime and terrorism. As laudable as these goals are, there currently exists an atmosphere of uncertainly and confusion about what is required of banks. This results from inconsistent messages being given by regulatory staff in the field, the region and Washington. For example, Washington officials repeatedly assure the banking industry that the banking agencies do not have a "zero-tolerance" policy, where every minor discrepancy is treated as a significant failure to comply with the law. Nevertheless, regional offices and individual examiners continue to articulate a "zero-tolerance policy" when conducting BSA examinations and when making presentations during industry conferences. In another example of inconsistent policy, FinCEN has admonished banks not to file "defensive suspicious activity reports," but as recent enforcement actions taken by the banking agencies and prosecutions by the Department of Justice demonstrate, it is safer for banks to file SARs, when in doubt.

The opportunity costs of BSA compliance go beyond hampering an institution's ability to expand and hire new employees. In some cases, fear of regulatory criticism has led some institutions to sever ties with existing banking customers or forego the opportunity to develop banking relationships with new customers.

ACB and other industry representatives have been working with FinCEN and the banking regulators to improve the regulation of our anti-money laundering efforts. As a result of this dialogue, FinCEN and the banking agencies recently issued joint guidance to banks on what level of scrutiny they should use with respect to the accounts of money service businesses. ACB

commends the agencies for providing this needed clarification of bank responsibilities. ACB will continue to work with government agencies to provide further clarification of the responsibilities of banks under the nation's anti-money laundering laws. We look forward to the release of additional guidance in this area and are pleased that the agencies have planned training sessions for examiners and bankers so that a consistent message can be given to everyone at the same time.

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, 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 and the Public Company Accounting Oversight Board 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 institutions and mutual institutions.

For example, the PCAOB requires the external auditor to audit the internal controls of a company, rather than audit the CEO's attestation with respect to the internal controls -- which was the practice generally permitted by the banking agencies for compliance with FDICIA's internal control requirements. 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 75percent over the prior year. Some banks are reporting audit fees equal to 20percent 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 non-public 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 appreciate the separate guidance on internal control reporting and attestation requirements issued concurrently by the SEC and the PCAOB, and are hopeful that it might provide some relief to the escalating audit fees.

(We have attached a letter, which ACB recently submitted to the banking regulators, detailing these suggestions and also suggestions for improving anti-money laundering regulation.)

## Legislative Recommendations

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. ACB's specific legislative proposals are attached in an appendix.

## Priority Issues

***Expanded Business Lending***

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. Today, savings associations are increasingly important providers of small business credit in communities throughout the country. As a result, even the "10 plus 10" limit poses a 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. An increase in commercial lending authority would help increase small business access to credit, particularly in smaller communities where the number of financial institutions is limited. 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.

***Parity Under the Securities Exchange Act and Investment Advisers Act***

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 SE C 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 and the SEC 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.

***Easing Restrictions on Interstate Banking and Branching***

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 may 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 five years. The new branching rights should not be available to newly acquired or chartered industrial loan companies with commercial parents (those that derive more than 15 percent of revenues from non-financial activities).

## Other Important Issues

***Interest on Business Checking***

Prohibiting banks from paying interest on business checking accounts is long outdated, unnecessary and anti-competitive. 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.

ACB supports the approach taken in H.R. 1224, Business Checking Freedom Act of 2005, as adopted by the Financial Services Committee on April 27, 2005.

***Eliminating Unnecessary Branch Applications***

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***

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***

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 non-residential 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 non-residential real property lending that exceeds 500 percent of capital.

***Loans to One Borrower***

ACB recommends eliminating the $500,000-per-unit limit in the residential housing development provision in the loans-to-one-borrower section of the Home Owners' Loan Act. This limit frustrates the goal of advancing residential development within the statute's overall limit – the lesser of $30 million or 30 percent of capital. This overall limit is sufficient to prevent

concentrated lending to one borrower/housing developer. The per-unit limit is an excessive regulatory detail that creates an artificial market restriction in high-cost areas.

***Home Office Citizenship***

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. The amendment would provide certainty in designating the state of their citizenship.

A recent court decision has cast doubt on national banks' ability to access the federal courts on the basis of diversity jurisdiction. Regulatory relief legislation should also clarify that national banks are citizens of their home states for diversity jurisdiction purposes.

***Interstate Acquisitions***

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***

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***

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***

ACB recommends another amendment to the ILSA that would add OTS to the multi-agency 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***

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***

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.

***Reducing Debt Collection Burden***

Under the Fair Debt Collection Practices Act, a debtor has 30 days in which to dispute a debt. ACB supports legislation that makes clear that a debt collector need not stop collection efforts for that 30-day period while the debtor decides whether or not to dispute the debt. This removes an ambiguity that has come up in some instances. If a collector has to cease action for 30 days, valuable assets, which may be sufficient to satisfy the debt, may vanish during the 30-day period.

***Mortgage Servicing Clarification***

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 on H.R. 314, 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***

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***

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, i.e., those other than housing, education, and certain secured loans. This would conform the law to the current requirement for all other officers, i.e., 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***

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.

***Bank Service Company Investments***

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 BSCs 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.

***Eliminating Savings Association Service Company Geographic Restrictions***

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***

ACB recommends that Congress eliminate the unnecessary requirement that a state 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.

***Authorizing Additional Community Development Activities***

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 CDCs. 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***

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 pre-notify the OTS of dividend payments.

***Reimbursement for the Production of Records***

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, that 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***

ACB recommends that unitary savings and loan holding companies that become multiple savings and loan holding companies be provided 10 years to divest non-conforming activities, rather than the current two-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 fire-sale divestiture.

***Restrictions on Auto Loan Investments***

Federal savings associations are currently limited in making auto loans to 35 percent of total assets. ACB recommends eliminating this restriction. 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***

ACB strongly supports amending the Community Reinvestment Act to define banks with less than $1 billion dollars 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.

***Credit Card Savings Associations***

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***

Recent 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.

## 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.

# Appendix A

# to

# America's Community Bankers'

# Testimony

# on

**Financial Services Regulatory Relief: Private Sector Perspectives**

**before the**

**Subcommittee on Financial Institutions and Consumer Credit**

**of the**

**Committee on Financial Services**

**of the**

**United States House of Representatives**

**on**

**May 19, 2005**

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# Expanded Business Lending

**SEC. __. SMALL BUSINESS AND OTHER COMMERCIAL LOANS –**

(a) ELIMINATION OF LENDING LIMIT ON SMALL BUSINESS LOANS- Section 5(c)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(1)) is amended by inserting after subparagraph (V) (as added by section 208 of this title) the following new subparagraph:

> `(W) SMALL BUSINESS LOANS- Small business loans, as defined in regulations which the Director shall prescribe.'

(b) INCREASE IN LENDING LIMIT ON OTHER BUSINESS LOANS- Section 5(c)(2)(A) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(2)(A)) is amended by striking `, and amounts in excess of 10 percent' and all that follows through `by the Director'.

**Explanation**

This would eliminate the lending limit on small business loans and increase the lending limit on other business loans from 10 percent to 20 percent of assets. Expanded authority would enable savings associations to make more loans to small- and medium-sized businesses, enhancing their role as community lenders.

## Parity for Savings Associations Under the Securities Exchange Act and Investment Advisers Act

### SEC.__. PARITY FOR SAVINGS ASSOCIATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934 AND THE INVESTMENT ADVISERS ACT OF 1940.

(a) SECURITIES EXCHANGE ACT OF 1934-

(1) DEFINITION OF BANK- Section 3(a)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(6)) is amended—

(A) in subparagraph (A), by inserting `or a Federal savings association, as defined in section 2(5) of the Home Owners' Loan Act' after `a banking institution organized under the laws of the United States'; and

(B) in subparagraph (C)—

(i) by inserting `or savings association as defined in section 2(4) of the Home Owners' Loan Act,' after `banking institution,'; and

(ii) by inserting `or savings associations' after `having supervision over banks'.

(2) INCLUDE OTS UNDER THE DEFINITION OF APPROPRIATE REGULATORY AGENCY FOR CERTAIN PURPOSES- Section 3(a)(34) of such Act (15 U.S.C. 78c(a)(34)) is amended—

(A) in subparagraph (A)—

(i) in clause (ii), by striking `(i) or (iii)' and inserting `(i), (iii), or (iv)';

(ii) by striking `and' at the end of clause (iii);

(iii) by redesignating clause (iv) as clause (v); and

(iv) by inserting the following new clause after clause (iii):

`(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation, a subsidiary or a department or division of any such savings association, or a savings and loan holding company; and';

(B) in subparagraph (B)—

(i) in clause (ii), by striking `(i) or (iii)' and inserting `(i), (iii), or (iv)';

(ii) by striking `and' at the end of clause (iii);
(iii) by redesignating clause (iv) as clause (v); and
(iv) by inserting the following new clause after clause (iii):
`(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation, or a subsidiary of any such savings association, or a savings and loan holding company; and';

(C) in subparagraph C—
(i) in clause (ii), by striking `(i) or (iii)' and inserting `(i), (iii), or (iv)';
(ii) by striking `and' at the end of clause (iii);
(iii) by redesignating clause (iv) as clause (v); and
(iv) by inserting the following new clause after clause (iii):
`(iv) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation, a savings and loan holding company, or a subsidiary of a savings and loan holding company when the appropriate regulatory agency for such clearing agency is not the Commission; and';

(D) in subparagraph (D)—
(i) by striking `and' at the end of clause (ii);
(ii) by redesignating clause (iii) as clause (iv); and
(iii) by inserting the following new clause after clause (ii):
`(iii) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation; and';

(E) in subparagraph (F)—
(i) by redesignating clauses (ii), (iii), and (iv) as clauses (iii), (iv), and (v), respectively; and
(ii) by inserting the following new clause after clause (i):
`(ii) the Director of the Office of Thrift Supervision, in the case of a savings association (as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b))) the deposits of which are insured by the Federal Deposit Insurance Corporation; and';
and

(F) at the end of the last undesignated paragraph, by inserting the following new sentence: `As used in this paragraph, the term `savings and

loan holding company' has the meaning given it in section 10(a) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)).'.

(b) INVESTMENT ADVISERS ACT OF 1940-

(1) DEFINITION OF BANK- Section 202(a)(2) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(2)) is amended—

(A) in subparagraph (A) by inserting `or a Federal savings association, as defined in section 2(5) of the Home Owners' Loan Act` after `a banking institution organized under the laws of the United States'; and

(B) in subparagraph (C)—

(i) by inserting `, savings association as defined in section 2(4) of the Home Owners' Loan Act,' after `banking institution'; and

(ii) by inserting `or savings associations' after `having supervision over banks'.

(2) CONFORMING AMENDMENTS- Subsections (a)(1)(A)(i), (a)(1)(B), (a)(2), and (b) of section 210A of such Act (15 U.S.C. 80b-10a), as added by section 220 of the Gramm-Leach-Bliley Act, are each amended by striking `bank holding company' each place it occurs and inserting `bank holding company or savings and loan holding company'.

(c) CONFORMING AMENDMENT TO THE INVESTMENT COMPANY ACT OF 1940- Section 10I of the Investment Company Act of 1940 (15 U.S.C. 80a-10I), as amended by section 213I of the Gramm-Leach-Bliley Act, is amended by inserting after `1956)' the following: `or any one savings and loan holding company (together with its affiliates and subsidiaries) (as such terms are defined in section 10 of the Home Owners' Loan Act)'.

**Explanation**

This amendment provides parity for savings associations with banks under the Securities Exchange Act and Investment Advisers Act. The provision 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.

**Easing Restrictions on Interstate Banking and Branching**

## SEC. ___. EASING RESTRICTIONS ON INTERSTATE BRANCHING AND MERGERS.

(a) DE NOVO INTERSTATE BRANCHES OF NATIONAL BANKS-

(1) IN GENERAL- Section 5155(g)(1) of the Revised Statutes of the United States (12 U.S.C. 36(g)(1)) is amended by striking `maintain a branch if--' and all that follows through the end of subparagraph (B) and inserting `maintain a branch.'.

(2) CLERICAL AMENDMENT- The heading for subsection (g) of section 5155 of the Revised Statutes of the United States is amended by striking `STATE `OPT-IN' ELECTION TO PERMIT'.

(b) DE NOVO INTERSTATE BRANCHES OF STATE NONMEMBER BANKS-

(1) IN GENERAL- Section 18(d)(4)(A) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(4)(A)) is amended by striking `maintain a branch if--' and all that follows through the end of clause (ii) and inserting `maintain a branch.'.

(2) INTERSTATE BRANCHING BY SUBSIDIARIES OF COMMERCIAL FIRMS PROHIBITED- Section 18(d)(3)) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(3)) is amended by adding at the end the following new subparagraph:

`(C) INTERSTATE BRANCHING BY SUBSIDIARIES OF COMMERCIAL FIRMS PROHIBITED-

`(i) IN GENERAL- If the appropriate State bank supervisor of the home State of any industrial loan company, industrial bank, or other institution described in section 2(c)(2)(H) of the Bank Holding Company Act of 1956, or the appropriate State bank supervisor of any host State with respect to such company, bank, or institution, determines that such company, bank, or institution is controlled, directly or indirectly, by a commercial firm, such company, bank, or institution may not acquire, establish, or operate a branch in such host State.

`(ii) COMMERCIAL FIRM DEFINED- For purposes of this subsection, the term `commercial firm' means any entity at least 15 percent of the annual gross revenues of which on a consolidated basis, including all affiliates of the entity, were derived from engaging, on an on-going basis, in activities that are not financial in nature or incidental to a financial activity during at least 3 of the prior 4 calendar quarters.

`(iii) GRANDFATHERED INSTITUTIONS- Clause (i) shall not apply with respect to any industrial loan company, industrial bank, or other institution described in section 2(c)(2)(H) of the Bank Holding Company Act of 1956--

`(I) which became an insured depository institution before October 1, 2003 or pursuant to an application for deposit insurance which was approved by the Corporation before such date; and

`(II) with respect to which there is no change in control. directly or indirectly, of the company, bank, or institution after September 30, 2003, that requires an application under subsection (c), section 7(j), section 3 of the Bank Holding Company Act of 1956, or section 10 of the Home Owners' Loan Act.

`(iv) TRANSITION PROVISION- Any divestiture required under this subparagraph of a branch in a host State shall be completed as quickly as is reasonably possible.

`(v) CORPORATE REORGANIZATIONS PERMITTED- The acquisition of direct or indirect control of the company, bank, or institution referred to in clause (iii)(II) shall not be treated as a `change in control' for purposes of such clause if the company acquiring control is itself directly or indirectly controlled by a company that was an affiliate of such company, bank, or institution on the date referred to in clause (iii)(II), and remained an affiliate at all times after such date.'.

(3) TECHNICAL AND CONFORMING AMENDMENTS- Section 18(d)(4) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(4)) is amended--

(A) in subparagraph (A) by striking `Subject to subparagraph (B)' and inserting `Subject to subparagraph (B) and paragraph (3)(C)'; and

(B) in subparagraphs (D) and (E), by striking `The term' and inserting `For purposes of this subsection, the term'.

(4) CLERICAL AMENDMENT- The heading for paragraph (4) of section 18(d) of the Federal Deposit Insurance Act is amended by striking `STATE `OPT-IN' ELECTION TO PERMIT INTERSTATE' and inserting `INTERSTATE'.

(c) DE NOVO INTERSTATE BRANCHES OF STATE MEMBER BANKS- The 3rd undesignated paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 321) is amended by adding at the end the following new sentences: `A State member bank may establish and operate a de novo branch in a host State (as such terms are defined in section 18(d) of the Federal Deposit Insurance Act) on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of a de novo branch of a national bank in a host State under section 5155(g) of the Revised Statutes of the United States or are applicable to an insured State nonmember bank under section 18(d)(3) of the Federal Deposit Insurance Act' after `Revised Statutes of the United States'. Such section 5155(g) shall be applied for purposes of the preceding sentence by substituting `Board of Governors of the Federal Reserve System' for `Comptroller of the Currency' and `State member bank' for `national bank'.'.

(d) INTERSTATE MERGER OF BANKS-

(1) MERGER OF INSURED BANK WITH ANOTHER DEPOSITORY INSTITUTION OR TRUST COMPANY- Section 44(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1831u(a)(1)) is amended--

(A) by striking `Beginning on June 1, 1997, the' and inserting `The'; and

(B) by striking `insured banks with different home States' and inserting `an insured bank and another insured depository institution or trust company with a different home State than the resulting insured bank'.

(2) NATIONAL BANK TRUST COMPANY MERGER WITH OTHER TRUST COMPANY- Subsection (b) of section 4 of the National Bank Consolidation and Merger Act (12 U.S.C. 215a-1(b)) is amended to read as follows:

`(b) MERGER OF NATIONAL BANK TRUST COMPANY WITH ANOTHER TRUST COMPANY- A national bank that is a trust company may engage in a consolidation or merger under this Act with any trust company with a different home State, under the same terms and conditions that would apply if the trust companies were located within the same State.'.

(e) INTERSTATE FIDUCIARY ACTIVITY- Section 18(d) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)) is amended by adding at the end the following new paragraph:

`(5) INTERSTATE FIDUCIARY ACTIVITY-

`(A) AUTHORITY OF STATE BANK SUPERVISOR- The State bank supervisor of a State bank may approve an application by the State bank, when not in contravention of home State or host State law, to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in a host State in which State banks or other corporations which come into competition with national banks are permitted to act under the laws of such host State.

`(B) NONCONTRAVENTION OF HOST STATE LAW- Whenever the laws of a host State authorize or permit the exercise of any or all of the foregoing powers by State banks or other corporations which compete with national banks, the granting to and the exercise of such powers by a State bank as provided in this paragraph shall not be deemed to be in contravention of host State law within the meaning of this paragraph.

`(C) STATE BANK INCLUDES TRUST COMPANIES- For purposes of this paragraph, the term `State bank' includes any State-chartered trust company (as defined in section 44(g)).

`(D) OTHER DEFINITIONS- For purposes of this paragraph, the term `home State' and `host State' have the meanings given such terms in section 44.'.

(f) TECHNICAL AND CONFORMING AMENDMENTS-

(1) Section 44 of the Federal Deposit Insurance Act (12 U.S.C. 1831u) is amended--

(A) in subsection (a)--

(i) by striking paragraph (4) and inserting the following new paragraph:

`(4) TREATMENT OF BRANCHES IN CONNECTION WITH CERTAIN INTERSTATE MERGER TRANSACTIONS- In the case of an interstate merger transaction which involves the acquisition of a branch of an insured depository institution or trust company without the acquisition of the insured depository institution or trust company, the branch shall be treated, for purposes of this section, as an insured depository institution or trust company the home State of which is the State in which the branch is located.'; and

(ii) by striking paragraphs (5) and (6) and inserting the following new paragraph:

`(5) APPLICABILITY TO INDUSTRIAL LOAN COMPANIES- No provision of this section shall be construed as authorizing the approval of any transaction involving a industrial loan company, industrial bank, or other institution described in section 2(c)(2)(H) of the Bank Holding Company Act of 1956, or the acquisition, establishment, or operation of a branch by any such company, bank, or institution, that is not allowed under section 18(d)(3).'.

(B) in subsection (b)--

(i) by striking `bank' each place such term appears in paragraph (2)(B)(i) and inserting `insured depository institution';

(ii) by striking `banks' where such term appears in paragraph (2)(E) and inserting `insured depository institutions or trust companies';

(iii) by striking `bank affiliate' each place such term appears in that portion of paragraph (3) that precedes subparagraph (A) and inserting `insured depository institution affiliate';

(iv) by striking `any bank' where such term appears in paragraph (3)(B) and inserting `any insured depository institution';

(v) by striking `bank' where such term appears in paragraph (4)(A) and inserting `insured depository institution and trust company'; and

(vi) by striking `all banks' where such term appears in paragraph (5) and inserting `all insured depository institutions and trust companies';

(C) in subsection (d)(1), by striking `any bank' and inserting `any insured depository institution or trust company';

(D) in subsection (e)--

(i) by striking `1 or more banks' and inserting `1 or more insured depository institutions'; and

(ii) by striking `paragraph (2), (4), or (5)' and inserting `paragraph (2)';

(E) by striking clauses (i) and (ii) of subsection (g)(4)(A) and inserting the following new clauses:

`(i) with respect to a national bank or Federal savings association, the State in which the main office of the bank or savings association is located; and

`(ii) with respect to a State bank, State savings association, or State-chartered trust company, the State by which the bank, savings association, or trust company is chartered; and';

(F) by striking paragraph (5) of subsection (g) and inserting the following new paragraph:

`(5) HOST STATE- The term `host State' means--

`(A) with respect to a bank, a State, other than the home State of the bank, in which the bank maintains, or seeks to establish and maintain, a branch; and

`(B) with respect to a trust company and solely for purposes of section 18(d)(5), a State, other than the home State of the trust company, in which the trust company acts, or seeks to act, in 1 or more fiduciary capacities.';

(G) in subsection (g)(10), by striking `section 18(c)(2)' and inserting `paragraph (1) or (2) of section 18(c), as appropriate,'; and

(H) in subsection (g), by adding at the end the following new paragraph:

`(12) TRUST COMPANY- The term `trust company' means--

`(A) any national bank;

`(B) any savings association; and

`(C) any bank, banking association, trust company, savings bank, or other banking institution which is incorporated under the laws of any State, that is authorized to act in 1 or more fiduciary capacities but is not engaged in the business of receiving deposits other than trust funds (as defined in section 3(p)).'.

(2) Section 3(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1842(d)) is amended--

(A) in paragraph (1)--

(i) by striking subparagraphs (B) and (C); and

(ii) by redesignating subparagraph (D) as subparagraph (B); and

(B) in paragraph (5), by striking `subparagraph (B) or (D)' and inserting `subparagraph (B)'.

(3) Subsection (c) of section 4 of the National Bank Consolidation and Merger Act (12 U.S.C. 215a-1(c)) is amended to read as follows:

`(c) DEFINITIONS- For purposes of this section, the terms `home State', `out-of-State bank', and `trust company' each have the same meaning as in section 44(g) of the Federal Deposit Insurance Act.'.

(g) CLERICAL AMENDMENTS-

(1) The heading for section 44(b)(2)(E) of the Federal Deposit Insurance Act (12 U.S.C. 1831u(b)(2)(E)) is amended by striking `BANKS' and inserting `INSURED DEPOSITORY INSTITUTIONS AND TRUST COMPANIES'.

(2) The heading for section 44(e) of the Federal Deposit Insurance Act (12 U.S.C. 1831u(e)) is amended by striking `BANKS' and inserting `INSURED DEPOSITORY INSTITUTIONS'.

**Explanation**

This amendment removes prohibition on national and state banks from expanding through de novo interstate branching. Currently, this may occur only if a state's law expressly permits interstate branching. The amendment clarifies that a state member bank may establish a de novo interstate branch under the same terms and conditions applicable to national banks. The authority for a state to prohibit an out-of-state bank or bank holding company from acquiring, through merger or acquisition, an in-state bank that has not existed for at least five years is eliminated. It also authorizes consolidations or mergers between an insured bank and a noninsured bank with different home states. The amendment would not apply to newly acquired or chartered industrial loan companies with commercial parents (those that derive more than 15 percent of revenues from non-financial activities).

## Interest on Business Checking

In the 109th Congress, ACB supported H.R. 1224, the Business Checking Freedom Act, as adopted by the House Financial Services Committee. H.R. 1224 repeals the Depression-era ban on interest bearing business checking accounts. In addition to permitting interest bearing checking accounts in banks and savings associations, the Committee's legislation permits certain industrial loan companies to offer interest-bearing business NOW accounts. This latter provision is restricted to certain grandfathered industrial loan companies and industrial loan companies with non-commercial parents. ACB supports the restriction on authority of industrial loan companies to offer interest-bearing business NOW accounts. ACB suggests the use of the language of H.R. 1224 as adopted by the Committee.

## Eliminating Unnecessary Branch Applications

**SEC. 1. BRANCH NOTIFICATION BY NATIONAL BANKS**—Section 5155(i) of the Revised Statutes (12 U.S.C. 36(i)) is amended to read as follows:

> "(i) A national bank that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Comptroller within 30 calendar days."

**SEC. 2. BRANCH NOTIFICATION BY STATE MEMBER BANKS**—Section 22 of the Federal Reserve Act is amended by adding the following new subsection:

> "(i) A State member insured bank that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Board within 30 calendar days."

**SEC. 3. BRANCH NOTIFICATION BY STATE NONMEMBER BANKS**—Section 18(d)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(1)) is amended to read as follows:

> "(1) A State nonmember insured bank that is well-capitalized (as that term is defined in section 38 of this Act) may establish a branch, provided that it notifies the Corporation within 30 calendar days."

**SEC. 4. BRANCH NOTIFICATION BY FEDERAL SAVINGS ASSOCIATIONS**– Section 4(m)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(m)(1)) is amended to read as follows:

> "(1) IN GENERAL. A Federal savings association that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Director within 30 calendar days."

**Explanation**

Section 1 replaces a requirement that a national bank receive prior approval to open a branch with a provision that permits a national bank to establish a branch so long as it notifies the Comptroller within 30 calendar days.

Section 2 provides that a state member bank may open a branch so long as it notifies the Federal Reserve within 30 calendar days. This overrides the regulatory requirement of Regulation H (12 C.F.R. 208.6).

Section 3 replaces a requirement that a state nonmember bank receive prior approval to open a branch with a provision that permits a state nonmember bank to establish a branch so long as it notifies the FDIC within 30 calendar days.

Section 4 replaces a requirement that savings associations located in the District of Columbia obtain prior approval with a provision that permits any Federal savings association to establish a branch so long as it notifies the Director of OTS within 30 calendar days.

Under current regulatory practice, applications for new branches are routinely granted for strong institutions. Many other application requirements have been replaced with notification procedures. These amendments will expedite the ability of those institutions to open new branches, allowing them to more quickly offer services to additional communities, enhance competition.

## Coordination of State Examination Authority

**SEC. ____. COORDINATION OF STATE EXAMINATION AUTHORITY.** Section 10(h) of the Federal Deposit Insurance Act (12 U.S.C. 1820(h)) is amended to read as follows:

"(h) COORDINATION OF EXAMINATION AUTHORITY.—

"(1) IN GENERAL.—The appropriate State bank supervisor of the home State of an insured State bank has authority to examine and supervise the bank. The State bank supervisor of the home State of an insured State bank shall exercise its authority to supervise and examine the branches of the bank in a host State in accordance with the terms of any applicable cooperative agreement between the home State bank supervisor and the State bank supervisor of the relevant host State. Except as expressly provided in a cooperative agreement between the State bank supervisors of the home State and host State(s) of an insured State bank, only the State bank supervisor of the home State of an insured State bank may levy or charge State supervisory fees on the bank.

"(2) HOST STATE EXAMINATION.—With respect to a branch operated in a host State by an out-of-State insured State bank that resulted from an interstate merger transaction approved under section 44 or that was established in such State pursuant to section 5155(g) of the Revised Statutes, the third undesignated paragraph of section 9 of the Federal Reserve Act or section 18(d)(4) of this Act, the appropriate State bank supervisor of such host State may—

"(A) with written notice to the State bank supervisor of the bank's home State and subject to the terms of any applicable cooperative agreement with the State bank supervisor of such home State, examine such branch for the purpose of determining compliance with host State laws that are applicable pursuant to section 24(j) of this Act, including those that govern community reinvestment, fair lending, and consumer protection; and

"(B) if expressly permitted under and subject to the terms of a cooperative agreement with the State bank supervisor of the bank's home State or if such out-of-State insured State bank has been determined to be in a troubled condition by either the State bank supervisor of the bank's home State or the bank's appropriate Federal banking agency, participate in the examination of the bank by the State bank supervisor of the bank's home State to ascertain that the activities of the branch in such host State are not conducted in an unsafe or unsound manner. The State bank supervisor of the home State of an insured State bank shall notify the State bank supervisor of each host State of the bank if there has been a final determination that the bank is in a troubled condition. The State bank supervisor of the bank's home State shall provide such notice as soon as reasonably possible but in all cases within 15 business days after the State bank supervisor has made such final determination or has received written notification of such final determination.

"(3) HOST STATE ENFORCEMENT.—If the State bank supervisor of a host State determines that a branch of an out-of-State insured State bank is violating any law of the host State that is applicable to such branch pursuant to section 24(j) of this Act, including a law that governs community reinvestment, fair lending, or consumer protection, the State bank supervisor of the host State or, to the extent authorized by the law of the host State, a host State law enforcement officer may, with written notice to the State bank supervisor of the bank's home State and subject to the terms of any applicable cooperative agreement with the State bank supervisor of the bank's home State, undertake such enforcement actions and proceedings as would be permitted under the law of the host State as if the branch were a bank chartered by that host State.

"(4) COOPERATIVE AGREEMENT.—The State bank supervisors from 2 or more States may enter into cooperative agreements to facilitate State regulatory supervision of State banks, including cooperative agreements relating to the coordination of examinations and joint participation in examinations. For purposes of this subsection (h), the term "cooperative agreement" means a written agreement that is signed by the home State bank supervisor and host State bank supervisor to facilitate State regulatory supervision of State banks and includes nationwide or multi-state cooperative agreements and cooperative agreements solely between the home State and host State. Except for State bank supervisors, no provision of this subsection (h) relating to such cooperative agreements shall be construed as limiting in any way the authority of home and host State law enforcement officers, regulatory supervisors, or other officials that have not signed such cooperative agreements to enforce host State laws that are applicable to a branch of an out-of-State insured State bank located in the host State pursuant to section 24(j) of this Act.

"(5) FEDERAL REGULATORY AUTHORITY.—No provision of this subsection shall be construed as limiting in any way the authority of any Federal banking agency.

"(6) STATE TAXATION AUTHORITY NOT AFFECTED.—No provision of this subsection (h) shall be construed as affecting the authority of any State or political SUBDIVISION of any State to adopt, apply, or administer any tax or method of taxation to any bank, bank holding company, or foreign bank, or any affiliate of any bank, bank holding company, or foreign bank, to the extent such tax or tax method is otherwise permissible by or under the Constitution of the United States or other Federal law.

"(7) DEFINITIONS.—For purpose of this section, the following definitions shall apply:

"(A) The terms "host State", "home State", and "out-of-State bank" have the same meanings as in section 44(g).

"(B) The term "State supervisory fees" means assessments, examination fees, branch fees, license fees, and all other fees that are levied or charged by a State bank supervisor directly upon an insured State bank or upon branches of an insured State bank.

"(C) Solely for purposes of subparagraph (2)(B) of this subsection (h), an insured State bank has been determined to be in "troubled condition" if the bank—

"(i) has a composite rating, as determined in its most recent report of examination, of 4 or 5 under the Uniform Financial Institutions Ratings System (UFIRS); or

"(ii) is subject to a proceeding initiated by the Corporation for termination or suspension of deposit insurance; or

(iii) is subject to a proceeding initiated by the State bank supervisor of the bank's home State to vacate, revoke, or terminate the charter of the bank, or to liquidate the bank, or to appoint a receiver for the bank.

"(D) For the purposes of paragraph (2)(B), the term 'final determination' means the transmittal of a Report of Examination to the bank or transmittal of official notice of proceedings to the bank.".

**Explanation**

This amendment would clarify home- and host-state authority for state-chartered banks operating on an interstate basis. It 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.

## Limits on Commercial Real Estate Loans

**SEC. ___. COMMERCIAL REAL ESTATE LOANS**—Section 5l(2)(B)(i) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(2)(B)(i)) is amended by striking "400 percent of the Federal savings association's capital" and inserting "500 percent of the Federal savings association's capital (or such higher amount that the Director determines)".

### Explanation

This section increases the limit on commercial real estate loans from 400 to 500 percent and permits the OTS to increase that amount. Institutions with expertise in non-residential real property lending and which have the ability to operate in a safe and sound manner should be granted increased flexibility.

## Loans to One Borrower

**SEC. ___. LOANS TO ONE BORROWER**—Section 5(u)(2)(A) of the Home Owners' Loan Act (12 U.S.C. 1464(u)(2)(A)) is amended by striking subclause (ii)(I).

### Explanation

In addition to the loans-to-one borrower authority, savings associations may lend the lesser of $30 million or 30 percent of capital for a residential development. Within that overall limit, there is a $500,000 per-unit limit. This amendment eliminates a $500,000 per unit cap, while retaining the $30 million/30 percent limit. The per-unit cap is an excessive regulatory detail that creates an artificial market limit in high cost areas.

## Home Office Citizenship

**SEC.____. HOME OFFICE CITIZENSHIP—**

(a) **Federal Savings Associations** -- Section 5 of the Home Owners' Loan Act (12 U.S.C. 1464) is amended by adding the following new subsection:

"(x) HOME STATE CITIZENSHIP- In determining whether a Federal court has diversity jurisdiction over a case in which a Federal savings association is a party, the Federal savings association shall be considered to be a citizen only of the State in which such savings association has its home office.".

**(b) National Banks.** – Chapter three of title LXII of the Revised Statutes of the United States (12 U.S.C. 81 et seq.) is amended by inserting after section 5190 the following new section:

"SEC. 5190A. STATE CITIZENSHIP. – In determining whether a Federal court has diversity jurisdiction over a case in which a national bank is a party, the national bank shall be considered to be a citizen only of the State in which such national bank maintains it main office.".

***Explanation***

This amendment provides 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. Federal law already provides that all national banks are deemed citizens of the states in which they are located for jurisdictional purposes. The second part of the amendment makes a similar clarification with respect to national banks.

## Interstate Acquisitions

**SEC. ___. INTERSTATE ACQUISITIONS**-- Section 10(e)(3)of the Home Owners' Loan Act (12 U.S.C. 1467a(e)(3)) is amended by adding the following new subparagraph and redesignating the following subparagraphs accordingly:

"(A) such acquisition would be permissible for a bank holding company under section 3(d) of the Bank Holding Company Act of 1956;"

**Explanation**

This amendment permits a multiple savings association 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.

## Application of QTL to Multi-State Operations

**SEC. __. APPLICATION OF QUALIFIED THRIFT LENDER TEST ACROSS STATE LINES.**

Section 5(r)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(r)(1)) is amended by striking the ultimate sentence.

***Explanation***

This section eliminates state-by-state application of the QTL test. This better reflects the business operations of savings associations operating in more that one state.

## Applying International Lending Supervision Act to OTS

**SEC. ____. -- BROADEN INTERNATIONAL LENDING SUPERVISION ACT OF 1983DEFINITION OF BANKING INSTITUTION TO APPLY TO THRIFTS.—**

Subparagraph (A)(i) of section 903(2) of the International Lending Supervision Act of 1983 (12 U.S.C. 3902(2)) is amended to read as follows:

> "(A)(i) an insured depository institution as defined in section 3(c)(2) of the Federal Deposit Insurance Act or any subsidiary of an insured depository institution;".

**Explanation**

This provision would benefit OTS-regulated savings associations operating in foreign countries by assisting the OTS in becoming recognized as a consolidated supervisor.

## OTS Representation on Basel Committee on Banking Supervision

**SEC. __. OTS REPRESENTATION ON BASEL COMMITTEE ON BANKING SUPERVISION.—**

(a) Section 912 of the International Lending Supervision Act of 1983 (12 U.S.C. 3911) is amended—

(1) by inserting at the end of the caption the following: "AND THE OFFICE OF THRIFT SUPERVISION";

(2) by striking "SEC. 912." And inserting "SEC. 912.(a)";

(3) in subsection (a), as designated by paragraph (2), by striking "three" and inserting "four"; and

(4) by inserting the following new subsection at the end:

"(b) As one of the four Federal bank regulatory and supervisory agencies, the Office of Thrift Supervision shall be given equal representation with the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation on the Committee on Banking Regulations and Supervisory Practices of the Group of Ten Countries and Switzerland.".

(b) CONFORMING AMENDMENTS.—Section 910(a) of such Act (12 U.S.C. 3909(a) is amended—

(1) in paragraph (2), by striking "insured bank" and inserting "insured depository institution"; and

(2) in paragraph (3), by striking "'insured bank', as such term is used in section 3(h)" and inserting "'insured depository institution', as such term is used in section (c)(2)".

**Explanation**

This provision adds the Office of Thrift Supervision to multi-agency committee that represents the United States before the Basel Committee on Banking Supervision. Savings institutions and other housing lenders would benefit by having the OTS perspective represented during the Basel committee's deliberations.

## Parity for Savings Associations Acting as Agents for Affiliated Depository Institutions

**SEC. ___. SAVINGS ASSOCIATIONS ACTING AS AGENTS** —Section 18(r) of the Federal Deposit Insurance Act (12 U.S.C. 1828(r)) is amended by --

(1) in paragraph (1), striking "Any bank subsidiary of a bank holding company" and inserting "A depository institution of a depository institution holding company";

(2) (A) in the heading for paragraph (2), striking "BANK" and inserting "DEPOSITORY INSTITUTION"; and

(B) in paragraph (2), striking "bank" and inserting "depository institution";

(3) in paragraph (3), striking "or (6)" each time it appears; and

(4) in paragraph (5), striking "or (6)"; and

(5) striking paragraph (6) in its entirety.

**Explanation**

This section provides savings associations the same authority that banks have under section 18(r) of the Federal Deposit Insurance Act to act as agents for their affiliated depository institutions.

## Inflation Adjustment for Depository Institution Management Interlocks

**SEC. ___. AMENDMENT TO PROVIDE AN INFLATION ADJUSTMENT FOR THE SMALL DEPOSITORY INSTITUTION EXCEPTION UNDER THE DEPOSITORY INSTITUTION MANAGEMENT INTERLOCKS ACT.**

Section 203(1) of the Depository Institution Management Interlocks Act (12 U.S.C. 3202(1)) is amended by striking `$20,000,000' and inserting `$100,000,000'.

**Explanation**

The Depository Institutions Management Interlocks Act prohibits depository organizations from having interlocking management officials, if the depositories are located or have an affiliate located in the same metropolitan statistical area, primary metropolitan statistical area, or consolidated metropolitan statistical area. This statutory prohibition does not apply to depository organizations that have less than $20 million in assets. This section increases the exemption limit to $100 million in assets.

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## Reducing Debt-Collection Burdens

**SEC. ___. CONTINUING COLLECTION EFFORTS –** Section 809 of The Fair Debt Collection Practices Act (12 U.S.C. 1692g) is amended by adding the following new subsection and redesignating the following subsection accordingly:

> "(c) Continuing Collection Efforts. A debt collector may continue to collect the debt until the debt collector receives the notice described in subsection (b) of this section."

**Explanation**

A debtor has 30 days in which to dispute a debt. This amendment makes clear that a debt collector need not wait for that 30-day period while the debtor decides whether or not to dispute the debt.

## Mortgage Servicing Clarification

**SEC.__. MORTGAGE SERVICING CLARIFICATION.**

(a) IN GENERAL- The Fair Debt Collection Practices Act (15 U.S.C. 1692 et seq.) is amended--

(1) by redesignating section 818 as section 819; and

(2) by inserting after section 817 the following new section:

`Sec. 818. Mortgage servicer exemption

`(a) EXEMPTION- A covered mortgage servicer who, whether by assignment, sale or transfer, becomes the person responsible for servicing federally related mortgage loans secured by first liens that include loans that were in default at the time such person became responsible for the servicing of such federally related mortgage loans shall be exempt from the requirements of section 807(11) in connection with the collection of any debt arising from such defaulted federally related mortgage loans.

`(b) DEFINITIONS- For purposes of this section, the following definitions shall apply:

`(1) COVERED MORTGAGE SERVICER- The term `covered mortgage servicer' means any servicer of federally related mortgage loans secured by first liens--

`(A) who is also debt collector; and

`(B) for whom the collection of delinquent debts is incidental to the servicer's primary function of servicing current federally related mortgagee loans.

`(2) FEDERALLY RELATED MORTGAGE LOAN- The term `federally related mortgage loan' has the meaning given to such term in section 3(1) of the Real Estate Settlement Procedures Act of 1974, except that, for purposes of this section, such term includes only loans secured by first liens.

`(3) PERSON- The term `person' has the meaning given to such term in section 3(5) of the Real Estate Settlement Procedures Act of 1974.

`(4) SERVICER; SERVICING- The terms `servicer' and `servicing' have the meanings given to such terms in section 6(i) of the Real Estate Settlement Procedures Act of 1974.'.

(b) CLERICAL AMENDMENT- The table of sections for the Fair Debt Collection Practices Act (15 U.S.C. 1692 et seq.) is amended--

(1) by redesignating the item relating to section 818 as section 819; and

(2) by inserting after the item relating to section 817 the following new item:

`818. Mortgage servicer exemption.'.

**Explanation**

This amendment incorporates H.R. 314, "The Mortgage Servicing Clarification Act," which has broad industry and bipartisan support, passing the House by a vote of 424-0 last year. This legislation provides that servicers of loans do not have to provide the min-Miranda notices under the Fair Debt Collection Practices Act (FDCPA).

## Repealing Overlapping Rules for Purchased Mortgage Servicing Rights

**SEC. __. REPEAL OF OVERLAPPING RULES GOVERNING PURCHASED MORTGAGE SERVICING RIGHTS.**

Section 5(t) of the Home Owners' Loan Act (12 U.S.C. 1464(t)) is amended--

(1) by striking paragraph (4) and inserting the following new paragraph: `(4) [Repealed]'; and

(2) in paragraph (9)(A), by striking `intangible assets, plus' and all that follows through the period at the end and inserting `intangible assets.'.

**Explanation**

The amendment eliminates the cap on valuation of purchased mortgage servicing rights at 90 percent of fair value and thereby permits savings associations 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 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

**SEC. 1. LOANS TO EXECUTIVE OFFICERS** -- Section 22(g)(4) of the Federal Reserve Act (12 U.S.C. 375a(4)) is amended by striking "in an amount prescribed in regulation of the member bank's appropriate Federal banking agency" and inserting "up to the Member bank's limit on loans to one borrower".

**SEC. 2. REPORTING REQUIREMENTS RELATING TO LOANS TO EXECUTIVE OFFICERS.**

(a) REPORTING REQUIREMENTS REGARDING LOANS TO EXECUTIVE OFFICERS OF MEMBER BANKS- Section 22(g) of the Federal Reserve Act (12 U.S.C. 375a) is amended--

(1) by striking paragraphs (6) and (9); and
(2) by redesignating paragraphs (7), (8), and (10) as paragraphs (6), (7), and (8), respectively.

(b) REPORTING REQUIREMENTS REGARDING LOANS FROM CORRESPONDENT BANKS TO EXECUTIVE OFFICERS AND SHAREHOLDERS OF INSURED BANKS- Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(2)) is amended--

(1) by striking subparagraph (G); and
(2) by redesignating subparagraphs (H) and (I) as subparagraphs (G) and (H), respectively.

**Explanation**

Section 1 would eliminate the special regulatory $100,000 lending limit on loans to executive officers. The limit applies only to executive officers for "other purpose" loan, i.e., those other than housing, education, and certain secured loans. This conforms the law to the current requirement for all other officers, i.e., directors and principal shareholders, who are simply subject to the loans-to-one-borrower limit.

Section 2 eliminates certain reporting requirements currently imposed on banks and their executive officers and principal shareholders related to lending by banks to insiders. The change in reporting requirements would not alter restrictions on the ability of banks to make insider loans or limit the ability of federal banking agencies to take enforcement action against a bank or its insiders for violation of lending limits.

## Decriminalizing RESPA

**SEC. ___. ELIMINATION OF IMPRISONMENT SANCTION** – Section 8(d)(1) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2607(d)(1)) is amended by striking "or imprisoned for not more than one year, or both".

**Explanation**

This strikes the imprisonment sanction for violations of RESPA. The possibility of a $10,000 fine remains, maintaining adequate deterrence.

## Bank Service Company Investments

**SEC. ___. INVESTMENTS IN SERVICE COMPANIES.**

(a) **BANK SERVICE COMPANIES.**

**(1) INVESTMENTS BY OTHER INSURED DEPOSITORY INSTITUTIONS IN BANK SERVICE COMPANIES AUTHORIZED.**—Subparagraphs (A)(ii) and (B)(ii) of section 1(b)(2) of the Bank Service Company Act (12 U.S.C. 1861(b)(2)) are each amended by striking "insured banks" and inserting "insured depository institutions, as defined in section 3 of the Federal Deposit Insurance Act".

**(2) TECHNICAL AMENDMENTS.**—Section 1(b)(4) of such Act (12 U.S.C. 1861(b)(4)) is amended—

(A) by striking "Federal Home Loan Bank Board" and inserting "Director of the Office of Thrift Supervision"; and

(B) by striking ", the Federal Savings and Loan Insurance Corporation,".

**(b) INVESTMENT BY OTHER INSURED DEPOSITORY INSTITUTIONS IN THRIFT SERVICE COMPANIES AUTHORIZED.**—The first sentence of section 5(c)(4)(B) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(4)(B)) is amended by striking "by savings associations of such State and by Federal associations" and inserting "by insured depository institutions, as defined in section 3 of the Federal Deposit Insurance Act,".

**Explanation**

The Bank Service Company Act permits national and state banks to invest in companies that may provide clerical, administrative and other services closely related to banking to depository institutions. This section amends the BSC Act and Home Owners' Loan Act to provide parallel investment ability for banks and thrifts to participate in both BSCs and thrift service corporations. It 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 thrifts thus would need to apply only to OTS to invest.

*Note:* Section 406 of HR 1375 also would permit thrifts to invest in BSCs, but would not allow a bank to invest in a thrift service corporation and would subject a thrift investor in a BSC to an additional regulator, the Federal Reserve. While Sec. 406 addresses the needs of thrifts seeking to invest in a BSC, it brings potential new regulatory burdens and is asymmetrical because it does not provide parallel treatment for banks.

## Eliminating Savings Association Service Company Geographic Restrictions

**SEC. ___. ELIMINATING GEOGRAPHIC LIMITS ON SAVINGS ASSOCIATION SERVICE COMPANIES.**

(a) IN GENERAL- The 1st sentence of section 5(c)(4)(B) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(4)(B)) (as amended by section 406(b)(3) of this Act) is amended--

(1) by striking `corporation organized' and all that follows through `is available for purchase' and inserting `company, if the entire capital of the company is available for purchase'; and

(2) by striking `having their home offices in such State'.

(b) TECHNICAL CORRECTIONS-

(1) The heading for subparagraph (B) of section 5(c)(4) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(4)(B)) is amended by striking `CORPORATIONS' and inserting `COMPANIES'.

(2) The 2nd sentence of section 5(n)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(n)(1)) is amended by striking `service corporations' and inserting `service companies'.

(3) Section 5(q)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(q)(1)) is amended by striking `service corporation' each place such term appears in subparagraphs (A), (B), and (C) and inserting `service company'.

(4) Section 10(m)(4)(C)(iii)(II) of the Home Owners' Loan Act (12 U.S.C. 1467a(m)(4)(C)(iii)(II)) is amended by striking `service corporation' each place such term appears and inserting `service company'.

**Explanation**

Permits federal savings associations to invest in service companies without regard to geographic restrictions.

## Streamlining Subsidiary Notifications

**SEC. ___. STREAMLINING SUBSIDIARY NOTIFICATIONS**—Section 18(m)(1)(A) of the Federal Deposit Insurance Act (12 U.S.C. 1828(m)(1)(A)) is amended by striking "the Corporation and" and by striking "each such agency" and inserting "the Director of the Office of Thrift Supervision".

**Explanation**

This amendment eliminates the requirement that a savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary. A savings association will still be required to notify the OTS, providing sufficient regulatory oversight.

## Authorizing Additional Community Development Activities

**SEC. ___. INVESTMENTS BY FEDERAL SAVINGS ASSOCIATIONS AUTHORIZED TO PROMOTE THE PUBLIC WELFARE.**

(a) IN GENERAL- Section 5(c)(3) of the Home Owners' Loan Act (12 U.S.C. 1464(c)) is amended by adding at the end the following new subparagraph:

`(E) DIRECT INVESTMENTS TO PROMOTE THE PUBLIC WELFARE-

`(i) IN GENERAL- A Federal savings association may make investments designed primarily to promote the public welfare, including the welfare of low- and moderate-income communities or families through the provision of housing, services, and jobs.

`(ii) DIRECT INVESTMENTS OR ACQUISITION OF INTEREST IN OTHER COMPANIES- Investments under clause (i) may be made directly or by purchasing interests in an entity primarily engaged in making such investments.

`(iii) PROHIBITION ON UNLIMITED LIABILITY- No investment may be made under this subparagraph which would subject a Federal savings association to unlimited liability to any person.

`(iv) SINGLE INVESTMENT LIMITATION TO BE ESTABLISHED BY DIRECTOR- Subject to clauses (v) and (vi), the Director shall establish, by order or regulation, limits on--

`(I) the amount any savings association may invest in any 1 project; and
`(II) the aggregate amount of investment of any savings association under this subparagraph.

`(v) FLEXIBLE AGGREGATE INVESTMENT LIMITATION- The aggregate amount of investments of any savings association under this subparagraph may not exceed an amount equal to the sum of 5 percent of the savings association's capital stock actually paid in and unimpaired and 5 percent of the savings association's unimpaired surplus, unless--

`(I) the Director determines that the savings association is adequately capitalized; and

`(II) the Federal Deposit Insurance Corporation determines, by order, that the aggregate amount of investments in a higher amount than the limit under this clause will pose no significant risk to the affected deposit insurance fund.

`(vi) MAXIMUM AGGREGATE INVESTMENT LIMITATION- Notwithstanding clause (v), the aggregate amount of investments of any savings association under this subparagraph may not exceed an amount equal to the sum of 10 percent of the savings association's capital stock actually paid in and unimpaired and 10 percent of the savings association's unimpaired surplus.

`(vii) INVESTMENTS NOT SUBJECT TO OTHER LIMITATION ON QUALITY OF INVESTMENTS- No obligation a Federal savings association acquires or retains under this subparagraph shall be taken into account for purposes of the limitation contained in section 28(d) of the Federal Deposit Insurance Act on the acquisition and retention of any corporate debt security not of investment grade.'.

(b) TECHNICAL AND CONFORMING AMENDMENT- Section 5(c)(3)(A) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(3)(A)) is amended to read as follows:

`(A) [Repealed.]'.

**Explanation**

This amendment permits Federal savings associations to make community development investments to the same extent permitted for national banks.

## Eliminating Dividend Notice Requirements

**SEC. ___. DIVIDEND NOTICES--** Section 10(f) of the Home Owners' Loan Act (12 U.S.C. 1467a(f)) is amended by adding the following paragraph and redesignating section 10(f) as section 10(f)(1):

> "(2) this subsection shall not apply to a subsidiary savings association that is well capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) and will remain well capitalized after the payment of the dividend."

**Explanation**

Under this amendment, well-capitalized savings associations in savings and loan holding companies will no longer be required to notify the OTS of their intention to pay a dividend, provided that they will remain well capitalized after they pay the dividend. This will allow well-capitalized institutions to conduct routine business without regularly conferring with the OTS.

## Reimbursement for the Production of Records

**SEC. ___. CORPORATE RECORDS**—Section 1101(4) of the Right to Financial Privacy Act (12 U.S.C. 3401(4)) is amended by adding ", except that such term shall mean any legal entity for purposes of section 1115 of this Act" after "individuals".

**SEC. ___. CLARIFICATION OF SCOPE**—Section 1115 of the Right to Financial Privacy Act is amended by adding the following new sentence—

> "This section shall apply to records required to be assembled or provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001."

**Explanation**

The Right to Financial Privacy Act provides that the government will reimburse banks for the cost of assembling and providing records of individual bank customers that the government is investigating. This amendment extends that to records of corporate bank customers. The amendment also clarifies that RFPA reimbursement requirements apply to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001.

## Extending Divestiture Period

**SEC. ___. EXTENDING DIVESTITURE PERIOD**—Section 10(c)(1)(C) of the Home Owners' Loan Act (12 U.S.C. 1467a(c) (1)(C)) is amended by striking "2-year period" and inserting "10-year period".

### Explanation

This amendment provides unitary savings association holding companies that become multiple savings association holding companies have 10 years to divest non-conforming activities. This is the same period granted to new financial services holding companies under the Gramm-Leach-Bliley Act.

## Restrictions on Auto Loans

**SEC.__. REMOVAL OF LIMITATION ON INVESTMENTS IN AUTO LOANS.**

(a) IN GENERAL- Section 5(c)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(1)) is amended by adding at the end the following new subparagraph:

`(V) AUTO LOANS- Loans and leases for motor vehicles acquired for personal, family, or household purposes.'.

(b) TECHNICAL AND CONFORMING AMENDMENT RELATING TO QUALIFIED THRIFT INVESTMENTS- Section 10(m)(4)(C)(ii) of the Home Owners' Loan Act (12 U.S.C. 1467a(m)(4)(C)(ii)) is amended by adding at the end the following new subclause:

`(VIII) Loans and leases for motor vehicles acquired for personal, family, or household purposes.'.

**Explanation**

Federal savings associations are currently limited in making auto loans to 35 percent of total assets. The amendment removes this restriction and expands consumer choice by allowing savings associations to allocate additional capacity to this important segment of the lending market.

## Credit Card Savings Associations

**SEC.___. AMENDMENT TO SECTION 10 OF THE HOME OWNERS" LOAN ACT.**

*Section 10(a)(1)(A) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)(1)(A)) is amended by inserting the following new sentence at the end: "The term 'savings association' does not include an institution described in section 2(c)(2)(F) of the Bank Holding Company Act of 1956 for purposes of subsections (a)(1)(E), (c)(3)(B)(i), (c)(9)(C)(i), and (e)(3).".*

### Explanation

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 thrifts. 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. This proposal amends the Home Owners' Loan Act 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

**SEC. ___. PRIVILEGES NOT WAIVED BY DISCLOSURE TO BANKING AGENCY.**

Section 18 of the Federal Deposit Insurance Act (12 U.S.C. 1828) is amended by adding at the end the following new subsection:

> "(x) PRIVILEGES NOT WAIVED BY DISCLOSURE TO BANKING AGENCY. The submission by a depository institution of any information to a Federal banking agency, a State bank supervisor, or a foreign banking authority for any purpose in the course of the supervisory process of such agency or supervisor shall not be construed as waiving, destroying, or otherwise affecting any privilege such institution may claim with respect to such information under Federal or State law.".

**Explanation**

This amendment provides 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. Recent court decisions have created ambiguity about the privileged status of information provided to supervisors.

# Appendix B

**to**

**America's Community Bankers'**

**Testimony**

**on**

**Financial Services Regulatory Relief: Private Sector Perspectives**

**before the**

**Subcommittee on Financial Institutions and Consumer Credit**

**of the**

**Committee on Financial Services**

**of the**

**United States House of Representatives**

**on**

**May 19, 2005**

May 6, 2005

Ms. Jennifer Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington D.C. 20551

Attention: Docket No. OP-1220

Office of the Comptroller of the Currency
250 E Street, SW
Mailstop 1-5
Washington D.C. 20219

Attention: Docket No. 05-01

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington D.C. 20552

Attention: No. 2005-02

Re: Request for Burden Reduction Recommendations; Money Laundering, Safety and Soundness, and Securities Rules; Economic Growth and Regulatory Paperwork Reduction Act of 1996 Review
70 FR 5571 (February 3, 2005)

Dear Sir or Madam:

America's Community Bankers (ACB)[1] is pleased to comment on the federal banking agencies' (the agencies)[2] review of regulatory burden imposed on insured depository institutions.[3] Required by section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA),[4] the agencies are reviewing and identifying outdated, unnecessary, and unduly burdensome regulatory requirements. This comment letter responds to the request for comments regarding money laundering, safety and soundness, and securities rules.

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[1] America's Community Bankers is the national trade association partner for community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*

[2] Federal Deposit Insurance Corporation ("FDIC"), Federal Reserve Board (the "Board"), Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS").

[3] 70 Fed. Reg. 5571 (February 3, 2005).

[4] Pub. L. 104-208, Sept. 30, 1996.

**ACB Position**

ACB strongly supports the agencies in their ongoing efforts to reduce the regulatory burden on insured depository institutions. Generally, the statutes enacted and the required implementing regulations serve a very useful purpose by themselves, but when layered upon the existing requirements, community banks frequently must comply with overlapping and voluminous regulations. Several of the regulations that are the subject of this request for comment are among those that community bankers raise as the being the most burdensome. We welcome the scrutiny of the agencies on these regulations and we hope that this review results in changes that relieve some of the regulatory burden while preserving the benefits of the requirements.

**Anti-money laundering regulations**

The anti-money laundering statutes and the implementing regulations were adopted with the best of intentions. The Bank Secrecy Act (BSA) was enacted in 1970 and one of the primary goals was to eliminate or mitigate the laundering of the profits of drug trafficking and other illicit businesses. The USA Patriot Act was enacted to root out terrorists, ensure the safety of the American people, and protect the integrity of the U.S. financial system. ACB supports the goals of these laws, however, inconsistent interpretation of the implementing regulations by examiners and a lack of regulatory guidance have made it increasingly difficult for community banks to comply with anti-money laundering demands and have produced a plethora of unintended consequences.

ACB offers the following suggestions to improve BSA oversight.

Consistent Implementation

Community banks are frustrated by the conflicting messages conveyed by banking regulators. Washington officials repeatedly assure the industry that the banking agencies do not have "zero tolerance" for anti-money laundering deficiencies. Nevertheless, regional offices and individual examiners continue to use this language when conducting BSA examinations and when making presentations during industry conferences. ACB is very pleased that Washington acknowledges that perfect compliance is impossible. We urge the agencies to ensure that all regional offices and examiners understand and adhere to this fundamental principle of regulatory policy.

ACB hopes that the anticipated interagency examination procedures will clarify the regulators' compliance expectations and will provide consistency across and within the agencies. It is important that institutions understand what is expected of them, yet many community banks believe that there are no pre-established standards against which their compliance efforts will be evaluated. Accordingly, we urge the agencies to make every effort to ensure that the examination procedures are made available by June 30, 2005, as promised.

Suspicious Activity Reporting

Examination for compliance with suspicious activity reporting requirements is one specific area where we ask the regulators to be more consistent and provide additional guidance.

*Defensive SARs.* The federal banking agencies are scrutinizing suspicious activity reporting more closely than ever and anxiety over whether an institution should file a SAR is at an all-time high. As a result, many depository institutions believe that filing more SARs is the key to avoiding regulatory criticism. Many institutions file SARs as a defensive tactic to stave off "second guessing" of an institution's suspicious activity determinations. This mindset is fueled by examiners who criticize institutions for not filing enough SARs based on their asset size. Furthermore, regulators have admitted in public fora that the agencies do not discourage the "when in doubt, fill it out" strategy.[5] Finally, enforcement actions in the past year appear to confirm the idea that it is better to have filed a SAR when it is not necessary than to have not filed one.

It is more time consuming and paperwork intensive for an institution to document why it elected not to file a SAR than to simply file the report. Institutions believe that the risk of regulatory criticism is higher for not filing and that examiners will disapprove of the bank's documentation or its decision not to file.

While institutions feel pressure to file more SARs by their primary regulator, FinCEN director William Fox has warned that the value of SAR data will be less valuable and that the integrity and usefulness of the SAR system will be compromised by the onslaught of "defensive" SARs. In March 2005, financial institutions submitted nearly 43,500 SARs, up 40 percent from March 2004. Director Fox recently wrote in the April 2005 *SAR Activity Review*, "these 'defensive filings' populate our database with reports that have little value, degrade the valuable reports in the database and implicate privacy concerns."

The problem of defensive SAR filing is further exacerbated by recent deferred prosecution agreements between the Department of Justice and financial institutions whose SAR reporting programs have been deemed deficient.

In this era of increased regulatory scrutiny, community banks deserve more guidance and information. ACB strongly urges the regulators to work with FinCEN and the Department of Justice to articulate a single, clear policy on suspicious activity reporting that is applied consistently. It is critical that this policy be made clear to the regional offices, bank examiners and officials of the Department of Justice across the country.

Further, we do not believe that insured institutions should be placed in the middle of a harsher enforcement regime when the federal agencies attempt to satisfy their Inspectors General.

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[5] While most industry feedback indicates that community banks feel pressured to file larger quantities of SARs, some institutions have been cautioned by their regulators against such liberal filing. This approach, too is frustrating.

Rather, the banking regulators, FinCEN, and the Department of Justice should work to help institutions identify activities that are genuinely suspicious and should be reported. We are generally sympathetic to the problems created by defensive SAR filing. However, without additional guidance regarding what events trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment. The current state of affairs is not the best use of the time and resources of all parties involved and is not helping to enhance the security of our country.

*SAR Guidance*. On December 23, 2004, ACB requested that FinCEN provide updated, centralized SAR reporting guidance (See Attachment A). In a response from FinCEN dated April 22, 2005, we have been assured that many of the points raised are being addressed. We welcome the changes and urge the agencies to work with FinCEN to ensure rapid dissemination of any changes and guidance. ACB continues to believe that not understanding what constitutes suspicious behavior continues to be one of the most burdensome aspects of BSA compliance. Accordingly, we urge the agencies to work with FinCEN to compile a comprehensive guide to SAR filing that includes:

- A list of common suspicious activities and red flags. Community bankers often ask, "What kind of activity is suspicious?" or "What activity is indicative of terrorist finance?" This is an important question for financial institutions that do not have legal departments or sophisticated compliance teams dedicated to BSA compliance. This question also is important in helping to separate those occurrences that should not be reported. We also encourage the agencies and FinCEN to include examples or case studies where SARs are or are not warranted.
- Centralized Guidance. Over the years, FinCEN and the federal banking agencies have produced helpful guidance, interpretations, and answers to frequently asked questions. While this information is useful, it has not been compiled in a centralized location. Accordingly, we ask the agencies to work with FinCEN to compile and update the issues that have been discussed over the years. Examples of FAQ's could include:
    - How to handle SAR subpoenas.
    - How much information bank managers should provide their boards of directors concerning SAR filings.
    - Whether institutions should file SARs retroactively after being notified by law enforcement that funds may have been laundered through an account.
    - Whether a SAR should be filed on a name found on the 314(a) list.
    - Whether a SAR should be filed on an OFAC hit.

Many publications exist about SAR filing, but the information contained in these materials would be more valuable to the banking industry if it were updated, supplemented, and centralized. Additionally, over the years, the federal banking agencies have issued various booklets and other publications (e.g. the Office of the Comptroller of the Currency's *Money Laundering: A Banker's Guide to Avoiding Problems* (December 2002)). Nevertheless, we believe that community bankers would find real value in a comprehensive SAR guidance publication.

*Account Monitoring Software*. Increasing numbers of community banks have been instructed by their examiners to purchase account monitoring software to help identify suspicious activity. However, it is unclear at what point the regulators will expect institutions to install such software. Some institutions have been told that in certain geographic locations, institutions with more than $250 million in assets are "strongly encouraged" to implement an account/customer monitoring software system. Representatives from the federal banking agencies have told ACB that they do not intend to identify the circumstances under which institutions will be expected to install such monitoring software.

We thoroughly agree that a one-size fits all approach is not appropriate. However, it would be very helpful for the agencies to elaborate on the circumstances under which such account monitoring systems should be considered. The cost of purchasing these systems is significant, and helping community banks to better understand when such systems will be required will enable institutions to better budget and plan for this large expense. Account monitoring software packages used by community banks often cost between $30,000 and $50,000 (and sometimes much more), plus a $5,000 per month service charge or maintenance fee. In many cases, institutions must hire additional personnel or take existing staff away from other bank responsibilities to run the software, review flagged accounts, and file SARs when necessary.

Some community banks have been instructed to use their account monitoring software to drill down to the fourth level of an account relationship (i.e. the fourth person listed on a signature card) to study tax identification numbers, names, and addresses for suspicious information. Many institutions report that they have difficulty making those correlations on the second level, let alone the fourth. We believe that the agencies are working with law enforcement to determine how money launderers adjust their techniques and are asking the industry to adjust its account monitoring processes accordingly.

Characterization of BSA Violations

ACB believes that BSA enforcement should be consistent, particularly with regard to whether BSA violations are characterized as "program violations" or "FinCEN violations." The federal banking agencies have indicated that compliance problems identified as "program violations" will result in an automatic written supervisory agreement with the institution, while problems classified as "FinCEN violations" will be addressed more informally.

The characterization of an institution's BSA violations has strong repercussions beyond the formality with which problems will be addressed. The characterization of compliance problems as "program violations" may affect the institution's CAMELS rating, its ability to merge with or purchase other institutions, build or acquire new branches or expand into new product lines. For publicly traded banks, a written, formal agreement may also warrant disclosure in filings with the Securities and Exchange Commission. Because the characterization of BSA violations has such a significant impact on the institution, ACB urges the banking agencies to emphasize the importance of this matter when training and updating their examiners.

We have heard a number of examination experiences that provide useful examples. One community bank that recently underwent a BSA compliance exam was cited by its examiners for failure to identify a local business as an money service business (MSB) and failure to file a suspicious activity report on that same business. The institution is well-capitalized and well managed and filed approximately 4,500 SARs last year. The report of examination devoted one paragraph to BSA issues and the institution took the required corrective actions, believing the matter to be closed. Over six months later, the institution's regional regulator re-characterized the violations as "program violations" and presented the bank with a written supervisory agreement. The bank ultimately persuaded the regional office to address the matter less formally, but the process remains unclear and too subjective.

It is imperative that examiners and regional offices understand how classifying violations as one form or another affects an institution. We urge the regulators to work to ensure that such characterizations are applied correctly, consistently, and in a timely manner.

Money Services Businesses

The provision of banking services to MSBs and an institution's corresponding regulatory requirements have been widely discussed within the banking industry in recent months. ACB believes that the issues underlying the supervision of depository institutions that provide banking services to MSB's are an extension of larger problems that permeate the entire BSA oversight mechanism.

MSB's play an important role in providing financial products and services to persons that do not have a traditional banking relationship with a depository institution. Many small businesses that are now dubbed MSBs have been good customers for community banks. Grocery stores, truck stops, and even feedstores are examples of the types of businesses that now fall within the category of MSBs because they cash checks in excess of $1,000 per person per day.

For example, depository institutions have been pressured by examiners to close accounts of long-time customers that may be considered to be a "money service business." Other institutions believe that the due diligence requirements for these accounts outweigh the benefit of having MSBs as customers. Many institutions are unwilling to take on the compliance risk now associated with MSB accounts. Others do not believe that they have an adequate understanding of what constitutes unusual activity for MSBs in general and have indicated that they will not bank MSB customers until they have more direction from FinCEN and the banking regulators.

On March 8, 2005, ACB was pleased to participate in the joint meeting of the Non-bank Financial Institutions and Examinations Subcommittee of the Bank Secrecy Act Advisory Group to discuss the provision of banking services to MSBs. This meeting explored why financial institutions large and small closed the accounts of their MSB customers. We believe that the meeting helped underscore the need for regulatory guidance and consistent interpretation of enhanced due diligence requirements for depository institutions that have MSB customers.

ACB also is very appreciative of the March 30, 2005 joint statement issued by the federal banking agencies and FinCEN clarifying that depository institutions are not expected to serve as a *de facto* regulator of the money services business industry. Notwithstanding the important policy positions articulated in the joint release, community banks are not re-opening accounts for MSBs in wide numbers. Furthermore, institutions continue to have varying interpretations of the regulatory requirements associated with banking MSBs.

We believe that this problem will be remedied by the joint guidance issued by FinCEN and the banking agencies on April 26, 2005. ACB is very encouraged that the agencies and FinCEN acted on requests for guidance and explained the different kinds of risks and appropriate due diligence required for MSB accounts. We also appreciate the examples of suspicious activity that the guidance provides. We hope that the guidance will help examiners evaluate the banking industry's monitoring of MSB accounts more consistently.

While the guidance on appropriate monitoring of MSB accounts is welcome, we believe that additional compliance questions should be addressed. Namely, how financial institutions should treat those businesses that engage in "MSB activity" in rare circumstances.

For example, a community bank reported that local farmers sometimes take on odd jobs to earn extra money. On occasion, a farmer will endorse his paycheck over to the local feedstore in exchange for goods. An examiner that interpreted the MSB requirements narrowly believed that the feedstore should be treated as an MSB. However, we do not believe that it is reasonable to require the feedstore to register as an MSB, nor is it appropriate to require a financial institution to monitor the account as such. Accordingly, we request the banking agencies to work with FinCEN to identify situations that are exempt or should be exempt from the MSB requirements.

We also encourage the regulators to help institutions recognize unidentified MSBs. Community banks are very concerned that they are unknowingly providing banking services to customers that are operating as MSBs and worry that they will face regulatory criticism for failing to identify these accounts. ACB requests the federal banking agencies to provide guidance on transaction patterns and other indicia of common MSB account activity. This information would help community banks identify business customers that qualify as MSBs and inform them of the associated registration and compliance requirements. In many cases, businesses do not know what an MSB is, much less that there are regulatory requirements for engaging in this activity. Finally, community banks are concerned about allegations of discrimination in connection with MSB accounts. Institutions have deemed some MSBs to pose a higher risk of money laundering than others. In many cases, banks are not equipped to monitor high-risk MSB accounts properly and have terminated these account relationships. Institutions worry that they will be accused of discriminatory practices for maintaining some MSB accounts but not others. Reputation risk in the community is a very real concern to community banks.

OFAC

The prohibition against processing transactions for persons and entities designated by the Office of Foreign Assets Control (OFAC) is not new. However, renewed focus on anti-money laundering efforts has raised many questions regarding an institution's obligations in this area.

OFAC simply prohibits financial institutions from processing a transaction for persons and entities on the OFAC list and institutes a strict liability standard for non-compliance that will result in monetary penalties. This broad standard does not address many practical questions that community banks have about OFAC compliance. For example, what is an institution's obligation regarding checking automated clearing house transactions? Are obligations different for originating or receiving institutions? ACB has heard that the Federal Reserve Board is considering implementing a program that may screen all ACH items and wire transfers against the OFAC list. While there would be many unanswered questions regarding how any "hits" would be addressed and who would have the obligation to freeze a transaction, we believe that Federal Reserve screening of ACH payments would provide valuable regulatory relief to community banks. ACB urges the Federal Reserve to seriously consider this option.

Community banks also ask how frequently they should check their customer base against the OFAC list or how soon they should check the OFAC list when presented with certain transactions. We understand that the agencies view these decisions as being "risk-based," but community banks need help understanding what the risk factors are. In addition, it would be instructive for the agencies to articulate their approach in the event an institution processes a transaction involving a person or entity on the OFAC list. U.S. banks process millions of financial transactions each day, and it is impossible to screen all interested parties against the OFAC list. Inevitably, some prohibited transactions will be processed. ACB requests the agencies to specify that they will not take regulatory action independent of OFAC sanctions.

ACB is pleased that the banking agencies and FinCEN have been able to work with OFAC to determine that, as a general matter, SAR requirements will be satisfied if an institution files a blocking report with OFAC in accordance with OFAC's Reporting, Penalties, and Procedures Regulations. OFAC will then provide the information to FinCEN for inclusion in the SAR reporting database, where it will be made available to law enforcement. The filing of a blocking report with OFAC, however, will not satisfy an institution's obligation to identify and report suspicious activity beyond the fact of an OFAC match. ACB believes that this clarification provides meaningful regulatory relief for community banks by eliminating what is essentially a duplicative reporting requirement to the U.S. Department of the Treasury.

Currency Transaction Reports

FinCEN regulations require financial institutions to file currency transaction reports for all cash transactions over $10,000.[6] FinCEN's regulations establish an exemption system that relieves financial institutions from filing CTRs on the cash transactions of certain entities, provided

[6] 31 CFR 103.22(b)(1).

certain requirements are met. The exemption system was intended to reduce regulatory burden associated with BSA compliance. The exemption process was well intentioned, but community banks have been reluctant to use the exemption system because:

- It is not cost effective for small institutions that do not file many CTRs.
- They fear regulatory action in the event that an exemption is used incorrectly.
- They lack the time to conduct the research necessary to determine whether a customer is eligible for an exemption.
- It is easier to automate the process and file a CTR on every transaction that triggers a reporting requirement.
- The regulations and the exemption procedures and requirements are overly complex.

As a result, financial institutions have filed over 12 million CTRs each year since 1995.[7] FinCEN and law enforcement report that the CTR database is littered with unhelpful CTRs because financial institutions do not use the exemption procedures that are designed to eliminate CTRs that are of no interest to law enforcement. As a result, it is more difficult to use the database to investigate possible cases of money laundering or terrorist finance.

ACB believes that currency transaction reporting requirements are ripe for review. We suggest the following reforms to ease regulatory burden on financial institutions and improve the utility of the CTR database for law enforcement.

*CTR Reporting Threshold.* ACB strongly supports raising the dollar value that triggers CTR filing. Increasing the reporting requirement would dramatically decrease the number of CTRs that are filed each year and would provide much needed relief from BSA regulatory burden.

An update of the CTR regulations is long overdue because the current rules have not kept pace with the economy. Since 1970, institutions have been required to file CTRs on cash transactions over $10,000. When adjusted for inflation, $10,000 in 1970 is equivalent to $50,335 today.[8] We have heard 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.

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.[9] 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 thirty years, ACB acknowledges that a $10,000 cash transaction is still a substantial amount of cash for an

[7] FinCEN Report to Congress, *Use of Currency Transaction Reports* (October 2002).
[8] Federal Reserve Bank of Minneapolis inflation calculator. http://woodrow.mpls.frb.fed.us/research/data/us/calc/
[9] FinCEN. *CTRs Posted By Amount Range*, (2004).

individual customer to deposit or withdraw from an institution. However, businesses of all sizes routinely conduct transactions over $10,000.

Some law enforcement officials strongly oppose adjusting the dollar value that triggers CTR reporting out of a concern that doing so would decrease the amount of data that could potentially assist in a future criminal investigation. As a practical matter, the 30-year old CTR filing requirements need to be updated to reflect today's economic reality. We believe that updating the regulations would help, not hinder the investigatory process. The reduction in the number of CTR filings would meet the Congressional mandate to reduce CTR filings by 30 percent, as required by the Money Laundering Suppression Act of 1994. More importantly, users of CTR data would benefit from a cleaner, more efficient CTR database. 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.

*Exemption System.* A discussion of solutions to reduce the number of CTR filings would not be complete without addressing the exemption system that relieves financial institutions from filing CTRs on certain entities.[10] While the exemption scheme was designed to minimize the number of CTRs that institutions file, community banks have reported that the cost of using the exemptions outweighs any associated benefits.

The exemption requirements are particularly challenging for community bankers that perform multiple functions within an institution and simply do not have the time to study the requirements and apply them to specific customers. In addition, institutions are reluctant to use

[10] Pursuant to the Money Laundering Suppression Act, FinCEN established two categories of transactions that are exempt from CTR reporting. Phase I exemptions (31 CFR 103.22 (d)(2)(i)-(v)) apply to banks, government agencies, government instrumentalities, publicly traded businesses (referred to in the regulations as a "listed business") and certain subsidiaries of publicly traded businesses. A business that does not fall into any of the above categories may still be exempted under the Phase II exemptions (31 CFR 103.22 (d) (2) (vi)-(vii)) if it qualifies as either a "non-listed business" or as a "payroll customer." The new rules also established specific procedures for exempting eligible customers. In determining whether to exempt a customer, a depository institution must document such steps a reasonable and prudent institution would take to protect itself from loan or other fraud or loss based on misidentification of a person's status. The institution must document the basis for its decision to exempt a customer from currency transaction reporting and maintain such documents for five years. After an institution has decided to exempt a customer, the bank must file a Designation of Exempt Person form within 30 days after the first customer transaction the institution wishes to exempt. For Phase I customers, the form has to be filed only once (though the institution must annually review the customer's status). For Phase II customers, the form must be refiled every two years as part of the biennial renewal process. As with Phase I customers, the bank must also annually review the status of Phase II customers.

the exemptions for fear of applying the rules incorrectly. As a result, many community banks have elected to automate the CTR reporting process and file on every transaction over $10,000.

There has been discussion in the financial community about providing interpretive guidance that provides examples and explains how to apply the rules. While guidance would be helpful, we do not believe that it would lead to a significant reduction in CTR filings. Even if guidance is issued, most community banks that have elected not to use the exemption process will continue to file on all cash transactions over $10,000. This compliance method is cost effective and exposes institutions to minimal compliance risk.

While many community banks do not use the exemption process, those that do would like to exempt customers more quickly than currently permitted by regulation. Before an institution can exempt a customer as a non-listed business or payroll customer, the customer must have maintained a transaction account with the bank for at least twelve months.[11] The 12-month rule was adopted to ensure that an institution is familiar with a customer's currency transactions.

ACB encourages the agencies to work with FinCEN to allow institutions to more quickly exempt business customers. Recent regulations implementing the Patriot Act allow institutions to make risk-based decisions about their anti-money laundering efforts. Likewise, FinCEN should give institutions greater discretion in determining when to exempt a business customer from CTR reporting. A community bank, not a regulatory agency, is in the best position to determine whether it is sufficiently familiar with a customer's account activity.
While allowing institutions to take a risk-based approach would not significantly reduce CTR filings, it would provide regulatory relief to those institutions that elect to use the exemption process.

Compliance Costs

Depository institutions are pillars of their communities and are an important part of the larger U.S. economy. As such, community banks are committed to ensuring our nation's physical security and the integrity of our financial system. BSA compliance costs have skyrocketed since the Patriot Act was signed into law. Increasingly, financial institutions believe that the federal government has little regard for the amount of time, personnel, and monetary resources that BSA compliance drains from a institution's ability to serve its community.

As mentioned earlier, institutions that purchase account monitoring software to flag suspicious transactions or other unusual circumstances easily costs $30,000 (and sometimes hundreds of thousands of dollars) upfront and $5,000 each month thereafter. Sometimes, institutions hire new personnel just to study the "red flags" identified by the software to determine if the flagged activity warrants a SAR filing. Furthermore, community banks commonly spend an initial $5,000 plus transaction fees to access identity "verification" databases to help satisfy the Patriot Act's customer identification requirements.

[11] 31 C.F.R. 103.22(d)(2)(vi)(A), (d)(2)(vii)(A).

To put these figures into context, the monthly fee for suspicious activity monitoring software is money that an institution could have spent to hire multiple tellers, hire a new loan officer to reach out to the community's small businesses, or develop and market a new product. What may seem like insignificant costs to lawmakers in Washington have very real business implications for community banks and their communities.

The opportunity costs of BSA compliance go beyond hampering an institution's ability to expand and hire new employees. In some cases, fear of regulatory criticism has led some institutions to sever ties with existing banking customers or forego the opportunity to develop banking relationships with new customers. In recent months, waves of depository institutions severed ties with MSB customers due to pressure from examiners, regulatory uncertainty, or simply being overwhelmed by regulatory requirements associated with these accounts. Community banks have also opted not to open accounts for non-resident aliens and other persons out of fear that the institution will not be able to meet the "reasonable belief" standard established in the customer identification requirements. While many institutions accept the matricula consular as a form of identification, others have taken a cautious approach to compliance and have elected not to accept the card. As a result, come community banks forego opportunities to establish banking relationships with the unbanked and promote financial literacy among this segment of the population – all because of concerns that the bank will not be able to satisfy regulatory requirements.

**Reporting Requirements Under the Securities Exchange Act of 1934**

The Sarbanes-Oxley Act of 2002 (SOX) significantly increased the burden of reporting under the Securities Exchange Act of 1934 for all public companies, but particularly for community banks. Much of that burden was imposed by the Securities and Exchange Commission (SEC) in implementing regulations. We believe that the SEC has issued final rules that include expanded the reporting requirements that go beyond what was required by SOX. ACB understands that many of the regulations addressed in this section of the letter have been promulgated by the SEC and that the agencies incorporate these regulations by reference into their regulations. We strongly urge the agencies to work with the SEC to minimize the reporting burden for community banks.

Two areas of great concern are internal control requirements under section 404 of SOX and the acceleration of filing deadlines for periodic reports on Forms 10-Q and 10-K, current reports on Form 8-K, and beneficial ownership reports under Section 16 of the Securities Exchange Act. In each of these cases, in adopting implementing regulations, the SEC went beyond the requirements of SOX. Under the Securities Exchange Act, the agencies have the ability to revise the reporting regulations as they apply to banking organizations if they find that the implementation of substantially similar regulations with respect to insured banks and savings associations are not necessary or appropriate in the public interest or for the protection of investors.

Section 404 Internal Control Reports

Many community banks are expressing serious concern that the cost of section 404 compliance will significantly outweigh the benefits of the resulting improvements in internal control processes and management's understanding of the effectiveness of these controls. In particular, they do not believe that the effort and expense resulting from additional certifications, documentation and testing requirements are commensurate with the risk from operations.

ACB is concerned that many community banks simply do not have the internal resources to meet the high threshold required by the Public Company Accounting Oversight Board's (PCAOB) attestation standard as it is being implemented by auditors. Banks in this position are facing significant external consulting costs, as well as increases in their auditing fees. Some community banks are reporting audit and attestation fee estimates up to 75 percent higher than what they have paid in the past and some community banks are reporting total fees that equal up to 20 percent of net income. Community banks also are facing a significant increase in legal fees associated with section 404. While we understand that companies will incur the most significant costs during the first year of section 404 compliance, there is strong evidence indicating that compliance costs will remain at a substantial level.

Many small companies already have made the choice to go private, for example, Sturgis Bancorp, Madison Bancshares, Home Financial Bancorp and Fidelity Federal Bancorp. Others are looking for merger partners. To the extent that the goals of SOX are laudable and the statute serves a useful purpose, we believe that the loss of a community bank to a local community is an example of the worst kind of unintended consequence.

The time devoted to section 404 compliance is taking time away from other matters. Executive officers must spend a great deal of time on the minutia required by the auditors at the expense of a focus on daily operations, long-term performance and strategic planning. Internal audit and other departments also are spending significant time with 404, taking away focus and efforts from other required activities. For example, we have heard reports that, in some instances, community banks have abandoned regular risk audits for this fiscal year to concentrate on 404 compliance. Also, compliance with 404 is adversely affecting the way companies are managed. Some members are indicating that they are being forced to centralize decision-making because the price to be paid for a problem or gap in an area would be too high. Without explicit and reasonable relief from these requirements, many community banks face significant costs and strains on resources that could erode retained earnings and weaken capital adequacy, creating very real safety and soundness issues.

In our recent letter to the SEC on section 404 and our participation in the SEC's public roundtable on April 13, we made the following suggestions for changes to the requirements:

We believe that insured depository institutions should be able to follow the requirements of Part 363 of the FDIC regulations in lieu of compliance with section 404. The PCAOB's requirement for a separate audit of internal controls by the external auditor has created much of the unnecessary burden of the section 404 requirements. Conducting a thorough and detailed review

of how management reaches its conclusions about internal controls can be as effective, but considerably more efficient and less burdensome, than the required audit. Requiring an independent audit of internal control over financial reporting is duplicative of work performed by a company's internal audit function and senior management and has resulted in the cost, burden and frustration arising from the PCAOB's Auditing Standard No. 2. Public auditors are interpreting their responsibilities under the standard quite broadly and, in an effort to avoid future liability, are erring on the side of doing too much, rather than not doing enough.

We urged the PCAOB to rethink whether a separate audit of internal controls is really necessary and scale back these standards to a reasonable level of inquiry that allows an auditor to opine on the conclusions reached by management. There are other protections recently put in place that will protect the investing public and that make a more burdensome standard inappropriate. For instance, the chief executive officer and chief financial officer must certify each quarter as to the accuracy of the company's financial statements and their responsibility for establishing and maintaining internal controls. They also must certify that the internal controls have been designed to provide reasonable assurance about the reliability of the financial statements and that they have evaluated the effectiveness of the internal controls. The certifications with regard to the accuracy of the financial statements are made under the threat of criminal liability if the officer knowingly makes a false certification. These new requirements coupled with a thorough review of management's assessment of the internal control environment by the external auditor should provide the protections needed by investors.

If the SEC and the PCAOB do not extend a full exemption to depository institutions, we urge the agencies to consider revising the section 404 approach for them in light of the other significant protections available to investors of a highly regulated depository institution. If the agencies do not believe that this would be warranted for all public depository institutions, then we urge that a partial exemption from section 404 for the depository institutions exempt from the Part 363 internal control reporting requirements be granted either through a change in the regulations or a change in the law by Congress. The federal banking regulators recognized years ago that internal control reporting and attestation requirements for the smaller community banks would be unduly burdensome, so the requirements were applied only to those institutions with $500 million or more in assets. The agencies felt comfortable with this approach because these smaller institutions are still subject to the full scope of banking laws and regulations, are required to have an adequate internal control structure in place, and, most importantly, are subject to regular safety and soundness examinations.

Acceleration of Filing Deadlines

Over the course of the last few years after passage of SOX, the SEC has accelerated the filing deadlines for periodic reports on Forms 10-Q and 10-K, current reports on Form 8-K, and insider beneficial ownership reports under section 16. Unlike larger companies, smaller public community banks do not have employees on staff dedicated to filing these reports so either have to divert attention from other matters to meet stringent deadlines or hire outside help. The two business day deadline for section 16 reports is particularly difficult because these reports are required from principal shareholders, directors and executive officers, and a certain amount of

coordination with these parties must be arranged. Also, in light of the significant number of items that now must be reported on Form 8-K, the new four-business day filing requirement takes its toll on staff. Smaller companies do not have the staff resources to handle the increasing amount of information that has to be filed. Also, shorter deadlines only encourage those investors who already have a short-term outlook on investments when it seems prudent to encourage longer-term investment objectives.

We suggest that the deadlines for insured depository institutions be changed to 10 calendar days for filing current reports on Form 8-K and section 16 beneficial ownership reports.

When the SEC accelerated the deadlines for periodic reports, it provided an exemption from the new deadlines for smaller companies. However, larger companies are also now experiencing problems with the deadlines in light of the substantial work that must be done to comply with SOX section 404. Therefore, the SEC and the agencies should consider freezing the current deadlines that are now in place rather than phasing in the final step in the acceleration schedule that would require annual reports be filed within 60 days and interim reports be filed within 35 days.

Annual Independent Audits and Reporting Requirements (Part 363)

In 1991, the exemption from the external independent audit and internal control requirements in Part 363 for depository institutions with less than $500 million in assets was adequate. With the increasing consolidation of the banking industry, coupled with the application by external auditors of the public company auditing standard to FDICIA banks, this exemption threshold needs to be increased to reduce burden on the smaller institutions. We have heard that many privately held and mutual community banks with assets between $500 million and $1 billion are experiencing substantial audit fee increases coupled with serious strains on internal resources in complying with the FDICIA requirements. We believe an increase in the threshold to $1 billion in assets will provide much needed relief for these institutions.

**Transactions with Affiliates**

The Federal Reserve Board issued Regulation W at the end of 2002 to implement sections 23A and 23B of the Federal Reserve Act. ACB has the following suggestions for reducing the burden of this regulation.

All state bank subsidiaries should be exempt from the requirements and restrictions of Regulation W, other than those subsidiaries that engage in activities specifically mentioned in section 121(d) of the Gramm-Leach-Bliley Act (i.e., subsidiaries engaging as principal in activities that would only be permissible for a national bank to conduct through a financial subsidiary). Also, Regulation W should exempt any subsidiary relationship that would not have been subject to sections 23A and 23B prior to the date that Regulation W was issued. These exemptions were supported by an FDIC proposed rulemaking in 2004. The activities of these subsidiaries, while not authorized for national banks to perform directly, have been conducted safely and prudently for some time. The activities are authorized by state law and must comply

with the requirements of the Federal Deposit Insurance Act, the FDIC's regulations, and prudential conditions in any approval order. Nothing in the history of these subsidiaries' operations suggests safety and soundness concerns that would warrant wholesale application of Regulation W.

If this exemption is deemed to be too broad, then we request an exemption to be extended at least for those state bank subsidiaries that engage only in agency activities. Agency activities typically do not require the same level of capital investment as other subsidiaries and generally do not pose significant risks to their parent depository institutions. The regulatory burden associated with applying Regulation W to these types of subsidiaries is not justified by any incremental supervisory benefits that might result.

The definition of "general purpose credit card" set forth in section 223.16(c)(4) is unduly restrictive in limiting the percentage of transactions involving the purchase of goods and services from an affiliate to 25 percent. So long as a majority of these transactions is between bank customers and nonaffiliated parties, this exemption should be available.

**Frequency of Safety and Soundness Examinations**

Safety and soundness exams are conducted on an annual basis, except that smaller depository institutions that meet certain requirements are examined on an 18-month cycle. One of those requirements is that the institution have assets of $250 million or less. ACB believes that this threshold should be increased to at least $500 million. Institutions that cross over the $250 threshold experience significantly increased burden from more intense examinations conducted more frequently. These institutions still are quite small and they have limited staff resources to devote to the examination process. We believe a higher threshold would be appropriate in light of the protection afforded by the other requirements of the less frequent exam cycle: the institution must be well capitalized and well managed, have one of the two highest ratings from its previous examination, and not be subject to any formal enforcement proceeding or order. Furthermore, the regulators have the authority to conduct more frequent examinations, as they may deem necessary.

**Financial Management Policies**

Section 563.170(d) of the rules and regulations of the OTS requires a savings association to have a resolution passed by its board of directors and a certified copy sent to the Regional Director before transferring records, or the maintenance of records, from or between the home office or any branch or service office. ACB recommends that this requirement be deleted or that only an after-the-fact written notice of a transfer to the Regional Director be required if records are transferred from a home office to a branch or service office, or from a branch or service office to the home office or another branch or service office. As long as maintenance and possession of the records are kept under the control of the savings association and not sent to a third party, an after-the-fact letter should be sufficient.

Section 563.170(e) requires that a savings association provide at least 90 days notice prior to maintaining any of its records by means of data processing services. This notice requirement should be deleted or reduced to 30 days.

**Rules on the Issuance and Sale of Institution Securities**

The requirement in section 563.5 that savings association certificates must include a statement about the lack of FDIC insurance should be moved to a place where it is adjacent to relevant material and can be more easily found. For example, the requirement would be more appropriate in section 552.6-3, which discusses the certificates for savings association shares generally.

**Securities Offerings.**

The notice requirements in sections 563g.4(c) and 563g.12 should be deleted as it should not be necessary to report the results of an offering 30 days after the first sale, every six months during the offering, and then again 30 days after the last sale.

**Recordkeeping and Confirmation of Securities Transactions Effected by Banks**

The FDIC, OCC and the Federal Reserve should conform their rules to those of the OTS and permit quarterly statements, rather than monthly statements, be sent for transactions in cash management sweep accounts. This will reduce the burden for national and state-chartered banks without adversely affecting bank customers. Most investment companies provide statements on a quarterly basis and customers are comfortable with this level of frequency.

**Appraisal Standards for Federally Related Transactions**

Each of the agencies requires that appraisals on residential real estate be conducted by state certified or state licensed appraisers for federally related transactions in excess of $250,000. We urge each of the agencies to amend its regulations to reflect the home price appreciation and inflation that has occurred in the years since the adoption of the final appraisal regulations in 1992. We suggest amending the regulation to aligning the threshold with the current conforming loan limits for Fannie Mae and Freddie Mac. As the conforming loan limit increases (or decreases), the threshold would increase (or decrease). When the final regulation was adopted the conforming loan limit was $202,300. Today it is $359,650, but the exemption threshold has remained unchanged.

This disparity puts federally regulated institutions at a disadvantage to their non-regulated competitors. It also disregards the innovations in automated loan underwriting and automated valuation models that are in such wide usage today. These innovations in underwriting and valuing property help lenders compete for business by providing simplified property evaluations, reducing borrowers' costs, and accelerating the loan approval process. For example, a typical automated valuation report obtained via the Internet costs about $30 and is very reliable, while it costs approximately $300 to hire a state certified appraiser.

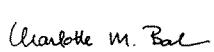
**Conclusion**

We live in a world where criminals seek to abuse our financial system and terrorists plot to change our way of life. We understand that anti-money laundering laws and regulations are necessary, but believe that the implementation of anti-money laundering requirements can be improved. Bottomline, the intentions behind these rules may be grounded in doing good yet their implementation is causing very real and measurable harm. Legitimate customers are being denied service and banks are being forced to adhere to an unattainable standard of perfect compliance. Without real regulatory relief our country will lose more community banks that opt out of burden.

ACB strongly urges the federal banking agencies to use this stage of the EGRPRA project to look at BSA oversight anew. We specifically request the agencies to articulate clear policy and ensure that the regional offices carry out that policy consistently. We again express our appreciation for the newly released MSB guidance and urge the agencies to work with FinCEN to produce further guidance on suspicious activity reporting and OFAC compliance.

We also urge the agencies to review the requirements of SOX as they are imposed on insured depository institutions. We stand ready to work with the agencies as this regulatory relief project progresses. We appreciate the opportunity to provide comments on all of these important matters. Please do not hesitate to contact the undersigned at (202) 857 3121 or cbahin@acbankers.org if you have questions about any of the issues addressed in this letter.

Sincerely,



Charlotte M. Bahin
Senior Vice President, Regulatory Affairs

December 23, 2004

William J. Fox
Director
Financial Crimes Enforcement Network
2070 Chain Bridge Road, Suite 200
Vienna, VA 22182

Re: SAR Resource Guide and Regulatory Issues

Dear Director Fox:

America's Community Bankers (ACB)[12] has been pleased to work with the Financial Crimes Enforcement Network (FinCEN) to provide feedback regarding various Bank Secrecy Act (BSA) related issues, including the development of new regulations to implement the USA Patriot Act. We wish to continue that relationship by making additional suggestions for improving BSA compliance, particularly in the area of suspicious activity reporting.

ACB requests FinCEN, as administrator of the BSA, to provide an updated, centralized resource guide regarding suspicious activity reporting that 1) helps institutions understand what kinds of transactions and occurrences are suspicious and reportable and 2) addresses other SAR related issues and frequently asked questions (FAQ's). We believe that such centralized guidance would be a helpful resource to community bankers and may be one way to help reduce the problem of defensive SAR filing.

Suspicious activity reporting has taken on new significance in our post-September 11th world, and FinCEN and the federal banking regulators expect institutions of all sizes and geographic locations to institute policies and procedures to detect possible illegal activity. In this era of increased regulatory scrutiny, community banks deserve more guidance and information. Otherwise, the anti-money laundering demands imposed on them are very unfair.

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[12] America's Community Bankers is the member driven national trade association representing community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*

Accordingly, we request FinCEN to compile a comprehensive guide to SAR reporting that includes:

1. A list of common suspicious activities and red flags. Community bankers often ask, "What kind of activity is suspicious?" or "What activity triggers a SAR filing?" This is an important question for financial institutions that do not have legal departments or sophisticated compliance teams dedicated to BSA compliance. This question is also important in helping to separate those occurrences that should not be reported to FinCEN. We also encourage FinCEN to include examples or case studies where SARs are or are not warranted.

2. FAQ's and key points made by previous SAR Activity Reviews. We appreciate the efforts of FinCEN to compile the semi-annual SAR Activity Review. This publication has been helpful in communicating SAR tips, trends, and issues, and we strongly urge FinCEN to continue to publish this document. However, we believe that it would be helpful to compile and update the issues that have been discussed over the years. Examples of FAQ's could include:

    - How to handle SAR subpoenas.
    - How much information bank managers should provide their boards of directors concerning SAR filings.
    - Whether institutions should file SARs retroactively after being notified by law enforcement that funds may have been laundered through an account.
    - Whether a SAR should be filed on a name found on the 314(a) list.
    - Whether a SAR should be filed on an OFAC hit.

Many publications exist about SAR filing, but the information contained in these materials would be more valuable to the banking industry if it were updated, supplemented, and centralized. We understand that the federal banking agencies are working to finalize interagency BSA examination procedures. We believe that the exam procedures will help clarify the regulators' BSA expectations, but we are skeptical that the procedures will provide a comprehensive suspicious activity reporting guide for community bankers. Additionally, over the years, the federal banking agencies have issued various booklets and other publications (e.g. the Office of the Comptroller of the Currency's *Money Laundering: A Banker's Guide to Avoiding Problems* (Dec 2002)). Nevertheless, we believe that community bankers would find real value in a comprehensive SAR guidance publication.

The uncertainty surrounding whether to file a SAR is compounded by the fact that many bankers have heard FinCEN's plea not to file defensive SARs. Simply requesting institutions not to file defensive SARs will not eliminate this problem. FinCEN must help institutions understand how to separate the wheat from the chaff and must work to ensure that the banking regulators do not create a culture that motivates institutions to file unnecessarily. ACB members are generally sympathetic to the problems created by defensive SAR filing. However, without additional guidance regarding what events

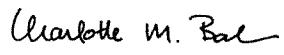
trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment.

One community banker recently told of an instance where he was unsure whether certain activity should be deemed suspicious. He called FinCEN's regulatory helpline only to be told that FinCEN does not comment on whether a particular activity triggers a SAR reporting obligation. While FinCEN obviously cannot comment without knowing all of the facts and circumstances surrounding a particular case, this instance is illustrative of the dilemma faced by many community bankers who are unsure whether to file a SAR.

ACB urges FinCEN to give serious consideration to our request for the development of an updated, centralized, comprehensive guide to suspicious activity reporting. Such a resource would be helpful to community banks, and ultimately law enforcement, as we pursue our common goal of preventing terrorism and other crimes. We also trust that FinCEN will work with the federal banking agencies to help eliminate the contradictory messages that are being sent about suspicious activity reporting.

ACB looks forward to working with FinCEN on this and other issues pertaining to BSA compliance. Please contact the undersigned at 202-857-3121 or Krista Shonk at 202-857-3187 should you have any questions. Thank you for your consideration.

Sincerely,



Charlotte M. Bahin
Senior Vice President
Regulatory Affairs

Testimony of

Bob Marquette
President/CEO of Members 1st Federal Credit Union

on Behalf of
The National Association of Federal Credit Unions

Regulatory Relief

Before the

Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives

May 19, 2005

**Introduction**

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of almost 800 federal credit unions—member owned financial institutions across the nation—representing nearly 26 million individual credit union members. NAFCU–member credit unions collectively account for approximately two-thirds of the assets of all 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.

Historically, credit unions have served a unique function in the delivery of necessary financial services to 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 no access to 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 86 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 USC 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 over 9,000 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 seven

years since Congress passed the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219) federal credit unions have added almost 1,000 underserved areas resulting in low cost financial services being made available to over 76 million people. 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.

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 United States Treasury, every dollar that has ever 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.

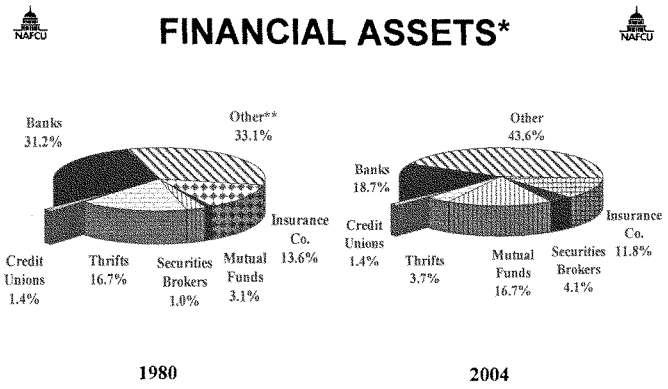
Currently, I serve as the President and CEO of Members 1st Federal Credit Union headquartered in Mechanicsburg, Pennsylvania, a position I have held for seven years. Established in 1950, Members 1st FCU is a community credit union with approximately 108,000 members and more than $1 billion in assets. We now provide a full range of financial services through 24 branches throughout south central Pennsylvania. I have been involved in the credit union movement for more than 30 years, including regulatory experience with the National Credit Union Administration (NCUA) and a stint as the Director for Member Contact at the Pennsylvania State Employees FCU.

Presently, I serve on the National Association of Federal Credit Unions' Board of Directors, the NAFCU Legislative Committee, the Philadelphia Federal Reserve's Credit

Union Advisory Council and also the Regulatory Review Committee of the Pennsylvania Credit Union Association. In addition, I am a board member of the Pennsylvania Credit Union Foundation where I serve as Fundraising Committee Chair.

**The Current Situation**

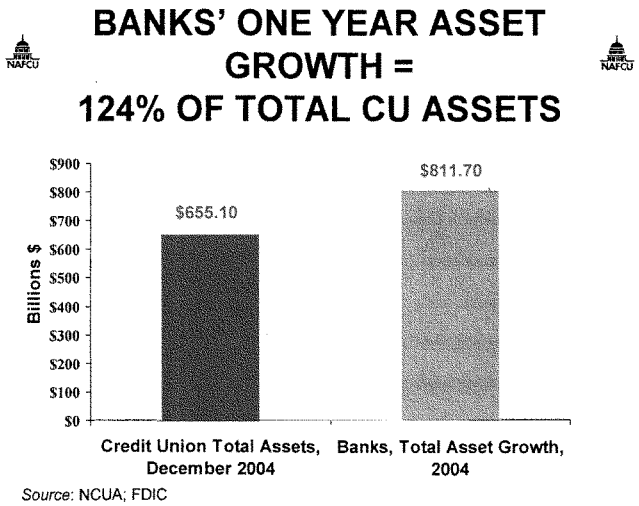
NAFCU is pleased to report to the Committee that credit unions today are vibrant and healthy. Membership in credit unions continues to grow with credit unions serving over 86 million Americans—more than at any time in history. At the same time, it is important to note that over the past 24 years, the 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 24 year period from 1980 to 2004 the percentage of total financial assets held by credit unions remained constant at only 1.4%.




**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. Today, the average credit union has $71 million in assets, while the "average" bank and thrift has over $1 billion in assets.




Furthermore, a number of individual banks have total assets greater than the entire credit union community combined. As noted in the chart above, the annual asset growth of the commercial bank sector last year exceeded the size of the entire credit union community, i.e. total assets—with banks growing in just one year by a magnitude that it took credit unions nearly a century to achieve.

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 61 percent over the course of the past 30 years, from an all-time high of 23,866 in 1969 to 9,104 at year-end 2004. Similar to the experience of all credit unions, the number of federal credit unions has declined by just about 56 percent over that same period, from a high of 12,921 in 1969 to 5,572 today.

**NAFCU Proposals for Comprehensive Regulatory Relief**

Over the past four years NAFCU has been working with former NCUA Board Chairman Dennis Dollar, current NCUA Chairman JoAnn Johnson, Board Member Deborah Matz and their staffs in a good faith effort to improve the regulatory environment for federal credit unions. We are pleased to see that these efforts have been fruitful 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 very 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 supports the following twelve provisions, all of which were included in both the *Financial Services Regulatory Relief Act of 2004*, which passed the House last year, and the *Credit Union Regulatory Improvements Act of 2005* (CURIA), H.R. 2317, introduced in the 109th Congress. NAFCU urges that the following provisions be included in any regulatory relief bill that is moved by the Committee:

Leases of land on federal facilities for credit unions

NAFCU supports the effort to give credit unions land leases on federal property under the same terms and conditions as credit unions now are provided space allotments under the FCUA. The credit unions that will be impacted by this change are 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 (e.g. $1.00 a year) to a "fair market value" rate of over $2,000 a month. For non-profit cooperative credit unions, this change in leasing costs will inevitably lead to higher fees and/or fewer services for the men and women they serve.

Investments in securities by federal credit unions

NAFCU supports this effort to increase investment options for federal credit unions by allowing certain limited investments in securities. The current limitations in the FCUA unduly restrict federal credit unions in today's dynamic financial marketplace and have the potential of adversely impacting both safety and soundness in the future. 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

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. We believe that 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 one-percent investment limit in credit union service organizations

NAFCU supports this provision to increase the one percent investment limit in credit union service organizations (CUSOs). However, in lieu of just raising the limit to three 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 legitimately warrant further adjustment.

Member business loan exclusion for loans to non-profit religious organizations

NAFCU supports this effort to exclude loans or loan participations by federal credit unions to non-profit 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

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 non-traditional 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

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, 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. In addition, we believe that 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.

Community charter conversions involving employee group credit unions

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.

Credit union governance

The FCUA contains many antiquated "governance" provisions that, while perhaps appropriate in 1934, are outdated, unnecessary and inappropriate restrictions on the day-to-day operations and policies of a federal credit union. We support changes that would remove many of these provisions from the FCUA and instead allow the NCUA the authority to keep these governance issues current. For example, one antiquated provision states that credit unions are not allowed to expel 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 this matter for extreme cases. Additionally, NAFCU supports the following credit union governance proposals which would:

- allow credit unions to limit the length of service of members of the board of directors to ensure broader representation; and
- allow credit unions to reimburse volunteers on the board of directors for wages they would otherwise forfeit by participating in credit union-related activities.

NAFCU also supports the following credit union governance proposals, which were not included in the regulatory relief package passed by the House last year:

- 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 the FCUA sets it 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 the FCUA stipulates that the Board must review approved or pending applications monthly).

Providing NCUA with greater flexibility in responding to market conditions

NAFCU supports the idea of giving NCUA the authority to adjust interest rates depending on market conditions. Under current law, federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans.

Exemption from pre-merger notification requirement of the Clayton Act

NAFCU supports the inclusion of this language which would exempt credit unions, just as banks and thrifts are already exempt, from the pre-merger notification requirements of the *Hart-Scott-Rodino Act*.

Treatment of credit unions as depository institutions under securities laws

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.

There are also additional provisions included in CURIA, which were not included in the *Financial Services Regulatory Relief* Act *of 2004* as it passed the House. Given the bipartisan support CURIA has enjoyed, NAFCU hopes that the Committee will consider including these provisions in any regulatory relief bill introduced in the House:

Modify the statutory definition of "net worth" to include the retained earnings from other institutions that have merged with the credit union

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: $5M (net worth of credit union A) + $5M (net worth of credit union B) = $10M (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 $5M ($5M (net worth of credit union A) + $5M (net worth of credit union B) = $5M (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. As a result, the surviving credit union

may have trouble meeting PCA requirements, unless credit union net worth is redefined. Until the legislation is enacted, we support including the language from H.R. 1042, the *Net Worth Amendment for Credit Unions Act* in any regulatory relief package and would note the widespread support that the bill received from this Subcommittee at a hearing last month.

Risk-based capital/PCA Reform

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. We urge inclusion of the proposal put forth by the NCUA and included as Title I of the CURIA bill in any regulatory relief legislation.

Limits on member business loans

NAFCU supports elimination of 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 net worth required for a well-capitalized credit union, and replacing it with a flat rate of 20 percent of the total assets of a credit union. 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

NAFCU supports the provision in CURIA that enhances the ability of credit unions to assist distressed communities with their economic revitalization efforts. It 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.

## 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 House 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 look forward to working with you on this important matter and would welcome your comments or questions.

*May 19, 2005*

*Testimony of*

Bradley E. Rock

*On Behalf of the*

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

Committee on Financial Services

United States House of Representatives

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**May 19, 2005**

Mr. Chairman and members of the Subcommittee, my name is Bradley Rock. I am Chairman, President and CEO of Bank of Smithtown, a $750 million community bank located in Smithtown, New York founded in 1910. I am also Chairman of the Government Relations Council 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 reduce or eliminate unnecessary, redundant, or inefficient regulatory burdens that increase costs not only for banks, but also for the customers and businesses that use banks – and that's nearly everyone.

In my testimony, I would like to make three key points:

- Excessive regulatory burden is not just a problem for banks – it 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, which has been the cornerstone of economic growth in this country, is in great danger of being regulated right out of business.

- The ongoing review of regulatory costs by the federal bank regulators is very positive; results are what counts, however, and many bankers are skeptical that significant relief from the regulators is possible without congressional action.

The federal banking agencies, which are now in the fourth phase of the 10-year regulatory review required by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), are evaluating ways to reduce unduly burdensome regulations. EGRPRA, which became law in 1996, is the last comprehensive regulatory relief bill enacted by Congress. In the decade following EGRPRA's enactment, banks have struggled to shoulder the effects of some the most imposing legislation of the past 100 years. Much of it was prompted by renewed focus on accounting practices and heightened security in the aftermath of September 11th. While the impetus behind the compliance obligations

imposed by the USA PATRIOT Act, the Sarbanes-Oxley Act, and the privacy provisions of the Gramm-Leach-Bliley Act (GLBA) are reasonable, too often their enforcement and practical effects are not.

When the cumbersome layering of additional rules, issued by the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), and the American Institute of Certified Public Accountants (AICPA) are also taken into account, it is abundantly clear that bank resources are being stretched too thin. Obviously, this is not in the interest of banks, but it also means that banks have fewer resources available to meet the stated policy goals of lawmakers and regulators.

We have submitted comments to regulators recommending changes that involve the Bank Secrecy Act (BSA), including discontinuing currency transaction reports (CTRs) for seasoned customers, eliminating the verification requirement for customers purchasing monetary instruments, and establishing a standard for suspending repetitive SAR filings on continuing activities in which law enforcement has no interest. Other suggested changes involve such issues as appraisal standards, real estate lending standards, and annual audit and reporting requirements.

We have long since reached a point where only the active involvement of Congress can result in a comprehensive reduction of outdated, inefficient, and costly regulatory burdens. A more detailed explanation of some of the areas in which ABA is seeking reform is found at the end of this testimony in the appendix.

## I. Regulatory Burden Has an Impact on Bank Customers and Local Economies

Reviewing regulations and their impact on our businesses and communities should be an ongoing process, as the marketplace continues to change rapidly. Outdated laws and regulations only squander 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 ours. While no single regulation by itself is overwhelming to most businesses, the cumulative weight of all the requirements is overwhelming. It is like boxing outside of one's weight class. Even the best moves will not, in the end, overcome the disadvantages of being dwarfed by the size of your challenger. New laws add heft to the regulatory burden. Banks are against the ropes.

The burden of regulation has a significant impact on bank customers and local economies. Compliance costs are a significant drain on bank resources, taking precious resources away from meeting the needs of our customers. And every new law, regulation or rule added means two things: more expensive bank credit and less of it. This is likely to hurt small businesses the most, as they cannot go directly to the capital markets, yet need low-cost financing. 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 would range from $34 billion to $42 billion per year and this does not include compliance costs due to

[1] "Survey of Regulatory Burden," American Bankers Association, 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.

legislation enacted in the last five years, such as the USA PATRIOT Act and Sarbanes-Oxley. 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 $69 billion to $84 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.

## II. Community Banks Are In Danger of Being Regulated Right Out of Business

Regulatory costs are significant for banks of all sizes, but pound for pound, small banks carry the heaviest regulatory load. For the typical small bank, about one out of every four dollars 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.

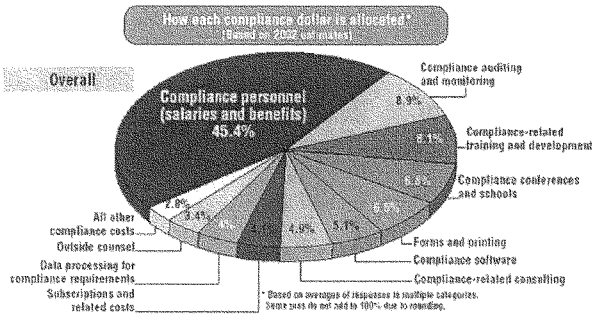
The cumulative effect of new rules and regulations will ultimately force many community banks to look for merger partners to help spread the costs; some will go out of business altogether or consolidate with larger banks. Our members routinely mention regulatory burden as the first or second critical factor threatening the viability of his or her community bank. 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 CEOs to compliance managers and tellers, spend endless hours on compliance paperwork. Much of this work falls heavily on tellers. For example, they fill out the more than 13 million CTRs filed annually. Yet the 35-year-old rules related to CTRs have become redundant and lost their usefulness due to several developments, including formalized customer identification programs; more robust suspicious activity reporting; and, government use of inquiry and response processes.

At Bank of Smithtown, every person in every department has major compliance responsibilities. 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 CEOs tell me that they are now spending nearly half of their time on regulatory issues. This means that for banking alone, CEOs spend over 5.5 million hours per year on compliance – time that could have been better spent on ways to expanding their businesses and to meet the changing needs of their customers.

Of course, labor costs are a small part of the entire cost required to meet all the compliance obligations that we have. 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.




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. Consider a small bank, which can have as few as 20 employees or less. In order to fulfill their compliance obligations, banks of this size often are forced to hire an additional full-time employee just to complete reports related to BSA. Not only is this a huge expenditure of time and money, but bankers wonder if these reports are even being read. 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.

In fact, there are more than ***3,200 banks and thrifts with fewer than 25 employees; nearly 1,000 banks and thrifts have fewer than 10 employees***. These banks, which serve primarily small communities in non-urban areas, simply do not have the human resources to run the bank *and* to read, understand and implement the thousands of pages of new and revised regulations, policy statements, directives, and reporting modifications they receive every year. According to the Small Business Administration's Office of Advocacy, the total cost of regulation is 60 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]

Banks that are regulated by more than one bank regulatory agency have a particular challenge, in that opinions about what is correct or adequate with regard to certain regulatory requirements differ between agencies. Such banks currently lack one definitive answer about what is required and necessary to comply with any specific aspect of a regulation. Another challenge facing institutions is the fact that compliance regulations can come from a variety of sources such as the SEC, FASB, PCAOB, and AICPA. The system lacks monitoring of the overall increasing regulatory and reporting burden on financial institutions. Just over the last few years, numerous accounting changes have been issued and have cost the industry an enormous amount of valuable staff time and money to implement. A few of the most recognizable rules include: fair value disclosures, accounting for derivatives, accounting for guarantees, accounting for loan loss reserves, accounting for special purpose entities, and accounting for purchased loans. These rules are being issued at a very rapid speed with an extraordinarily short amount of time given to implement them; this presents a significant challenge to all banking institutions. Moreover, we are concerned that a significant amount of time, effort and expense has been directed to rules that have not been demanded by investors and will not be used or even understood by them.

While we recognize there have been positive benefits of the Sarbanes-Oxley Act, banks have experienced inordinately large increases in annual auditing fees as a result of it and new rules developed by the PCAOB. Even non-publicly traded banks have been impacted. Many community

[2] Crain and Hopkins, "Impact of Regulatory Costs for Small Firms," Small Business Administration, Office of Advocacy, 2001

banks' accounting fees have more than doubled. ***One community bank in New York saw its accounting fees jump from $193,000 in 2003 to more than $600,000 in 2004.***

Not only have outside auditing fees increased tremendously, but so too have attorneys' fees and insurance costs. Many publicly traded community banks are exploring whether to de-register under the Securities Exchange Act of 1934 because the huge regulatory expenses and the doubling – and even tripling – of accounting and legal costs that result directly from Section 404, Management Assessment Of Internal Controls, and other provisions of the Sarbanes-Oxley Act. We urge that the Subcommittee look at the costs versus benefits in the application of some of the Act's provisions to community banks. We have also asked the SEC to increase the 500 shareholder registration threshold.

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'm sure I speak for all bankers when I say that I would much rather be spending my time talking with our customers about their financial needs and how my bank will fulfill them than poring over piles of government regulations. The losers in this scenario are bank customers and the communities that banks serve.

## III. Congressional Support for Burden Reduction is Critical

The agencies have made considerable progress in the last several years in improving some of their regulations. Nonetheless, not all of the agencies' regulations have been so revised, although we certainly recognize that, in many cases, the agencies are constrained by the language of statutes in reducing the burdens in a meaningful fashion.

We are hopeful that the current review of bank regulations, required under EGRPRA, will provide meaningful relief. We applaud the openness of the banking regulators to the concerns of the industry as they conduct this review. Doubt exists as to whether this effort will be – or even can be – successful in achieving a meaningful reduction in the burden unless Congress becomes an active partner. Most bankers have seen previous regulatory relief efforts come and go without noticeable effect, while the overall level of regulatory burden has kept rising. Results are what matters.

There is a dilemma here: at the same time that the regulatory agencies are undertaking a review of all regulations with an eye toward reducing the overall compliance burden, they must promulgate new rules for the new laws that Congress has enacted. Simply put, any reduction in existing compliance obligations is likely to be obliterated by compliance requirements of new regulations implementing new laws.

It should be noted that even when Congress has acted to reduce a burden, the agencies have at times not followed through. For example, in 1996, Congress amended RESPA so as to reduce the amount of information that must be provided to mortgage customers relating to a lender's sale, transfer or retention of mortgage loan servicing. This change eliminated the requirement that lenders provide historical data on the likelihood of this transfer and that customers acknowledge receipt of this information in writing. ***HUD has never implemented this statutory change to RESPA.*** Thus, since 1996 HUD's regulation continues to require language in the disclosure form, which Congress struck from the statute. This creates an unnecessary burden on banks. ABA pointed this out to Congress years ago and HUD has still not implemented this 1996 statutory change.

Bankers continue to be concerned about "the uneven playing field" in compliance between depository institutions and other financial institutions. While bankers spend increasing amounts of time and money dealing with regulatory red tape, non-bank competitors, including money market funds and mutual funds, are selling savings and investment products to bank customers. The same is true of credit unions and the Farm Credit System, both of which are free from much of the red tape and expenses imposed on banks. Even when the regulatory requirement is the same on paper, such as the case with the Truth in Lending requirements, non-bank competitors are not subject to the frequent, in-depth, on-site examination that banks are subject to. The result is slower growth for banks, leaving fewer community resources available for meeting local credit needs.

Bankers know that their loans will be examined for consumer compliance at least once every two years. They also know that non-bank lenders will not have their loans examined, probably ever, because the Federal Trade Commission (FTC) and the state agencies that have jurisdiction over them do not have the examination and supervision infrastructure to do so. One solution is to fund, by assessment of the non-bank lenders, if necessary, a real supervisory examination program to stop some of the consumer abuse and predatory lending that we hear about constantly. Congress should ensure that the FTC has the resources to actually enforce against non-bank lenders the consumer protection laws currently in effect.

Importantly, the EGRPRA mandate encompasses more than just regulatory action: it calls for the agencies to advise the Congress on unnecessary burdens imposed by statute, which the agencies cannot change but the Congress can. As noted, in many cases, meaningful compliance burden reduction cannot be achieved absent statutory changes. Mr. Chairman, we hope this Subcommittee will seriously consider the recommendations made under this effort.

**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 Subcommittee to achieve this goal.

## Appendix

## Recommended Changes in Regulation

Currently, the most burdensome of regulations are the combined anti-terrorist, anti-criminal financial information laws. Not only are the demands on banks enormous but they seem to change daily, which is its own form of burden. But there are many other areas that should be addressed. Below is a summary of some recommended areas for reform. ABA is pleased to offer more detailed information to the Subcommittee upon request on any of these points:

### a. Bank Secrecy Act (BSA)/Anti-Money Laundering

- **Eliminate CTR Filings for Seasoned Customers**

  ABA and its members strongly believe that the current Currency Transactions Report (CTRs) standards have long departed from the statutory goal of achieving a high degree of usefulness. ABA members believe that CTR filing has been rendered virtually obsolete by several developments: formalized customer identification programs, more robust suspicious activity reporting and government use of the 314(a) inquiry/response process. We believe that maintaining the CTR threshold at the current level generates too many reports that capture extensive immaterial activity wasting banker and law enforcement time that could be spent on Suspicious Activity Report (SAR) detection and investigation. Consequently, we believe that the time has come to recognize the redundancy of CTR filings for seasoned customers with transaction accounts to eliminate this inefficient use of resources by bankers and law enforcement.

- **Eliminate Identity Verification for Monetary Instruments Conducted by Customers**

In view of the passage of the USA PATRIOT Act and the regulations implementing section 326 requiring a Customer Identification Program ("CIP"), we recommend that the verification requirement of 31 CFR 103.29(a)(ii) be eliminated, since bank customers purchasing these instruments will have already been identified through their institution's CIP program.

- **Eliminate Notification to Directors or Designees of SARs**

The federal banking agencies instruct a bank that "whenever [it] files a SAR ..., the management of the bank shall promptly notify its board of directors, or a Subcommittee of the board of directors or executive officers designated by the board of directors to receive notice." (See, e.g. 12 C.F.R. 21.11 (h).) No such requirement exists in the Financial Crimes Enforcement Network's (FinCEN) parallel SAR regulation.

ABA believes that this expectation imposes a role on directors and executive officers (that who not serve as an institution's BSA officer) that is inconsistent with rational risk management responsibilities and compromises the board's independence in evaluating management performance under the board approved BSA compliance program. The requirement diverts scarce board and executive resources from more significant strategic and policy oversight functions. At the same time, it adds further risk to information security issues without any concomitant benefit to the bank. Mandating notification of SAR filing to the board or executive level for all institutions is an unwarranted imposition on, and deleterious to, sound corporate governance.

- **Establish Standard for Suspending SARs on Continuing Activity**

There are many reasons that banks file continuing SARs when the underlying customer transaction activity is not considered inconsistent with reasonable banking behavior. For example, many institutions file SARs out of a literal interpretation of the structuring guidance and in an abundance of caution, when they have no conviction that the customer is engaging in activity that constitutes money laundering.

Accordingly, ABA proposes that when an institution would otherwise file serial SARs on repeatedly similar customer activity, they should be permitted by a clear regulatory interpretation to suspend further SAR filing when: an original and two additional SARs report continuing similar activity by the same customer have been filed; law enforcement has not requested the continued reporting of the identified activity; and when no substantively different conduct alters the nature, significance or criminality of the repeated activity, or merits a SAR identifying the activity as a different type or involving perpetrators not previously identified.

- **Include FFIEC Exam Instruction to Invoke FinCEN Helpline**

ABA considers the FinCEN Helpline to be a valuable source of BSA interpretive guidance. Many bank representatives and agency examiners utilize this service to obtain staff analysis to assist in evaluating compliance issues. This option has helped many bankers and examiners resolve their disagreements about BSA regulatory applications arising during an exam. However, other examiners resist using this resource when their interpretations are challenged by management.

ABA proposes that the FFIEC agencies include in their uniform exam procedures the following mandatory instruction to expedite exam dispute resolution without requiring a banking agency to compromise its supervisory judgment: "Whenever management submits a written rebuttal to an examiner's BSA exception pertaining to 31 CFR Part 103 and includes therein a request to call the FinCEN Helpline, the examiner shall then call the FinCEN Helpline and, in the presence of the institution BSA Officer, obtain a FinCEN staff advisory interpretation of the issue. If the advisory interpretation does not alter the examiner's judgment with respect to the exception, the FinCEN interpretation is to be recorded on the exception sheet along with any supplemental management position after the BSA Officer has heard the FinCEN interpretation."

- **Include FFIEC Exam Instruction on Conducting Transaction Analysis**

Despite agency requirements for a tailored risk-based BSA compliance program and mandatory testing of bank BSA controls, agencies request transaction files and conduct transaction analyses without finding fault with the bank's audit/testing of the same processes. This is not an appropriate use of resources by agencies and is unduly burdensome for banks.

The FFIEC should adopt the following uniform BSA exam instruction: "Examiners should not request a bank to assemble files or records for the purpose of conducting transaction testing, or engage in transaction testing, of any provision of a bank's BSA compliance program before evaluating the adequacy of the bank's audit or independent testing of the relevant program provision and concluding either (i) that the audit/independent testing is demonstrably not a reliable indicator of bank performance of the program provision

being examined, or (ii) that deficiencies identified by bank audit or independent testing of the program provision have not been timely corrected."

## b. Sarbanes-Oxley Implementation

- **Continued Oversight Critical**

ABA is appreciative that the Subcommittee has held a hearing on Section 404 of the Sarbanes-Oxley Act, and we also appreciate SEC Chairman Donaldson's leadership in hosting an all-day roundtable discussion about ways to improve the process. These two events helped identify the areas that are in dire need of attention, especially the need to streamline the process in order to reduce costs. We believe that this streamlining, including increasing the number of shareholders for registration purposes, can be done through regulatory processes with your support. Continued oversight is important to facilitating these changes.

- **Exemption for Small Depository Institutions**

We request that the Subcommittee consider modifying Section 404 of the Sarbanes-Oxley Act to exempt depository institutions with $1 billion or less in assets from the management reporting requirement (and the audit and attestation of that report) and independent membership (other than the chairman) of the audit Subcommittee. Today, institutions of less than $1 billion represent only 14 percent of total industry assets. These standards have imposed serious burdens on the smaller institutions that frequently result in duplication of these banks' internal audits and are not necessary to safe and sound operation of institutions of less than $1 billion.

The previous threshold, established by the FDIC in 1993, of $500 million is not appropriate today given the state of the industry. At the time the threshold was set, banks under $500 million represented 25 percent of total industry assets. The makeup of the industry has changed considerably since then. While more than 1,200 new banks have been chartered since then, today under-$500 million institutions represent only 10.2 percent of total industry assets. Moreover, in light of the structural changes which have taken place the widely-held definition of a community bank today is one with assets as large as $1 billion or even more.

- **Increase Shareholder Threshold for Registration**

To ameliorate the burdens associated with registration under the Securities Exchange Act of 1934, which the Exchange Act of 1964 necessitated for institutions with 500 or more shareholders, ABA proposes increasing the triggering shareholder threshold to a number between 1,500 and 3,000. This level would appropriately establish a registration threshold comparable in effect to the level enacted in 1964 in terms of market presence. That is to say it is the same market presence today that 500 shareholders would have occupied in 1964 would require six times the dollar investment, or six times the shareholders. Recent activities that by the SEC recognize that the cost of compliance with reporting requirements is relatively greater for smaller companies than for larger issuers. Yet new requirements have significantly increased the costs to small companies.

The Exchange Act also provides 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) should be

similarly updated to place the threshold for de-registration within the range of 900 to 1,800 shareholders of record.

### c. Eliminate Cross-Marketing Restrictions

ABA supports elimination of the prohibition in the Gramm-Leach-Bliley Act on cross-marketing between banks and non-financial portfolio companies where the Financial Holding Company (FHC) that owns the bank also has an investment position in a non-financial portfolio company made through its securities affiliate. No such prohibition exists when the investment position in a portfolio company is made through an FHC's insurance affiliate.

### d. Problems in the Consumer Protections on Bank Sales of Insurance Law

Section 47 of the Federal Deposit Insurance Act establishes certain protections for consumers who purchase insurance products from depository institutions. These protections include a disclosure that insurance products are not backed by the Federal Deposit Insurance Corporation, that such products may involve an investment risk, and that the purchase of an insurance product cannot be conditioned upon the approval of a loan. This disclosure is intended to distinguish insurance products from other banking products, especially insured deposit products.

Section 47, however, does not define the term "insurance product." As a result, the statute has been interpreted to apply to all types of insurance products, even insurance products for which the disclosure either is not necessary or is potentially confusing to the consumer. To address this problem, we recommend modifying the scope of the disclosure requirement to only apply to products wherein there is an investment risk, e.g. not fixed rate annuities or credit insurance.

### e. Control of Shares by Trusts

We propose a safe harbor from the attribution rules of Section 2(g) (2) of the Bank Holding Company Act: (1) for shares held in trust through a regulated employee benefit plan; or (2) for mutual fund shares held in trust provided any investment adviser or affiliate with the power to vote 25 percent 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 purpose of this safe harbor is to exempt certain bank and bank holding company employee investment holdings from being improperly attributed to the bank holding company when those holdings are held through an employee benefit plan or a common or collective fund, or the employee assets are invested in mutual fund shares held in trust. Without this exemption, bank holding companies, by virtue of their employees' activities, could be deemed to control the mutual fund or other company in which the plan or trust has invested.

### f. Provide Parity for Savings Associations

ABA recommends eliminating disparate treatment of thrifts under the federal securities laws eliminating the investment adviser and broker-dealer registration requirements that apply to thrifts, but not banks, under the Investment Advisers Act (IAA) and the Securities Exchange Act of 1934.

Thrifts and banks provide investment adviser, trust and custody, third party brokerage, and other related services in the same manner, but have been subject to disparate requirements under the SEC's interpretation of the securities laws. There is no logical basis to structure the regulatory oversight of thrifts and banks differently. Removing the disparity will reduce regulatory burden by

providing cost savings to affected thrift institutions and enhance competition that will benefit consumers.

### g. Flood Insurance Compliance Problems

The Flood Disaster Protection Act of 1973 should be amended to streamline and simplify flood insurance requirements; resolve compliance problems when the official flood map is more than 10 years old; increase the "small loan" exception (currently $5,000) and allow adjustments for inflation on a regular basis; and to 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.

In addition, the forced-placement rules should be changed to allow lenders to force-place flood insurance within 30 days (instead of the current 45 days) of notifying the borrower and mandatory civil monetary penalties should be eliminated 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.

### h. Clarify Citizenship of National Banks & Federal Savings Associations

Statute generally provides that national banks are "citizens" of the states in which they are "located." However, the term "located" is not defined in statute, and the federal courts have not defined the term consistently. Since 1992, federal courts have disagreed about the meaning of "located," resulting in national banks having multiple state citizenships. Additionally, there is no similar provision for federal savings associations. Therefore, to avoid inconsistent treatment of financial institutions under the diversity statute, we recommend a change in the law to consider that a

national bank or a federal savings and loan is a citizen in the state where its home office is located for federal court jurisdiction.

### i. Establish Protections for Information Provided to Banking Agencies

ABA proposes amending the Federal Deposit Insurance Act to provide 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. Recent court decisions have created ambiguity about the privileged status of information provided to supervisors when outside of the narrow confines of the actual examination. However, the purpose of providing confidentiality for examiner information is to encourage open communication between the regulator and the regulated financial institution. The process of preserving safety and soundness applies just as clearly to additional information supplied to regulators in any part of the supervisory process. The bank agencies have supported the change and we urge Congress to adopt these important protections for bank customers.

Credit Unions

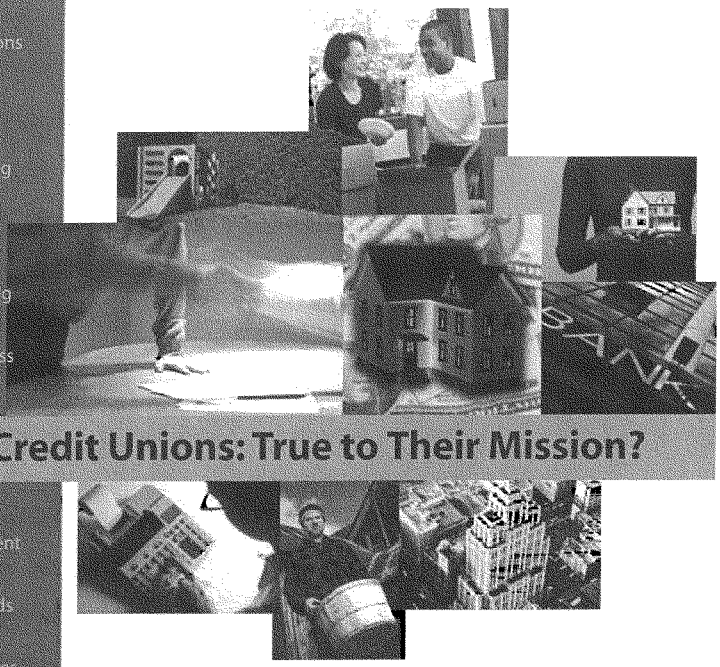
Banks

Fair Lending

CRA

Fair Housing

Equal Access




# Credit Unions: True to Their Mission?

Reinvestment

Credit Needs

Communities

Consumers

Underserved

Performance

Regulations

NATIONAL COMMUNITY REINVESTMENT COALITION NCRC

Credit unions are established "to make [credit] more available to people of small means..."

- Federal Credit Union Act, 1934

The National Community Reinvestment Coalition

The 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.

The Board of Directors would like to express their appreciation to the NCRC professional staff who contributed to this publication and serve as a resource to all of us in the public and private sector who are committed to responsible lending. For more information, please contact:

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## Executive Summary

The National Community Reinvestment Coalition (NCRC) has conducted a comprehensive study comparing the performance of banks and credit unions in serving minorities, women, and low- and moderate-income borrowers with home mortgage, home improvement and refinance loans. Despite credit unions' origins as institutions devoted to people of modest means, NCRC's study finds that banks make a higher portion of their home loans with fewer loan denials than credit unions to traditionally underserved populations. NCRC's study is the first that we know of that has compared credit union and bank performance in home lending over three years across the country as a whole and in each state.

In 1934, the Federal Credit Union Act (FCUA) established the federal supervision of credit unions as alternatives to banks. The necessity for such an alternative arose because the financial needs of low- and moderate-income people were not being met by traditional lenders Spurred by the 1934 legislation, credit unions increased their presence around the country as lending institutions controlled and owned by people of modest means. Based on the assumption that credit unions are serving the needs of low- and moderate-income members, credit unions are afforded certain benefits, such as federal tax exemptions, to help them fulfill their mission.

In the year 2005, after 70 years of federal supervision of credit unions, most people would be surprised to learn that banks are doing a better job of serving low- and moderate-income people than credit unions. This comes in the wake of the 1998 Credit Union Membership Access Act, which provided for significant expansions of credit union membership. While this law empowered credit unions by reversing Supreme Court restrictions on credit union membership, it has not resulted in credit unions markedly improving their performance in lending to traditionally underserved communities.

NCRC's study adds powerful evidence to the numerous studies over the years that have detailed credit unions' lackluster service to people of modest means. The Federal Reserve's 2001 Survey of Consumer Finances revealed that only 36 percent of the households that primarily used credit unions had low- and moderate-incomes in contrast to 42 percent of the households that primarily used banks. In 2003, the Government Accountability Office (GAO) released a report finding that banks provided 34 percent of their mortgage loans to low- and moderate-income borrowers while credit unions issued just 27 percent of their loans to these borrowers in 2001. NCRC's previous analyses of Home Mortgage Disclosure Act (HMDA) data also showed that credit unions trailed banks in the percent of their loans to low- and moderate-income borrowers in 1999 and 2000.

In the first study of its kind, NCRC's three year analysis concludes that banks consistently exceed credit unions' performance in lending to women, minorities, and low- and moderate-income borrowers and communities. NCRC scrutinized lenders' performance on 14 fair lending measures including the percent of loans to different groups of borrowers and the differences in denial rates to minorities versus whites and low- and moderate-income borrowers versus middle- and upper-income borrowers. Banks are compared to credit unions because federal Community Reinvestment Act (CRA) requirements to serve low- and moderate-income communities apply to banks but not credit unions.

When considering performance in home purchase lending by itself, or when considering home purchase, refinance and home improvement lending combined, credit unions consistently lagged banks in service to minorities, low- and moderate-income (LMI) borrowers, women, and LMI and minority neighborhoods. Over a three year period from 2001 through 2003, when all three loan types are taken together, banks outperformed credit unions in 36 states or 72 percent of the states. When home purchase lending is analyzed by itself, credit unions' performance drops off even more - banks outperform credit unions in 40 states or 80 percent of the time. While credit union performance improved over each year of the analysis, banks were still exceeding credit union fair lending performance in the great majority of states by 2003. This is indeed not good performance for institutions that were originally devoted to serving the credit needs of poor people.

When considering lending on a national level, we find that bank fair lending performance exceeds credit union performance by even greater margins than when considering performance state by state. This finding is the result of banks consistently out-performing credit unions in the largest states while credit unions held the advantage in states that were predominantly rural and less heavily populated.

Just one state in our country, Massachusetts, has applied CRA to credit unions over a long period of time. Our study featured a perfect control experiment in that it compared the performance of state-charted credit unions in Massachusetts against federally-charted credit unions not subject to CRA. When considering home purchase, home improvement and refinance lending together, state-chartered credit unions outperform their federally-chartered counterparts in Massachusetts 69 percent of the time. While banks outperform all credit unions in Massachusetts 71 percent of the time in single family lending, banks and state-chartered credit unions perform almost the same – the bank advantage is reduced to only 55 percent.

NCRC recognizes that a significant segment of the credit union industry remains devoted to serving people of modest means. Community development credit unions (CDCUs), for example, are specifically dedicated towards communities left out of the financial mainstream. About 300 CDCU's have more than 860,000 members and assets of $3.1 billion. But the credit union industry is now large, totaling over 9,000 credit unions with assets of $629 billion. While a number of credit unions toil daily to reach poor people, it is clear that the industry as a whole has some catching up to do and also has the resources to do a much better job.

NCRC's findings strengthen the argument that credit unions overall are not meeting their intent of serving low- and moderate-income people. Based on our analysis of the impact of Massachusetts' Community Reinvestment Act (CRA) law and our findings that CRA regulated banks consistently outperform credit unions on fair lending measures, NCRC concludes that federal CRA must be expanded to credit unions. Research has long documented CRA's effectiveness in its application to banks. Likewise, CRA can be effectively applied to credit unions as is evidenced by the Massachusetts experience. The next step in the evolution of credit unions in this country is applying CRA to credit unions, thereby requiring credit unions to abide to an affirmative and continual obligation of meeting the credit needs of low- and moderate-income communities.

# Literature Review

## History of Credit Unions

In 1934 Congress enacted the Federal Credit Union Act (FCUA) to charter and supervise Federal credit unions. Federal credit unions were expressly established to provide credit to people of small means or to those who might only have limited ability to borrow from traditional lenders. The preamble of the FCUA states that the purpose of this act is "to make more available to people of small means credit for provident purposes through a national system of cooperative credit."

The unifying characteristic of these early credit unions is that credit union members, who shared a common bond, would pool their resources together in order to assist one another with credit and lending. Typically, the common link among members was sharing a similar background, having the same occupation or employer, or living in the same community. Credit unions were purposefully created as not-for-profits, so that the benefits inured to credit union members, not external shareholders.

However, the credit union industry has undergone a tremendous evolution since these early days when most were based in church basements, factory shops, and other community institutions. While a segment of the credit union industry remains focused on people of modest means, such as community development credit unions and low-income credit unions, many have become expansive institutions increasingly resembling banks. Much of this change has been largely due to the swelling definition of "common bond" and the shrinking focus on serving those of modest means.

Over the past thirty years, legislative and regulatory alterations have changed the dynamics in which credit unions function and, ultimately, led to a broader definition of common bond. In 1971, for example, Congress authorized credit unions to offer federal share (deposit) insurance. As members no longer bore the personal risk of default, the need for an intimate association amongst credit union members no longer existed and more expansive fields of membership were now feasible. Legislation passed in the 1980s continued to gradually enable credit unions to compete with banks. For instance, in 1980 credit unions were allowed to offer money market accounts, credit cards, home equity credit lines and other services. In 1982, the National Credit Union Administration (NCUA) authorized "multiple common bonds," which directly expanded the field of membership for credit unions.

With the liberalization of the fields of membership and more expansive product and service offerings, credit union membership and assets dramatically grew. Since 1984, total assets held by credit unions have more than tripled.

In 1998, Congress enacted the Credit Union Membership Access Act (CUMAA), which overturned a six-month old Supreme Court ruling on credit union field of membership practices. CUMAA further loosened the common bonds of credit unions by authorizing multiple group credit unions. While CUMAA made legal NCUA's select employee group policy, the legislation attempted to limit the size of any geographic community served by a credit union by adding the term "local" to well-defined. However, NCUA's application of the Congressional mandate has been more expansive than restrictive as the agency has approved ever-larger community charter requests from credit unions.

CUMAA also stirred up debate on whether or not the original intention of the Federal Credit Union Act should be enforced. In the original House version of the CUMAA bill, the credit union mission to serve people of modest means was reaffirmed and credit unions were ordered to meet CRA-like obligations to ensure they achieved it. However, in a very tight vote of 44-50, the Senate subcommittee elected to omit the CRA requirements for credit unions. Such a close debate over the need for a CRA obligation for credit unions highlights Congress's concern that credit unions maintain their focus on borrowers of modest means.

## Basic Overview of Credit Unions

In addition to having the fundamentally unique purpose of serving people of modest means, credit unions differ from banks and other depository institutions in several administrative ways. First, credit unions are member-owned cooperatives that are run in general by a board of volunteers elected by the members of the credit union. Not-for-profits by nature, they do not issue capital stock but instead build capital by retaining earnings.

Unlike banks, credit unions must serve a defined field of membership. Federal credit unions either have a single group, a multiple group, or a community common bond. Some states permit hybrid charters where credit unions can mix geographic common bonds with group common bonds.

> Credit unions are chartered and regulated by either the federal or state government. One major and coveted privilege of credit unions is their tax-exempt status. Both charter types are exempt from federal income taxes, and most state-chartered credit unions are exempt from state income taxes as well. According to year-end 2003 CUNA data, there are currently 9709 credit unions, of which 5774 (or roughly 60%) are federally chartered and 3935 (or approximately 40%) are state chartered. The total assets of all credit unions exceed $629 billion.[1]

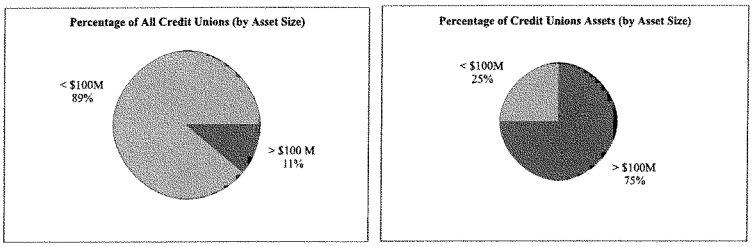
Originally, credit unions provided small consumer loans and savings accounts. However, over the last thirty years, credit unions have begun to expand their services, some to the point that they are even seen as direct competitors to large banks.

## Large vs. Small Credit Unions

While the average credit union has $65.2[2] million in assets , this information does not paint a representative picture of the credit union industry. Due to continued consolidation over the past decade, there is a growing disparity between large and small credit unions within the credit union industry. In 2003 the U.S. General Accounting Office (GAO), now known as the Government Accountability Office, released a study which reported that large credit unions, or those with over $100 million in assets, accounted for about 11% of all credit unions but represented 75% of total credit union assets

[1] Credit Union National Association. www.cuna.org.download/curepd03.pdf. August 3, 2004.
[2] Credit Union National Association. www.cuna.org.download/freq_compar.pdf. August 3, 2004.

in 2002.[3] By comparison, small credit unions, or those with under $100 million in assets, account for 89% of all credit unions but hold only 25% of all credit union assets. Despite CUNA's description of the size of the average credit union, the evidence shows that most credit union assets are controlled by those larger credit unions with over $100 million.




*Source: General Accounting Office report*

In 2001, a U.S. Department of Treasury study comparing credit unions to other depository institutions discovered a similar inequality, stating that "credit union assets [were] concentrated within the largest institutions."[4] According to NCUA statistics, as of year-end 2003 there were 81 credit unions with asset sizes over $1 billion. While billion-dollar plus credit unions account for less than 1% of all credit unions, they held over $176.6 billion in assets or more than 28% of all credit union assets. [5]

The GAO study continued this line of analysis noting that large credit unions offered automatic teller machines, provided credit card loans as well as mortgage and equity loans, and had "sophisticated financial services" such as online banking and loan applications. Furthermore, "when compared with similarly sized peer group banks and thrifts, larger credit unions tended to appear very similar to their bank peers."[6]

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[3] General Accounting Office. *Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management.* October 2003.

[4] U.S. Department of the Treasury. *Comparing Credit Unions with Other Depository Institutions.* January 2001, p. 6.

[5] National Credit Union Administration. http://ncua.gov/ReportsAndPlans/statistics/Midyear2003.pdf. August 3, 2004.

[6] Ibid., p.16.

## Review of Credit Union Fair Lending Performance

*Credit Unions vs. Banks*

With their expanding fields of membership and services and growing asset sizes, it would be fair to assume that credit unions have been increasingly empowering the populations they were created to serve: low- and moderate-income individuals. Yet despite these advances, most existing studies suggest that credit unions *lag* banks in the serving low- and moderate-income borrowers.

A recent assessment by the GAO found that credit unions serve a more affluent clientele than banks. After analyzing the Federal Reserve Board's 2001 Survey on Consumer Finances (SCF), the GAO concluded that "credit unions overall served a lower percentage of households of modest means (low- and moderate-income households combined) than banks."[7] The SCF data showed that while 36 percent of households that only or primarily used credit unions had low- or moderate-incomes, 42 percent of households using banks had low- or moderate-incomes. In addition, when the income levels were analyzed in more detail, the differences became more stark. The SCF data revealed that 16 percent of households using credit unions were low-income, compared to 26 percent of households using banks.

In its 2002 *National Membership Survey*, CUNA, the chief advocate for credit unions, does not dispute credit unions' inclination towards serving higher-income households over lower-income households. CUNA describes credit union members as having higher average household incomes and being more likely to have a college degree and be employed full-time than nonmembers. Without disclosing specific figures, the authors of the CUNA survey simply comment that credit unions "also do well attracting consumers with moderate to moderately-high household incomes."[8]

The GAO study confirmed that a majority of credit union members are middle- and upper-income households. The SCF data illustrates that just 36% of households only and primarily using credit unions are low- and moderate-income while the other 64% are middle- and upper-income. Even more striking, only 16% of credit union households are low-income while 43% are upper-income.[9]

Thus, in addition to demonstrating that credit unions trail the banking industry in serving people of modest means, the GAO also verified that nearly two-thirds of credit union members are not the individuals credit unions were intended to serve.

Other studies conducted by the Chicago-based Woodstock Institute and the Virginia Commonwealth University similarly observed credit unions reaching a smaller market share of low- and moderate-income households than middle- and upper-income households. Based on data gathered from the 2000 Metro Chicago Information Center *Metro Surveys*, Woodstock determined in its 2002 report

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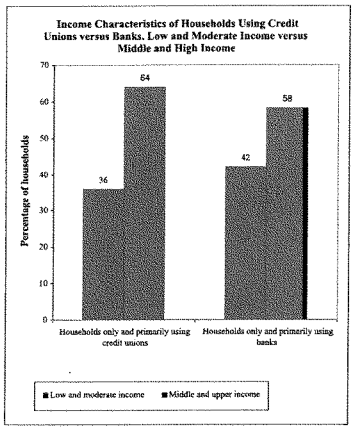
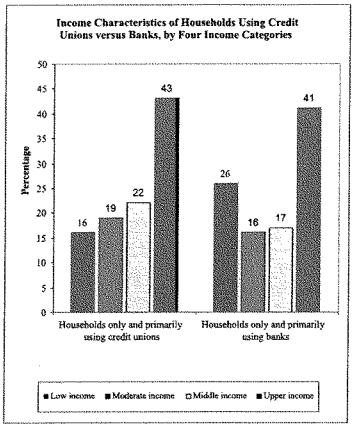
[7] General Accounting Office. *Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management.* October 2003, p. 19.

[8] Credit Union National Association. 2002 National Membership Survey. 2002, p. 2-10.

[9] General Accounting Office. Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management. October 2003.

that credit unions served a lower percentage of low-income households than middle- and upper-income households. More specifically, 40% of surveyed households earning $60,000-$70,000 were credit union members, compared to only 23% of households earning $30,000-$40,000. [10]




*Source: 2001 SCF*

Likewise, in 1997, the Virginia Commonwealth University released a study analyzing the financial service usage patterns of Virginia households from 1996 .[11] The authors concluded that credit unions tended to serve a higher proportion of wealthier households, indicating that 42% of respondents with incomes of $50,000-$69,000 were credit union users, while only 25% of respondents with incomes of $20,000-$34,999 used credit unions. Furthermore, only 13% of those with incomes less than $20,000 used credit unions.

Analyzing 2000 and 1999 HMDA data, NCRC also discovered that credit unions trailed their banking counterparts in serving minorities and low- and moderate-income borrowers. For example, in 2000, banks and thrifts covered by CRA issued 32.1 percent of their single-family loans (home purchase, refinance, and home improvement loans) to low- and moderate-income (LMI) borrowers while

[10] Woodstock Institute. Rhetoric and Reality: An Analysis of Mainstream Credit Unions' Record of Serving Low-Income People. February 2002.

[11] School of Business, Virginia Commonwealth University. A Study on the Comparative Growth of Banks and Credit Unions in Virginia: 1985-1995. August 1997.

credit unions issued only 24.2 percent of their loans across the country to LMI borrowers. Likewise, CRA-covered lenders made 27.8 percent of their conventional home purchase loans to LMI borrowers while credit unions issued just 22.4 percent of these loans to LMI borrowers. From 1999 to 2000, CRA-covered lenders had larger percentage increases in conventional home purchase lending than credit unions to African-Americans, LMI borrowers, LMI census tracts, and tracts with more than 50 percent minority residents. [12]

While credit unions have a social mandate to serve people of modest means, there are currently no guidelines requiring credit unions to report the income levels of the members they serve and, therefore, no administered systematic approach to evaluate the effectiveness of credit unions in serving people of modest means. Instead, the NCUA relies on "potential membership" as a way of determining if credit unions are penetrating underserved areas. But the GAO referred to this as an "indirect measure"[13] and stressed as a primary recommendation that the NCUA administer "tangible indicators to determine whether credit unions are serving people in underserved areas." [14]

## Credit Union Efforts to Serve Those of Modest Means

The available evidence suggests that credit unions serve fewer households of modest means than other financial institutions.

CUNA even concedes this point: "credit unions' relatively low member penetration level among lower-income consumers."[15] While CUNA recommends that credit unions needed to increase awareness of their ability and desire to reach LMI members, CUNA reiterates "the fact remains that [their] high-income members are members, too, and deserve to have the credit unions work just as hard to meet their financial needs." [16] However, the original authors of the Federal Credit Union Act would most likely disagree and would, instead, cite the needs of the low- and moderate-income members as a primary focus of credit unions.

John Caskey's study entitled *Credit Unions and Asset Accumulation by Lower-Income Households* suggested that most credit unions do not concentrate their efforts on serving low- and moderate-income households. His study, which was funded by credit unions and CUNA via the Filene Research Institute, consisted of formal and informal surveys of credit union managers and administrators. Caskey concluded that a main reason for their negligence was that many credit unions were tempted to "free ride",[17] or rely on the special efforts of a few credit unions to improve the image of the industry without having to incur the costs themselves. In addition, some surveyed managers reported they were too distracted with other priorities to be concerned with low- and moderate-income member

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[12] National Community Reinvestment Coalition. NCRC Analysis of National Lending Trends of Credit Unions and CRA-Covered Lending Institutions. January 2002.

[13] General Accounting Office. Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management. October 2003, p. 5.

[14] Ibid., Highlights.

[15] Credit Union National Association. 2002 National Membership Survey. 2002, p. 5.

[16] Ibid., p. 10.

needs. Others felt that focusing on high-quality low-cost services to all members, rather than making special efforts to lower-income households, was the best approach. Yet, aren't those of modest means suppose to be the focus of credit unions?

According to the 2002 Woodstock Institute report, CUNA does not believe so, as it attempted to eliminate the distinct purpose of serving people of small means from the FCUA. Woodstock reported that a CUNA commission in 2001 declared that "it [was] time to declare a victory in achieving this mission, and to craft a new mission that [would] carry credit unions into the 21st century." Furthermore, the Commission stressed that "it [was] not the responsibility of regulatory authorities to define, direct, or examine the social mission of credit unions." [18]

## Community Development Credit Unions

### Characteristics of Community Development Credit Unions

While Community Development Credit Unions (CDCU) only comprise a small portion of the credit union industry, they are most in line with the original concept of what a credit union should be – a member-owned institution, serving people of modest means in a specific community. With the changes in field of membership restrictions in recent years, stemming from the Credit Union Membership Access Act of 1998 (CUMAA), credit unions have grown to become comparable in size and scope to some banks. While many credit unions have evolved beyond what some would view as their definitive role in society, CDCUs remain true to the spirit of the credit union, as set forth in the Federal Credit Union Act of 1934.

A Community Development Credit Union has all the same characteristics as conventional credit unions: not-for-profit, member-owned and democratically run. CDCUs however, have the explicit objective of serving primarily low-income people. To this end, the National Credit Union Administration (NCUA) has developed the Low-Income Credit Union (LICU) designation to help CDCUs remain viable and well capitalized.

To receive a LICU-designation from NCUA, at least 50% of a LICU's members must make less than 80% of the average for all wage earners (as established by the Bureau of Labor Statistics) or must have a household income of less than 80% of the national household median income (as established by the Census Bureau).

While not every CDCU obtains a LICU designation, the benefits of doing so are very attractive. LICU's have more leniency in accepting non-member deposits, are exempt from limits on business lending, may offer secondary-capital accounts, and can participate in special funding programs such as the Community Development Revolving Loan Program. These benefits are intended to help build capital for LICU's, allowing them to provide credit to low-income populations, who might not be as profitable borrowers, as higher-income people that would borrow more money, more often.

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[17] Filene Research Institute. *Credit Unions and Asset Accumulation by Lower-Households.* July 1999, p. 41.

[18] Woodstock Institute. *Rhetoric and Reality: An Analysis of Mainstream Credit Unions' Record of Serving Low-Income People.* February 2002.

As of the fiscal year ending in 2002, there were roughly 297 Community Development Credit Unions.[19] CDCUs can be found in 43 states throughout the United States, and in Puerto Rico and the District of Columbia. Most are located in the Northeast and Southeast. About two-thirds of CDCUs are located in urban areas, while the remaining third are located in rural areas or reservations.[20] Sixty percent of the median CDCU's membership is women. The average CDCU member composition is 60% minority and 80% low- to moderate-income. Furthermore, 65% of CDCU board members are minorities.[21]

As of fiscal year 2002, CDCUs had 865,969 member depositors and total assets of $3.1 billion. These numbers suggest the relatively small size of CDCUs. The average CDCU has 3,623 members and $12.9 million in assets. The median CDCU, on the other hand, had only 954 members and $1.5 million in assets.[22] "As of 1999, over 64 percent of the CDCUs had total assets of under $5 million and over half of these had total assets of under $1 million," according to Tansey.[23]

## History of Government Funding and Oversight of CDCUs

The oldest CDCUs date back to the late 1930's, and were started to provide banking services to poor, often rural, African Americans, who were denied financial services by traditional lenders. In the late 1950's, the Credit Union National Association (CUNA) began looking into national strategies to expand credit unions into low-income areas.

In the 1960's, the "War on Poverty" opened the door to credit unions serving primarily low-income communities. In 1964, President Johnson created the Office of Economic Opportunity (OEO), and CUNA quickly established a relationship with OEO. OEO provided funding to credit unions serving low-income populations, but this approach for serving the poor was not effective and OEO funding to CUNA was cut back.

In the 1970's, the successful fight to obtain share insurance for credit unions came at the cost of more government regulation, which both excited and worried small community credit unions. Share insurance was a step forward, but stricter regulation threatened to close small credit unions that were not well capitalized. This issue united CDCUs and in 1974, the National Federation for Community Development Credit Unions (NFCDCU) was formed, as a trade organization representing the needs of CDCUs. The Carter administration promised to be more amenable to CDCUs than previous administrations, prompting the NFCDCU to present an ambitious plan asking for funding. After much discussion and some squabbling, the Community Development Revolving Loan Fund was set up, which would provide secondary capital to CDCUs at a low rate of interest. The recognition of

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[19] CDFI Data Project, *CDFIs: Providing Capital, Building Communities, Creating Impact*, June 2004, p. 28.

[20] National Federation of Community Development Credit Unions Web Site, http://www.natfed.org/i4a/pages/index.cfm?pageid=256

[21] CDFI Data Project, CDFIs: *Providing Capital, Building Communities, Creating Impact*, June 2004, p. 27.

[22] CDFI Data Project, *CDFIs: Providing Capital, Building Communities*, Creating Impact, June 2004, p. 27.

[23] Tansey, Charles D., *Community Development Credit Unions: An Emerging Player in Low Income Communities*, The Brookings Institute, September 2001, p. 4.

and investment in CDCUs by the government was a major victory for the industry, but hard times would come in the early 1980's.

Broad budget cuts in the first term of the Reagan Administration doomed most CDCUs, which were reliant upon funding from government agencies. By 1982, many CDCUs had closed down and their primary advocate, the NFCDCU was reduced to one employee operating out of his home. Later in 1982, the NFCDCU leadership met to try and turn the situation around. The solution agreed upon was to begin capitalization efforts with private sponsors as partners. The new capitalization strategy helped get the CDCU movement back on its feet, but additional sources of capital were still needed. The NFCDCU fought through the mid-80's to revive the Revolving Loan Fund, which had been frozen by the Reagan Administration. In 1987 the Fund was transferred to the NCUA, but because of restrictions, was unable to actually loan any money. After interest by the White House in CDCUs as sources of non-governmental poverty alleviation, private sector sponsors began to take notice of the CDCU movement. Private investments began pouring in and CDCUs seemed for the first time to be securing their foot-hole in the industry.

The NCUA had an equivocal attitude towards CDCUs until the arrival of the Clinton Administration. President Clinton appointed former Congressman Norm D'Amours as chairman of the NCUA. Chairman D'Amours was a firm believer that credit unions should serve low-income populations, and he put CDCUs at the forefront of his administration. Under D'Amours' stewardship, CDCUs were finally able to stop worrying about survival, and were able to start concentrating on growth and innovation.

## CDCU Best Practices in Serving Low-Income Members

Community Development Credit Unions have the ability to provide all the services that regular credit unions provide, but typically tend to offer an abbreviated list of services tailored to the needs of their members. As the financial needs and practice of low-income people generally differ from those of higher-income people, CDCUs must be creative in offering products and services that will be useful to their membership base. Below are some examples of innovative products offered by CDCUs throughout the country.

Shiloh of Alexandria FCU in Alexandria, VA is partnering with Fannie Mae to offer mortgages at very attractive rates. The National Credit Union Foundation has provided funds to Shiloh of Alexandria to expand the credit union's mortgage lending operations, and the credit union has used some of these funds to help members who have been victimized by predatory lending practices. John Dupree Sr., president of Shiloh of Alexandria FCU, said the credit union was committed to helping those in the community who were of modest means. "By working together, we can help provide more opportunities for affordable homeownership to residents of the [lower income] Parker Gray area," he said. [24]

In response to the high demand for payday loans in Uptown Chicago, North Side Community Federal Credit Union introduced its Payday Alternative Loan (PAL) program in 2002. A PAL allows credit union members and non-members alike to borrow up to $500 for six months, at a rate of

[24] Credit Union National Association Web Site, http://www.cuna.org/newsnow/archive/list.php?date=093004#story3

16.5% per year- as opposed to the 400% and more APR charged by commercial payday lenders. To avoid getting into a cycle of payday loan dependency, borrowers are only allowed two loans per year and the maximum outstanding loan balance is capped at $500. The PAL program has proven to be incredibly popular – and successful. By May 2004, 2,220 loans had been made – 1,321 had been paid off and only 28 had to be written off. [25] North Side estimates that its payday alternative loans save borrowers an average of $950 per year. In total, the PAL program saves approximately $2 million dollars total per year, which goes back to the community.

Alternatives Federal Credit Union in Ithica, NY developed an Individual Development Account (IDA) program. Alternatives' program, relying on external funders, matches every dollar of the participants with three dollars. Alternatives' participants however are required to make a minimum monthly deposit of $20. Savings must remain in the account for at least one year to qualify for matching, and participation in the program is limited to four years. Other terms include mandatory monthly financial education classes and the stipulation that failure to make deposits for three consecutive months will result in expulsion from the program. After the program has been completed, the funds must be used to buy or repair a home, start a small business, or pay school tuition.

A final example of creative products offered by CDCUs is the Smart Loan program, developed by the Cincinnati Central Credit Union (CCCU). The Smart Loan program was designed to provide small loans to members who cannot receive traditional loans because of impaired credit. The program developers started by raising funds (about $30,000) which were placed in an account and used as collateral for the future loans. Small loans (up to $3,000) are then made for up to 18 month terms. CCCU is able to make loans to credit impaired borrowers, using the collateral account to cover loan defaults. Between January 1998 and March 1999, the credit union had loaned out $110,000 under the program. Only 10% of the loans had not been recovered, and because of the collateral account, the CCCU had not taken a loss. [26] Because of their willingness to provide creative alternatives to lower-income borrowers, CCCU and the others demonstrate how CDCUs can serve lower-income people, provide alternatives to high cost and abusive fringe lenders, and remain viable.

## Objectives of Study

As a front-runner in the economic justice movement, the National Community Reinvestment Coalition (NCRC) has taken on the responsibility of promoting fair and equal access to credit, capital and banking services. Currently, the best vehicle for achieving that goal is the Community Reinvestment Act (CRA). CRA imposes upon banks an "affirmative and continuing" obligation to meet the credit needs of low- and moderate-income communities. Federal regulatory agencies examine and rate banks based on the level of lending, service and investments to low- and moderate-income communities. Poor CRA performance can result in regulatory sanctions, such as the delay or

[25] Carlson, Neil F., *Capital Ideas: Five new ways to serve America's unbanked*, Fall 2004, Ford Foundation Website, http://www.fordfound.org/publications/ff_report/view_ff_report_detail.cfm?reports_index=526

[26] Caskey, John P., *Credit Unions and Asset Accumulation by Lower-Income Households*, the Filene Research Institute, July 1999, p. 16.

denial of bank merger applications. An inconsistency arises however, between achieving the goal of economic equality and in the application of CRA- specifically the exclusion of a significant portion of the lending community from CRA compliance.

NCRC believes that a law designed to protect the public from discrimination should target for inclusion all entities from which the public could possibly need protection. In the case of CRA, a large segment of the lending community currently has no CRA obligation whatsoever. To put things in perspective, as of September 2004 there were 9,031 active credit unions in the United States. [27] Aside from 149 Massachusetts and Connecticut state-chartered credit unions (about 1.6% of all credit unions), none of these institutions are subject to CRA. In contrast, there were 9,037 banks in September 2004, every one of which was subject to some form of CRA. [28]

The credit union industry is rife with contradictions when it comes to community investment, development and responsibility in general. When the Federal Credit Union Act was enacted in 1934, it explicitly stated that credit unions have the responsibility to serve people of modest means. An abundance of studies have come out within the last several years however, finding that credit unions are by-and-large failing to meet this obligation. This trend is peculiar because the Community Development Credit Union segment of the industry has proven that credit unions have the ability to reach low- and moderate-income people and neighborhoods, and can remain economically viable while doing so. Furthermore, the application of the Community Reinvestment Act to banks has been a successful catalyst for economic justice -- and banks too are able to remain economically viable. Since 1977, CRA has led to approximately $4 trillion in lending and investment to low- and moderate-income communities, according to a unique NCRC database on CRA commitments. Rather than imposing a burden on banks, the CRA obligation has created new opportunities in previously overlooked neighborhoods. The banking industry is currently flourishing and continues to grow stronger every year.

As alluded to above, Massachusetts and Connecticut are the only two states that currently have CRA-like laws that apply to credit unions. The Massachusetts law was enacted in 1982 and Connecticut's was enacted in 2001. Intrigued by the idea of expanding CRA to cover credit unions, NCRC decided to look further into the discrepancy in lending practices between credit unions and banks. While many previous studies have focused on credit union performance in a particular locality, NCRC will look at industry performance throughout the entire United States, both at the national level and state-by-state. We will add to the collection of research an analysis of different loan types, including home purchase, refinance and home improvement. NCRC, to our knowledge, will also be the first to examine the effect Massachusetts' CRA law has had on the lending performance of credit unions. (Unfortunately, because Connecticut's law is so recent, the data available to us does not support similar research into that state).

NCRC hypothesizes that banks' obligation to reach low- and moderate-income communities and people will lead them to outperform credit unions in most, if not all localities. CRA, despite its short-

[27] National Credit Union Administration Web Site, http://www.ncua.gov/data/custmqry.html.

[28] Federal Deposit Insurance Corporation, *Statistics on Depository Institutions (SDI)*, September 30, 2004, http://www2.fdic.gov/sdi/main.asp.

comings, has had a huge (and measurable) effect on the communities it is designed to protect. An increase in lending to underserved communities can often be the first step in putting a stagnant or failing community on the track to economic equality and prosperity. It is likely that CRA's effect will be evident, when bank performance is put side-by-side with credit union performance. Further, NCRC expects that credit unions that are subject to CRA-like laws in Massachusetts will probably close the gap considerably between banks and credit unions. A notable difference in the performance of Massachusetts state-chartered credit unions and federally-chartered credit unions in Massachusetts is also likely.

It is high time that credit unions are held accountable for their fair-lending efforts and work actively to meet their explicit obligation to serve the needs of low- and moderate-income people and communities. If this report does indeed show that credit unions are not meeting the needs of low- and moderate-income people as well as banks, we believe there will be ample evidence supporting the claim that credit unions need CRA or CRA-like obligations.

## Methodology

### Source Data

The primary data used in this analysis is Home Mortgage Disclosure Act (HMDA) data. All depository institutions (banks, thrifts and credit unions) are required to report HMDA data, provided they exceed a specified asset limit for the year in question. This limit is adjusted yearly by the Federal Reserve Board, to reflect inflation. In 2001 the asset floor was $31 million, in 2002 it was $32 million and in 2003 it remained $32 million. Non-depository institutions, such as mortgage companies, are also required to report HMDA data if they meet certain criteria.

HMDA data covers a variety of loan types. HMDA data consists of all home purchase, home improvement, and refinance loans. The data includes loans to single-family dwellings and multi-family (rental) units as well as loans to dwellings occupied by the owner or by non-owners. Furthermore, HMDA data records the number of applications received by a lender and whether a loan was originated, denied, approved but not accepted by the applicant, or if the application was withdrawn or incomplete. HMDA data indicates whether a loan is conventional or government-insured (FHA, VA, FSA). Both loan originations and loan purchases (from another lender) are subject to HMDA disclosure.

Demographic data on each individual application is also recorded. Demographic data includes the race/ethnicity of the applicant, the applicant's income level, the applicant's gender, a co-applicant's race/ethnicity and gender, and minority and income level of the census tract from which the application came.

NCRC used CRA Wiz software, provided by PCI Services, Inc. to access the HMDA data used in this report.

## Units of Analysis

The main focus of this analysis is the performance of credit unions in relationship to banks. For the purposes of this report, a "credit union" is any institution that reports HMDA to the National Credit Union Administration (NCUA). A "bank" is any institution that reports HMDA data and is regulated by the Federal Reserve Board (FRB), Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency (OCC), or the Federal Deposit Insurance Corporation (FDIC).

Performance of banks and credit unions is measured in two categories: home purchase lending only and single family lending. Single family lending refers to home purchase, refinance, and home improvement loans going to single family dwellings (as opposed to rental units). NCRC looked at both loan types in order to get a more complete picture of lending activity. It is generally considered harder to reach underserved populations with home purchase lending alone because of the lower wealth of first-time homebuyers in contrast to homeowners that are refinancing their loans or acquiring home improvement loans. Thus, since home purchase lending is more difficult, NCRC included in this study home purchase lending separately as well as combined with the other types of single family lending. This report focuses on lending to owner-occupants only.

NCRC's analysis is at the state level; each state (and the District of Columbia) is analyzed separately. Lender performance is scrutinized for all loans made by the given lender group in each state. For example, credit union performance in Wisconsin is based on all loans made in the state of Wisconsin by credit unions.

## Description of Indicators

Credit union and bank performance was measured in 14 separate indicators. These indicators can be broken up into two categories: portfolio share indicators and denial-disparity ratio indicators. A portfolio share indicator can most easily be explained as a lender's loan percentage to a specific group, for example percentage of loans to LMI borrowers. Denial-disparity ratio indicators measure the rate of denial to one group (ex. African-American borrowers) in relation to another group (ex. White borrowers). In other words, an African-American –to-white denial disparity ratio would be the percentage of black denials divided by the percentage of white denials, for a given lender group. Following is a brief description of the 14 performance indicators.

1. Percent of loans to African-American Borrowers – This indicator measures the percentage of loans made by a specific lender group to African-American borrowers. It is calculated by dividing the number of loans to African-American borrowers by the total number of loans originated by the lender group.

2. Percent of loans to Hispanic Borrowers – This indicator measures the percentage of loans made by a specific lender group to Hispanic borrowers. It is calculated by dividing the number of loans to Hispanic borrowers by the total number of loans originated by the lender group.

3. Percent of loans to LMI Borrowers – This indicator measures the percentage of loans made to low- and moderate-income borrowers. Low-income borrowers are defined as those making less than 50% of the median area income. Moderate-income borrowers are those making between 50% and 80% of the median area income. This percentage is calculated by dividing the number of loans to low- and moderate-income borrowers by the total number of loans originated by a specific lender group.

4. Percent of loans to Women – This measures the percentage of loans made to women, by dividing the number of loans made to women by the total number of loans made by a lender group.

5. Percent of loans to LMI Minorities – This indicator measures the percentage of loans made to borrowers who are both low- or moderate-income and who are racial minorities. It is calculated by dividing the number of loans to LMI minorities by the total number of loans made by a lender group.

6. Percent of loans to LMI Women – This indicator measures the percentage of loans to low- and moderate-income women. It divides the number of loans to LMI women by the total number of loans.

7. Percent of loans to Minority Census Tracts – This indicator measures the percentage of loans made to census tracts in which more than 50% of the residents are racial minorities. It divides the number of loans to minority tracts by the total number of loans made by a lender group.

8. Percent of loans to LMI Census Tracts – This indicator measures the percentage of loans to LMI census tracts. A LMI census tract is one in which the median income of the residents meets the LMI definitions quoted above- effectively, making less than 80% of the median area income. The indicator divides the number of loans to LMI census tracts by the total number of loans.

9. Percent of loans to LMI and/or Minority Census Tracts – This indicator measures the percentage of loans going to census tracts that are LMI and/or minority. It divides the number of loans to LMI and/or minority tracts by the total number of loans.

10. African-American –to-White Denial-Disparity Ratio – This indicator measures the difference in denial rates to African-American borrowers and white borrowers. It divides the African-American denial rate by the white denial rate. The resulting ratio shows the number of African-American borrowers denied per every white denial.

11. Hispanic-to-White Denial-Disparity Ratio – This indicator measures the difference in denial rates to Hispanic borrowers and white borrowers. It divides the Hispanic denial rate by the white denial rate. The resulting ratio shows the number of Hispanic borrowers denied per every white denial.

12. Minority-to-White Tract Denial-Disparity Ratio – This indicator measures the difference in denial rates between predominately minority census tracts and white census tracts. It divides the minority tract denial rate by the white tract denial rate. The resulting ratio shows the number of loans denied in minority tracts per every loan denied in white tracts.

13. LMI-to-MUI Borrower Denial-Disparity Ratio – This indicator measures the difference in denial rates to LMI borrowers and middle- and upper-income (MUI) borrowers. Middle-income borrowers are those making between 80% and 120% of the median area income, and upper-income borrowers are those making more than 120% of the median area income. This indicator divides the LMI denial rate by the MUI denial rate. The resulting ratio shows the number of LMI borrowers denied per every MUI denial.

14. LMI-to-MUI Tract Denial-Disparity Ratio – This indicator measures the difference in denial rates between LMI census tracts and MUI census tracts. It divides the LMI tract denial rate by the MUI tract denial rate. The resulting ratio shows the number of loans denied in LMI tracts per every loan denied in MUI tracts.

## Measuring Performance

The portfolio share indicators measure performance as a percentage and advantages in percentage point differences. Bank performance (as marked by a percentage of loans made to a given group) is subtracted from credit union performance. The resulting difference indicates whether banks or credit unions perform better in the given indicator. A positive percentage point difference indicates that credit unions made a higher percentage of loans to the given group than banks, and thus have the advantage. A negative percentage point difference indicates an advantage for banks. If there is no difference in percentages, no advantage is assigned to the given indicator. Example: If credit unions make 3.1% of their loans to black borrowers and banks only make 1.6% of their loans to black borrowers, the difference is 1.5 percentage points. The positive nature of this number reflects an advantage in favor of credit unions. On the other hand, if banks had made 3.6% of their loans to black borrowers, the resulting difference would be -0.5 percentage points indicating an advantage for banks.

Denial-disparity ratio indicators measure performance of credit unions and banks as a ratio. Advantages are also measured as a ratio: credit union performance is divided by bank performance, showing the likelihood that credit unions will have higher denial-disparity rates than banks. In this category of indicators, a resulting ratio of less than 1.00 indicates an advantage for credit unions- credit unions deny the given borrower (or tract) at a lower rate than banks. A resulting ratio of more than 1.00 indicates that banks deny the given borrower at a lower rate than credit unions, and thus have the advantage. A perfect 1.00 ratio indicates no difference, and therefore no advantage would be assigned. Example: If credit unions have a black-to-white denial-disparity ratio of 3.41 and banks have a denial-disparity ratio of 1.48, then the formula (3.41/1.48) returns a ratio of 2.30. Since this returned ratio is greater than 1.00, we can see that banks deny black borrowers at a lower rate relative to white borrowers than credit unions, and therefore have the advantage.

Performance is measured for each of the 14 indicators and an advantage is assigned. A tally of the number of indicators in which banks have the advantage, in which credit unions have the advantage, and in which there is no advantage is compiled. This tally will be used for the ranking section of the analysis, to be discussed later.

## Decision Rules

NCRC decided upon two decision rules that would exclude an indicator from use in this analysis.

1. Insufficient Applications – An indicator was excluded from analysis if less than 20 applications were received by a lender group from a given underserved applicant group. This could include women, minorities, or LMI borrowers or census tracts. NCRC decided that if less than 20 applications were received, there would not be a sufficient number of observations to make a meaningful analysis.

2. Insufficient Loans or Denials – If no loans or denials were made by a lender group to a given borrower group, the corresponding indicator was excluded from the analysis. NCRC decided that an advantage could not be assigned if one lender group failed to make any loans or denials, because there would be no percentage or denial rate to compare against the other lender group.

## Ranking

States were ranked based on the number of indicators in which banks had the advantage over credit unions. A state in which banks had the advantage in 14 of 14 indicators would be ranked higher than a state in which banks only had the advantage in 12 of 14 indicators. To account for states in which indicators were excluded or in which ties occurred, the percentage of indicators in which banks had the advantage was calculated. The states were ranked according to that percentage. Therefore, a state in which banks held the advantage in 11 of 12 indicators (91.7%) would be ranked higher than a state in which banks held the advantage in 12 of 14 indicators (85.7%).

This ranking process took place for each of the three years studied, and in both of the loan types. An aggregate advantage table was also created for each loan type, which adds each of the three years together. The result is a ranking based on a possible total of 42 indicators.

## Massachusetts

The Massachusetts segment of this analysis is very similar to the nationwide segment: the same loan types, performance indicators and advantage methodology were used. The difference is in the institutions being analyzed.

In order to examine the effect of the Massachusetts state CRA law, NCRC compared Massachusetts state-chartered credit unions, federally-chartered credit unions in Massachusetts, and banks in Massachusetts. By comparing federal- and state-chartered credit unions, we can see if the Massachusetts state CRA exam has an effect on credit union performance. By comparing federally- and state-chartered credit unions with banks, we can also assess the impacts of the Massachusetts CRA law as applied to state-chartered credit unions.

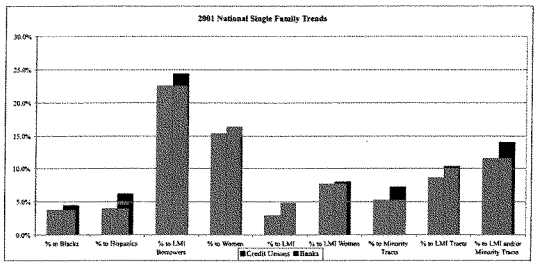
# Results of Three Year HMDA Data Analysis

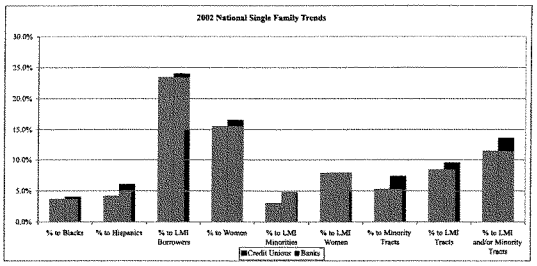
## National

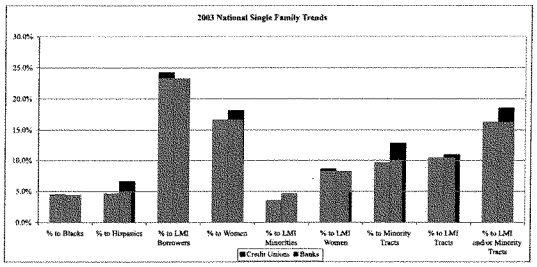
### All Single Family Lending

On aggregate, credit unions performed poorly in relation to banks. Out of 42 indicators, spanning three years, credit unions held the advantage in only five (12%). All five of these instances occurred in the year 2003, which indicates some improvement for credit unions, but banks still out-performed them in the great majority of indicators.

Credit unions turned in their best performance in 2003, earning the advantage in 5 of 14 indicators. Credit unions edged past banks in percent of loans to African-Americans, percent of loans to LMI borrowers, percent of loans to LMI women, African-American-to-White denial-disparity



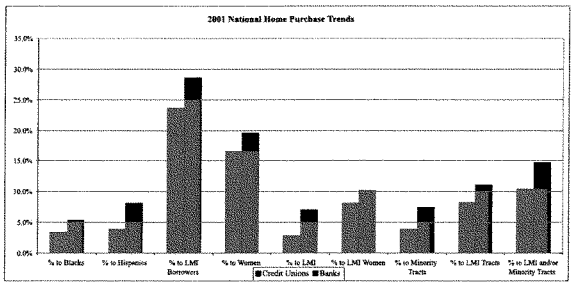


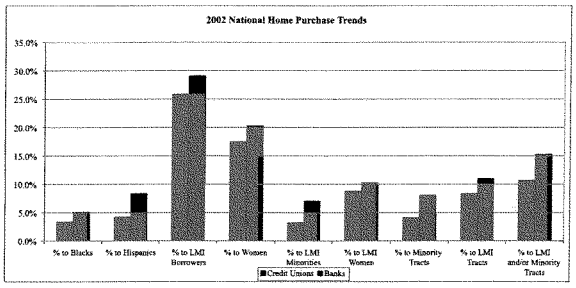

ratio, and Hispanic-to-White denial-disparity ratio. Differences in loan shares and denial-disparity ratios between banks and credit unions were larger when banks won the advantage than when credit unions won. The largest percentage-point difference in favor of credit unions was 1.0 points, and the largest disparity in denial rates was only .02 from a perfect 1.00 (which would indicate no difference). The largest percentage-point difference in favor of banks was 3.1 points and the largest denial-disparity was 1.27.

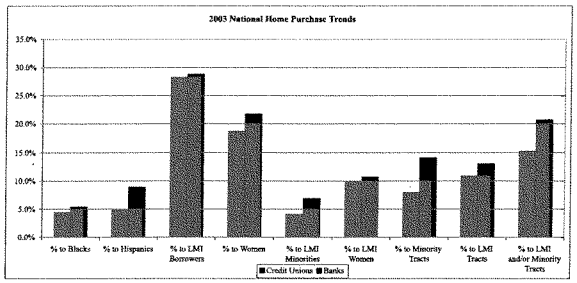
In 2002 and 2001 banks earned the advantage in all 28 possible indicators. The largest advantage in loan share percentage points was in the indicator "percent of loans to LMI and/or minority census tracts" (2001), in which banks outperformed credit unions by 2.5 percentage points. The largest disparity in denial rates was 1.40, occurring in the indicator "Minority-to-White denial-disparity ratio" (2001).

### Home Purchase Lending

Credit unions performed even worse in home purchase lending than in single family lending, earning the advantage in only 1 of 42 indicators (2%). This advantage occurred in 2003, in the indicator "Hispanic-to-White denial-disparity ratio." The disparity between bank and credit union performance was small - only .07 away from a perfect 1.00.






Banks tended to out-perform credit unions in a more convincing manner in home purchase lending than all single family lending. The magnitude of difference in loan share indicators was generally in the two-to-five percentage point range. In two cases however, the difference between banks and credit unions exceeded 5 percentage points. In the 2003 indicator "percent of loans to minority census tracts," banks made 14.1% of their loans to minority tracts while credit unions only made 7.9% - a difference of 6.2 percentage points in favor of banks. In terms of the loan portfolio, banks make almost twice the percentage of loans to minority tracts that credit unions make. Also in 2003, banks made 20.8% of their loans to LMI and/or minority census tracts, while credit unions only made 15.3% - a difference of 5.5 percentage points.

The disparity in denial rates between banks and credit unions were slightly higher in home purchase lending than in single family lending as well. In the 2002 indicator "African-American-to-White denial-disparity ratio" credit unions denied African-American borrowers 3.25 times for every white

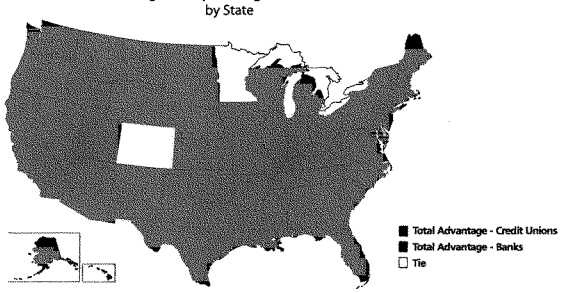
denial. Banks on the other hand, denied African-Americans at a rate of 2.03 per every white denial. The resulting credit union-to-bank ratio was 1.60 - the highest observed disparity between the two lender groups. In 2001, credit unions also lagged banks significantly in the indicator "African-American-to-White denial-disparity ratio." Credit unions denied African-American borrowers at a rate of 3.12 per every White denial, while banks denied African-Americans at a rate of 1.97 per every White denial. The resulting credit union-to-bank ratio of 1.58 is the second largest disparity observed between the two lender groups.

## State-by-State

NCRC compiled data on each of the 14 indicators for all three years of the study in each of the 50 states as well as Washington DC. It was then determined for each state whether banks or credit unions performed better.

### All Single Family Lending

Banks v. Credit Unions
Single Family Lending 2001-2003
by State



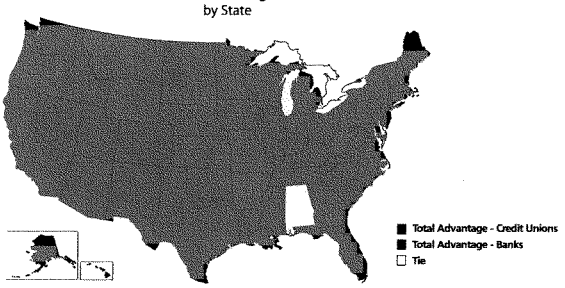

Single Family lending refers to home purchase, refinance, and home improvement lending combined. For this category banks outperformed credit unions in 36 (or 72%) of the states. The states where banks did not perform as well as credit unions were typically rural, less populated areas, including Wyoming, Wisconsin, Montana, Alaska, South Dakota, Nebraska and North Dakota. In Colorado and Minnesota credit unions and banks tied in the number of indicators in which they performed well. Reviewing the entire United States over the three year span from 2001 to 2003, there were a total of 1,968 indicators that were analyzed. Of the 1,968 indicators, banks outperformed credit unions 61.1% of the time. Credit unions outperformed banks in 36.5% of the indicators, and in 2.4% of the indicators banks and credit unions tied in performance. The states in which credit union performance was the worst were Florida, New Jersey, Mississippi, Tennessee, and Louisiana. In each of these states banks outperformed credit unions in 88% or more of the total indicators analyzed.

An analysis of the breakdown by year for single family lending leads to the same conclusions found in the aggregate trends with two exceptions. In the aggregate trends Michigan is one of the states where

credit unions outperformed banks, however when looking specifically at lender performance in 2003, banks outperformed the credit unions in 8 out of the 14 indicators in Michigan. The second worthy note is that while in the aggregate analysis credit unions outperformed banks in 13 states, the number of states in which credit unions outperformed banks increased from year to year. In 2001 credit unions outperformed banks in 11 states, 15 states in 2002, and 17 states in 2003.

### Home Purchase Lending

Banks v. Credit Unions
Home Purchase Lending 2001-2003
by State




NCRC also analyzed bank and credit union performance in making just home purchase loans, to assess differences in performance in making all single family loans versus home purchase loans. Credit unions struggled even more so in this specific category, with banks outperforming them in 40 of the states. The states where banks did not perform as well as credit unions were West Virginia, Wyoming, Montana, Oregon, Vermont, New Hampshire, Alaska, South Dakota, and North Dakota. In Delaware and Alabama credit unions tied with banks in the number of indicators in which they outperformed each other. Reviewing the entire United States over the three year span from 2001 to 2003, there were a total of 1,735 indicators for home purchase lending that were analyzed. Of the 1,735 indicators, banks outperformed credit unions 72.2% of the time. Credit unions outperformed banks in only 27.4% of the indicators, and for 0.4% of the indicators banks and credit unions tied in performance. The five states where credit union performance was the worst were Indiana, Texas, Ohio, Florida, and the District of Columbia. In each of these states, banks outperformed credit unions in 95% or more of the total indicators.

Analyzing each of the three years individually, each state maintained the same pattern in lender performance as was previously noted in the aggregate analysis. However, one interesting note was the performance of Wyoming in 2001 and 2002. Between those two years credit union performance improved significantly. In 2001, banks outperformed credit unions in the only two indicators that were available for Wyoming. In 2002, the number of testable indicators rose to six, and credit unions outperformed banks in all six of those indicators.

As with the *All Single Family Lending* data, when examining each year separately the number of states in which credit unions outperformed banks increased annually. In 2001 credit unions outperformed banks in 7 states, while in 2002 that number was 12, and 14 for 2003.

## Massachusetts

As stated above, Massachusetts applies CRA regulations to credit unions chartered in that state. Federally-chartered credit unions do not have CRA obligations. A comparison of Massachusetts state-chartered credit unions and federally-chartered credit unions is appropriate to determine if CRA-covered credit unions perform better than their non-covered counterparts.

### *MA State-chartered Credit Unions v. MA Federally-chartered Credit Unions*

With respect to the *All Single Family* lending category, state-chartered credit unions outperformed federally-chartered credit unions in a larger portion of the indicators for all three years of the study. State-chartered credit unions outperformed their federal counterparts in 51%, 76%, and 71% of the indicators respectively for 2001, 2002, and 2003. There was also a noticeable difference between charter-type performance and the type of indicator. State-chartered credit unions consistently outperformed the federally-chartered credit unions in the portfolio share indicators (ex. the percent of all loans made to LMI borrowers), however federally-chartered credit unions faired better in the denial- disparity ratio indicators.

Some observers have asserted that portfolio share indicators should be weighted more heavily than denial-disparity indicators. These observers suggest that lenders making higher percentages of loans to underserved borrowers may also have higher denial rates since they accept more applications from underserved borrowers. According to this line of thought, state-chartered credit unions are performing even better, relative to federally-chartered credit unions, than an un-weighted index of performance would indicate. NCRC is using an un-weighted index; we leave it to the reader to judge the importance of portfolio share indicators versus denial-disparity ratio indicators.

Performance was more competitive among the two charter types when analyzing *Home Purchase* lending trends, with state-chartered credit unions having an advantage in 50%, 43%, and 43% of the indicators for 2001, 2002 and 2003 respectively. In this category, as in the *All Single Family* lending category, federally-chartered credit unions faired better in denial-disparity ratio indicators, while state-chartered credit unions performed better in terms of portfolio shares. There were three portfolio share indicators where federally-chartered credit unions had the advantage in all three years. These indicators were percent of loans to women, LMI borrowers, and LMI women. Better performance in these portfolio share indicators is what put the federally-chartered credit unions ahead of the state-chartered credit unions for the *Home Purchase* lending category. In the majority of the portfolio share indicators state-chartered credit unions out-performed federally-chartered credit unions.

### *MA Banks v. MA Federally-Chartered Credit Unions*

As per the hypothesis that CRA-covered lenders would perform better, banks outperformed the federally-chartered credit unions in terms of the total number of indicators in which they had the edge over

credit unions. For the *All Single Family* lending category, banks had the advantage in 62%, 64%, and 79% of the indicators that were assessed in 2001, 2002, and 2003 respectively. Two portfolio share indicators in which banks consistently underperformed were the percentage of loans made to LMI borrowers and the percentage of loans made to LMI women. With regard to denial-disparity ratio indicators, banks did not perform well in the category that compared denial rates of LMI tracts to those of MUI tracts.

Banks also outperformed federally-chartered credit unions in the *Home Purchase* lending category where they had an advantage in 83%, 64%, and 62% of the indicators in 2001, 2002, and 2003 respectively. Bank performance was consistently strong among all of the indicators with the exception of two portfolio shares. These were the same indicators in which banks underperformed in the *All Single Family* lending category. For those two indicators, the percentage of loans made to LMI borrowers and percentage of loans made to LMI women, federally-chartered credit unions had the advantage in performance for all three years of the study.

***MA Banks v. MA State-Chartered Credit Unions***

Performance between banks and state-chartered credit unions was much more competitive than for the previous comparisons of banks and federally-chartered credit unions with respect to *All Single Family* lending. State-chartered credit unions had the performance advantage over banks in 43%, 50%, and 43% of the indicators for 2001, 2002, and 2003 respectively. One interesting note is that in 2001 and 2003, when state-chartered credit unions had a performance advantage in 43% of the indicators, state-chartered credit unions and banks were only separated in performance by one indicator. State-chartered credit unions consistently had the performance advantage in all three years for the following portfolio share indicators: percent of all loans made to LMI borrowers, percent of all loans made to LMI tracts, and percent of all loans made to LMI and/or Minority Tracts. Banks maintained the performance advantage in all three years for all of the denial-disparity ratio indicators, and they also outperformed state-chartered credit unions in portfolio share to Minority Tracts for all three years of the study.

Although banks and state-chartered credit unions were competitive in the *All Single Family* lending category, banks had an obvious advantage with regards to the *Home Purchase* lending category. State-chartered credit unions had a performance advantage in only two out of the fourteen indicators, in all three years.

## Conclusion and Recommendations

As hypothesized, banks outperformed credit unions in service to low- and moderate-income communities, as well as to other traditionally underserved groups, such as women and minorities. Banks outperformed credit unions on all levels - nationally and state-by-state - in the years of 2001, 2002, and 2003 – the most recent years for which HMDA data is available. Credit union performance has lagged in all types of lending: home purchase, refinance, and home improvement. Even more remarkable is the fact that credit union performance declines when home purchase lending is isolated

in the analysis. The importance of home purchase lending can not be stressed enough because it is a crucial step in homeownership and general wealth-building.

NCRC attributes the drastic difference between the performance of credit unions and banks to the presence of CRA. In Massachusetts, one of the only states where there is CRA for credit unions, state-chartered credit unions outperformed their federally-chartered counterparts. That CRA regulation does not apply to federally-chartered credit unions helps explain why they lagged behind banks and CRA-covered state-chartered credit unions in the state of Massachusetts. As was expected, the discrepancy in performance between banks and the state-chartered credit unions diminishes, which can be attributed (at least in part) to the fact that they are both regulated by a CRA law. The evidence that credit unions need CRA regulation continues to accumulate.

## Recommendations

*Congress Must Expand CRA to Credit Unions*

NCRC believes that the overwhelming evidence to date indicates that credit unions overall do not perform as well as banks in making loans to minority and low- and moderate-income borrowers and communities. A significant segment of the credit union industry consists of community development credit unions and other credit unions devoted to serving borrowers of modest means. Research, however, indicates that mainstream credit unions are not serving minority and lower income borrowers and communities as well as banks in large part because banks comply with CRA requirements while credit unions do not.

Applying CRA to credit unions is feasible as the experience in the state of Massachusetts suggests. More importantly, CRA would represent a win-win proposition. Communities would benefit as CRA would increase credit union lending, investing, and services to low- and moderate-income communities. Credit unions themselves would benefit by finding previously overlooked and profitable business opportunities in low- and moderate-income communities. Harvard University, the Treasury Department, and Federal Reserve economists conclude that CRA as applied to banks has increased lending to low- and moderate-income communities and that this lending is profitable. [29] It is reasonable to expect that the same impact would result if CRA was applied to credit unions.

*Congress Must Amend HMDA to Require Smaller Institutions to Report*

Smaller banks and credit unions are exempt from reporting HMDA data on home lending. Until 1996, HMDA exempted smaller institutions from reporting data if they had assets of $10 million or less. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 required the Federal Reserve Board to adjust the asset threshold each year to take inflation into account. Therefore, if an institution had assets of less than $34 million in December of 2004, it will not report HMDA data

[29] The Joint Center for Housing Studies at Harvard University, *The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System*, March 2002; Robert Litan, Nicolas Retsinas, Eric Belsky and Susan White Haag, *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, produced for the United States Department of the Treasury, April 2000; *The Performance and Profitability of CRA-Related Lending*, Report by the Board of Governors of the Federal Reserve System, July 17, 2000; Raphael Bostic and Breck Robinson, *Do CRA Agreements Influence Lending Patterns?* July 2002, available via bostic@usc.edu.

for 2005. This was an increase of $1 million from the asset threshold of $33 million for exemption of reporting data for 2004.

Smaller banks and credit unions are important lenders, particularly in smaller cities and rural communities. In order to determine whether these vital institutions are serving their communities, the public must have access to their home lending data via HMDA data reporting requirements. The argument against HMDA data reporting is that compiling data is expensive and burdensome for smaller institutions. Vast technological improvements since HMDA's passage in 1975 has considerably reduced the time and expense of reporting. Thus, the public policy imperatives of full disclosure would argue for eliminating exemptions from HMDA reporting requirements altogether, or moving the threshold back towards $10 million. While NCRC stands by the results of this study as a valid indicator of overall credit union and bank performance, we hope that Congress expands HMDA reporting requirements so that future research can examine the home lending performance of smaller institutions as well.

*NCUA Must Act on GAO's Recommendations to Measure Credit Union Performance*

NCRC agrees strongly with the recommendations in the Government Accountability Office's study that the National Credit Union Administration (NCUA), as the regulator of credit unions, must immediately and rigorously measure credit union performance in reaching minority and low- and moderate-income borrowers and communities. For starters, the NCUA can adopt an approach similar to this study and measure credit unions on a series of CRA and fair lending indicators that compare their performance against other credit unions and banks of similar asset sizes. The NCUA should compile and release these comparisons on an annual basis so that credit union members and the general public can assess performance of their local credit unions. In addition, the NCUA should report on the performance of credit unions in making consumer loans, investments, and other financial services available to traditionally underserved communities. The NCUA has access to data that is not generally publicly available, and should use its authority as a regulator in shining sunshine on the extent of credit union responsiveness to credit and capital needs.

*Community Support Reviews of Credit Unions by Federal Housing Finance Board*

The Federal Home Loan Banks (FHLB) are government-sponsored enterprises that provide long-term advances and other financial instruments to lending institutions including credit unions. The regulator of the FHLB banks, the Federal Housing Finance Board, conducts community support reviews every two years of banks and credit unions that receive FHLB bank financing. The Finance Board reviews the CRA performance of lenders subject to CRA, and the performance of all lenders, including credit unions, in serving first time homebuyers. A poor community support review can result in the suspension of FHLB bank advances to any bank or credit union. Any member of the general public can comment on the record of the CRA and fair lending performance of lending institutions undergoing community support reviews.

NCRC believes that the Finance Board should work closer with the NCUA in reviewing the community support performance of credit unions. As mentioned above, the NCUA should annually assess

the fair lending performance of credit unions and should share these assessments with the Finance Board. NCRC will work with our 600 community organization members to increase the number of comments submitted by the general public on credit union community support performance.

*Partnerships among Banks, Credit Unions and Community Groups*

Our chapter on community development credit unions (CDCUs) highlighted many examples of innovative programs operated by CDCUs in making loans and providing bank services and accounts to traditionally underserved populations. In a number of cases, these programs need more resources than CDCUs alone can muster. NCRC urges banks and larger credit unions to increase their amount of lending to and investments in credit unions devoted to low-income communities. Community organizations likewise should seek out additional partnerships with credit unions and banks for reaching traditionally underserved populations. Regulatory agencies and lender trade associations should compile better data on the community development financing activities of banks and credit unions. In particular, the industry and the regulatory agencies should collaborate on developing a database documenting the financing of low-income credit unions and CDCUs.

This study has found compelling evidence that CRA-covered banks made a higher percentage of home loans with fewer denials to women, minorities, and low- and moderate-income borrowers than credit unions. As stated above, NCRC believes that applying CRA to credit unions will increase credit union lending to traditionally underserved populations. HMDA home loan data must be enhanced so that it records the lending of smaller banks as well as credit unions. Even before Congress applies CRA to credit unions, stakeholders can work together to improve the fair lending performance of credit unions. These stakeholders include the National Credit Union Administration, banks, credit unions, and community groups.

# Appendix

## Summary Charts of National, State and Massachusetts Credit Union and Bank Lending Trends 2001, 2002 & 2003

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| National<br>2003 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share indicators | Credit Unions | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 4.5% | 4.4% | 0.1% | CUs |
| % to Hispanics | 4.6% | 6.6% | -2.0% | Banks |
| % to LMI Borrowers | 24.2% | 23.2% | 1.0% | CUs |
| % to Women | 16.6% | 18.1% | -1.5% | Banks |
| % to LMI Minorities | 3.5% | 4.6% | -1.2% | Banks |
| % to LMI Women | 8.6% | 8.2% | 0.4% | CUs |
| % to Minority Tracts | 9.7% | 12.9% | -3.1% | Banks |
| % to LMI Tracts | 10.5% | 10.9% | -0.4% | Banks |
| % to LMI and/or Minority Tracts | 16.1% | 18.5% | -2.3% | Banks |
| Denial Disparity Ratios | | | CU/Bank Ratio | |
| Blacks to Whites | 1.27 | 1.28 | 0.99 | CUs |
| Hispanics to Whites | 1.02 | 1.06 | 0.97 | CUs |
| Minority to White Tracts | 2.12 | 1.67 | 1.27 | Banks |
| LMI to MUI Borrowers | 2.18 | 1.75 | 1.25 | Banks |
| LMI to MUI Tracts | 2.11 | 1.78 | 1.19 | Banks |
| Total Advantage | CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 5 | 9 | 0 | 14 |

| National<br>2002 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Credit Unions | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 3.6% | 4.1% | -0.5% | Banks |
| % to Hispanics | 4.2% | 6.0% | -1.9% | Banks |
| % to LMI Borrowers | 23.3% | 24.0% | -0.7% | Banks |
| % to Women | 15.5% | 16.5% | -1.0% | Banks |
| % to LMI Minorities | 3.0% | 4.8% | -1.7% | Banks |
| % to LMI Women | 7.8% | 7.9% | 0.0% | Banks |
| % to Minority Tracts | 5.3% | 7.4% | -2.1% | Banks |
| % to LMI Tracts | 8.4% | 9.5% | -1.1% | Banks |
| % to LMI and/or Minority Tracts | 11.4% | 13.6% | -2.2% | Banks |
| Denial Disparity Ratios | | | CU/Bank Ratio | |
| Blacks to Whites | 3.09 | 2.40 | 1.29 | Banks |
| Hispanics to Whites | 2.50 | 1.95 | 1.28 | Banks |
| Minority to White Tracts | 2.37 | 1.79 | 1.32 | Banks |
| LMI to MUI Borrowers | 2.19 | 1.81 | 1.21 | Banks |
| LMI to MUI Tracts | 2.00 | 1.75 | 1.14 | Banks |
| Total Advantage | CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 0 | 14 | 0 | 14 |

| National<br>2001 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Credit Unions | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 3.8% | 4.5% | -0.7% | Banks |
| % to Hispanics | 4.0% | 6.2% | -2.2% | Banks |
| % to LMI Borrowers | 22.5% | 24.4% | -1.9% | Banks |
| % to Women | 15.3% | 16.4% | -1.0% | Banks |
| % to LMI Minorities | 2.9% | 4.9% | -2.0% | Banks |
| % to LMI Women | 7.7% | 8.1% | -0.3% | Banks |
| % to Minority Tracts | 5.2% | 7.2% | -2.0% | Banks |
| % to LMI Tracts | 8.7% | 10.4% | -1.7% | Banks |
| % to LMI and/or Minority Tracts | 11.5% | 14.0% | -2.5% | Banks |
| Denial Disparity Ratios | | | CU/Bank Ratio | |
| Blacks to Whites | 2.98 | 2.32 | 1.29 | Banks |
| Hispanics to Whites | 2.40 | 1.73 | 1.39 | Banks |
| Minority to White Tracts | 2.39 | 1.71 | 1.40 | Banks |
| LMI to MUI Borrowers | 2.29 | 1.81 | 1.26 | Banks |
| LMI to MUI Tracts | 2.03 | 1.69 | 1.20 | Banks |
| Total Advantage | CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 0 | 14 | 0 | 14 |

| National<br>2003 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Credit Unions | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 4.4% | 5.4% | -1.0% | Banks |
| % to Hispanics | 4.8% | 9.0% | -4.2% | Banks |
| % to LMI Borrowers | 28.3% | 28.9% | -0.6% | Banks |
| % to Women | 18.7% | 21.8% | -3.1% | Banks |
| % to LMI Minorities | 4.1% | 6.9% | -2.8% | Banks |
| % to LMI Women | 10.0% | 10.7% | -0.7% | Banks |
| % to Minority Tracts | 7.9% | 14.1% | -6.2% | Banks |
| % to LMI Tracts | 10.8% | 13.0% | -2.2% | Banks |
| % to LMI and/or Minority Tracts | 15.3% | 20.8% | -5.5% | Banks |
| Denial Disparity Ratios | | | CU/Bank Ratio | |
| Blacks to Whites | 1.40 | 1.25 | 1.12 | Banks |
| Hispanics to Whites | 0.94 | 1.02 | 0.93 | CUs |
| Minority to White Tracts | 1.70 | 1.46 | 1.17 | Banks |
| LMI to MUI Borrowers | 2.26 | 1.73 | 1.30 | Banks |
| LMI to MUI Tracts | 2.04 | 1.60 | 1.28 | Banks |
| Total Advantage | CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 1 | 13 | 0 | 14 |

| National<br>2002 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Credit Unions | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 3.4% | 5.2% | -1.8% | Banks |
| % to Hispanics | 4.2% | 8.4% | -4.2% | Banks |
| % to LMI Borrowers | 25.8% | 29.1% | -3.3% | Banks |
| % to Women | 17.5% | 20.3% | -2.7% | Banks |
| % to LMI Minorities | 3.3% | 7.1% | -3.8% | Banks |
| % to LMI Women | 8.8% | 10.2% | -1.4% | Banks |
| % to Minority Tracts | 4.1% | 8.1% | -4.1% | Banks |
| % to LMI Tracts | 8.4% | 11.0% | -2.6% | Banks |
| % to LMI and/or Minority Tracts | 10.7% | 15.2% | -4.6% | Banks |
| Denial Disparity Ratios | | | CU/Bank Ratio | |
| Blacks to Whites | 3.25 | 2.03 | 1.60 | Banks |
| Hispanics to Whites | 2.04 | 1.58 | 1.29 | Banks |
| Minority to White Tracts | 2.23 | 1.56 | 1.43 | Banks |
| LMI to MUI Borrowers | 2.19 | 1.89 | 1.16 | Banks |
| LMI to MUI Tracts | 2.03 | 1.62 | 1.25 | Banks |
| Total Advantage | CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 0 | 14 | 0 | 14 |

| National<br>2001 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Credit Unions | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 3.5% | 5.5% | -2.0% | Banks |
| % to Hispanics | 3.9% | 8.1% | -4.2% | Banks |
| % to LMI Borrowers | 23.6% | 28.6% | -5.0% | Banks |
| % to Women | 16.6% | 19.5% | -2.9% | Banks |
| % to LMI Minorities | 2.9% | 7.1% | -4.2% | Banks |
| % to LMI Women | 8.2% | 10.1% | -2.0% | Banks |
| % to Minority Tracts | 3.9% | 7.5% | -3.6% | Banks |
| % to LMI Tracts | 8.2% | 11.2% | -2.9% | Banks |
| % to LMI and/or Minority Tracts | 10.4% | 14.8% | -4.4% | Banks |
| Denial Disparity Ratios | | | CU/Bank Ratio | |
| Blacks to Whites | 3.12 | 1.97 | 1.58 | Banks |
| Hispanics to Whites | 1.97 | 1.39 | 1.42 | Banks |
| Minority to White Tracts | 2.16 | 1.59 | 1.37 | Banks |
| LMI to MUI Borrowers | 2.33 | 2.08 | 1.12 | Banks |
| LMI to MUI Tracts | 2.03 | 1.66 | 1.23 | Banks |
| Total Advantage | CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 0 | 14 | 0 | 14 |

## State Rankings by Lender Advantage
### Single Family Lending Trends - Aggregate

| | Credit Unions | No Difference | Banks | No. of Indicators | CU adv./# Indicators | Bank adv./# Indicators |
|---|---|---|---|---|---|---|
| Florida | 0 | 1 | 41 | 42 | 0.0% | 97.6% |
| New Jersey | 1 | 0 | 41 | 42 | 2.4% | 97.6% |
| Mississippi | 2 | 0 | 36 | 38 | 5.3% | 94.7% |
| Tennessee | 3 | 1 | 38 | 42 | 7.1% | 90.5% |
| Louisiana | 5 | 0 | 37 | 42 | 11.9% | 88.1% |
| New York | 5 | 0 | 37 | 42 | 11.9% | 88.1% |
| Virginia | 5 | 0 | 37 | 42 | 11.9% | 88.1% |
| Rhode Island | 6 | 0 | 36 | 42 | 14.3% | 85.7% |
| Illinois | 7 | 0 | 35 | 42 | 16.7% | 83.3% |
| Georgia | 7 | 1 | 34 | 42 | 16.7% | 81.0% |
| Connecticut | 9 | 0 | 33 | 42 | 21.4% | 78.6% |
| Maryland | 10 | 0 | 32 | 42 | 23.8% | 76.2% |
| Ohio | 9 | 2 | 31 | 42 | 21.4% | 73.8% |
| District of Columbia | 11 | 0 | 31 | 42 | 26.2% | 73.8% |
| Maine | 6 | 0 | 16 | 22 | 27.3% | 72.7% |
| Massachusetts | 10 | 2 | 30 | 42 | 23.8% | 71.4% |
| Idaho | 7 | 1 | 20 | 28 | 25.0% | 71.4% |
| Kansas | 11 | 1 | 30 | 42 | 26.2% | 71.4% |
| West Virginia | 8 | 0 | 20 | 28 | 28.6% | 71.4% |
| Arkansas | 10 | 1 | 27 | 38 | 26.3% | 71.1% |
| Indiana | 9 | 4 | 29 | 42 | 21.4% | 69.0% |
| Texas | 13 | 0 | 29 | 42 | 31.0% | 69.0% |
| Delaware | 11 | 1 | 22 | 34 | 32.4% | 64.7% |
| California | 12 | 3 | 27 | 42 | 28.6% | 64.3% |
| Missouri | 14 | 2 | 26 | 42 | 33.3% | 61.9% |
| Washington | 15 | 2 | 25 | 42 | 35.7% | 59.5% |
| Kentucky | 13 | 3 | 22 | 38 | 34.2% | 57.9% |
| Alabama | 17 | 1 | 23 | 41 | 41.5% | 56.1% |
| Iowa | 17 | 1 | 22 | 40 | 42.5% | 55.0% |
| Pennsylvania | 19 | 0 | 23 | 42 | 45.2% | 54.8% |
| Vermont | 11 | 1 | 13 | 25 | 44.0% | 52.0% |
| New Hampshire | 16 | 2 | 18 | 36 | 44.4% | 50.0% |
| North Carolina | 19 | 2 | 21 | 42 | 45.2% | 50.0% |
| South Carolina | 19 | 2 | 21 | 42 | 45.2% | 50.0% |
| Oklahoma | 18 | 4 | 20 | 42 | 42.9% | 47.6% |
| Utah | 19 | 3 | 20 | 42 | 45.2% | 47.6% |
| Colorado | 21 | 0 | 21 | 42 | 50.0% | 50.0% |
| Minnesota | 21 | 0 | 21 | 42 | 50.0% | 50.0% |
| Hawaii | 21 | 0 | 18 | 39 | 53.8% | 46.2% |
| Michigan | 23 | 1 | 18 | 42 | 54.8% | 42.9% |
| Oregon | 24 | 0 | 18 | 42 | 57.1% | 42.9% |
| Arizona | 21 | 4 | 17 | 42 | 50.0% | 40.5% |
| New Mexico | 25 | 0 | 16 | 41 | 61.0% | 39.0% |
| Wyoming | 15 | 0 | 9 | 24 | 62.5% | 37.5% |
| Nevada | 25 | 2 | 15 | 42 | 59.5% | 35.7% |
| Wisconsin | 27 | 0 | 15 | 42 | 64.3% | 35.7% |
| Montana | 15 | 0 | 8 | 23 | 65.2% | 34.8% |
| Alaska | 32 | 0 | 10 | 42 | 76.2% | 23.8% |
| South Dakota | 30 | 3 | 5 | 38 | 80.0% | 20.0% |
| Nebraska | 35 | 0 | 7 | 42 | 83.3% | 16.7% |
| North Dakota | 39 | 0 | 2 | 41 | 95.1% | 4.9% |
| United States | 718 | 48 | 1202 | 1968 | 36.5% | 61.1% |

Banks did better in 36 states: FL, NJ, MS, TN, LA, NY, VA, RI, IL, GA, CT, MD, OH, DC, ME, MA, ID, KS, WV, AR, IN TX, DE, CA, MO, WA, KY, AL, IA, PA, VT, NH, NC, SC, OK, UT

CUs did better in 13 states: HI, MI, OR, AZ, NM, WY, NV, WI, MT, AK, SD, NE, ND

Tied in 2 States: CO, MN

## State Rankings by Lender Advantage
### Single Family Lending Trends - 2003

| | Credit Unions | No Difference | Banks | No. of indicators | CU adv./# Indicators | Bank adv./# Indicators |
|---|---|---|---|---|---|---|
| Florida | 0 | 1 | 13 | 14 | 0.0% | 92.9% |
| Mississippi | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| New Jersey | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Idaho | 1 | 0 | 8 | 9 | 11.1% | 88.9% |
| Tennessee | 1 | 1 | 12 | 14 | 7.1% | 85.7% |
| Illinois | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| New York | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Rhode Island | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Connecticut | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Kansas | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Louisiana | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Virginia | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Maine | 2 | 0 | 6 | 8 | 25.0% | 75.0% |
| Massachusetts | 2 | 2 | 10 | 14 | 14.3% | 71.4% |
| California | 3 | 1 | 10 | 14 | 21.4% | 71.4% |
| Georgia | 3 | 1 | 10 | 14 | 21.4% | 71.4% |
| Indiana | 3 | 1 | 10 | 14 | 21.4% | 71.4% |
| Maryland | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Arkansas | 5 | 0 | 9 | 14 | 35.7% | 64.3% |
| Iowa | 5 | 0 | 9 | 14 | 35.7% | 64.3% |
| Vermont | 3 | 1 | 6 | 10 | 30.0% | 60.0% |
| Kentucky | 4 | 2 | 8 | 14 | 28.6% | 57.1% |
| Michigan | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Ohio | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Texas | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Washington | 6 | 1 | 7 | 14 | 42.9% | 50.0% |
| Alabama | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| District of Columbia | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Hawaii | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Minnesota | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Missouri | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Oregon | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Pennsylvania | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| West Virginia | 5 | 0 | 5 | 10 | 50.0% | 50.0% |
| Utah | 7 | 1 | 6 | 14 | 50.0% | 42.9% |
| Colorado | 8 | 0 | 6 | 14 | 57.1% | 42.9% |
| Delaware | 6 | 1 | 5 | 12 | 50.0% | 41.7% |
| Wyoming | 6 | 0 | 4 | 10 | 60.0% | 40.0% |
| Oklahoma | 7 | 2 | 5 | 14 | 50.0% | 35.7% |
| Wisconsin | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| New Hampshire | 7 | 1 | 4 | 12 | 58.3% | 33.3% |
| Montana | 5 | 0 | 2 | 7 | 71.4% | 28.6% |
| North Carolina | 10 | 0 | 4 | 14 | 71.4% | 28.6% |
| Alaska | 11 | 0 | 3 | 14 | 78.6% | 21.4% |
| Arizona | 11 | 0 | 3 | 14 | 78.6% | 21.4% |
| Nevada | 11 | 0 | 3 | 14 | 78.6% | 21.4% |
| New Mexico | 11 | 0 | 3 | 14 | 78.6% | 21.4% |
| North Dakota | 6 | 0 | 1 | 7 | 85.7% | 14.3% |
| South Dakota | 9 | 0 | 1 | 10 | 90.0% | 10.0% |
| South Carolina | 12 | 1 | 1 | 14 | 85.7% | 7.1% |
| Nebraska | 13 | 0 | 1 | 14 | 92.9% | 7.1% |
| United States | 283 | 17 | 369 | 669 | 42.3% | 55.2% |

Banks did better in 26 states: FL, MS, NJ, ID, TN, IL, NY, RI, CT, KS, LA, VA, ME, MA, CA, GA, IN, MD, AR, IA VT, KY, MI, OH, TX, WA

CUs did better in 17 states: UT, CO, DE, WY, OK, WI, NH, MT, NC, AK, AZ, NV, NM, ND, SD, SC, NE

Tied in 8 States: AL, DC, HI, MN, MO, OR, PA, WV

## State Rankings by Lender Advantage
### Single Family Lending Trends - 2002

| | Credit Unions | No Difference | Banks | No. of Indicators | CU adv./# Indicators | Bank adv./# Indicators |
|---|---|---|---|---|---|---|
| Florida | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| New Jersey | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Illinois | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| New York | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Rhode Island | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Tennessee | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Virginia | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Mississippi | 1 | 0 | 11 | 12 | 8.3% | 91.7% |
| West Virginia | 1 | 0 | 8 | 9 | 11.1% | 88.9% |
| District of Columbia | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Georgia | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Louisiana | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Arkansas | 2 | 0 | 10 | 12 | 16.7% | 83.3% |
| Delaware | 2 | 0 | 8 | 10 | 20.0% | 80.0% |
| Ohio | 1 | 2 | 11 | 14 | 7.1% | 78.6% |
| Maryland | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Connecticut | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Maine | 2 | 0 | 5 | 7 | 28.6% | 71.4% |
| Massachusetts | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Texas | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Idaho | 3 | 0 | 7 | 10 | 30.0% | 70.0% |
| Missouri | 4 | 1 | 9 | 14 | 28.6% | 64.3% |
| South Carolina | 4 | 1 | 9 | 14 | 28.6% | 64.3% |
| Kansas | 5 | 0 | 9 | 14 | 35.7% | 64.3% |
| Utah | 5 | 0 | 9 | 14 | 35.7% | 64.3% |
| California | 5 | 1 | 8 | 14 | 35.7% | 57.1% |
| Washington | 5 | 1 | 8 | 14 | 35.7% | 57.1% |
| Alabama | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Colorado | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Pennsylvania | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Hawaii | 6 | 0 | 7 | 13 | 46.2% | 53.8% |
| Indiana | 5 | 2 | 7 | 14 | 35.7% | 50.0% |
| North Carolina | 5 | 2 | 7 | 14 | 35.7% | 50.0% |
| New Hampshire | 5 | 1 | 6 | 12 | 41.7% | 50.0% |
| Minnesota | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Oklahoma | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Iowa | 7 | 1 | 6 | 14 | 50.0% | 42.9% |
| Nevada | 7 | 1 | 6 | 14 | 50.0% | 42.9% |
| Kentucky | 6 | 1 | 5 | 12 | 50.0% | 41.7% |
| New Mexico | 8 | 0 | 5 | 13 | 61.5% | 38.5% |
| Vermont | 5 | 0 | 3 | 8 | 62.5% | 37.5% |
| Arizona | 6 | 3 | 5 | 14 | 42.9% | 35.7% |
| Michigan | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| Oregon | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| Wisconsin | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| Montana | 5 | 0 | 2 | 7 | 71.4% | 28.6% |
| South Dakota | 5 | 0 | 2 | 7 | 71.4% | 28.6% |
| Alaska | 12 | 0 | 2 | 14 | 85.7% | 14.3% |
| Wyoming | 6 | 0 | 1 | 7 | 85.7% | 14.3% |
| Nebraska | 13 | 0 | 1 | 14 | 92.9% | 7.1% |
| North Dakota | 7 | 0 | 0 | 7 | 100.0% | 0.0% |
| United States | 233 | 17 | 400 | 650 | 35.8% | 61.5% |

Banks did better in 34 states: FL, NJ, IL, NY, RI, TN, VA, MS, WV, DC, GA, LA, AR, DE, OH, MD, CT, ME, MA, TX ID, MO, SC, KS, UT, CA, WA, AL, CO, PA, HI, IN, NC, NH

CUs did better in 15 states: IA, NV, KY, NM, VT, AZ, MI, OR, WI, MT, SD, AK, WY, NE, ND

Tied in 2 States: MN, OK

## State Rankings by Lender Advantage
### Single Family Lending Trends - 2001

| | Credit Unions | No Difference | Banks | No. of Indicators | CU adv./# Indicators | Bank adv./# Indicators |
|---|---|---|---|---|---|---|
| Florida | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Louisiana | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Mississippi | 0 | 0 | 12 | 12 | 0.0% | 100.0% |
| New Jersey | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Tennessee | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Virginia | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Indiana | 1 | 0 | 12 | 14 | 7.1% | 85.7% |
| Connecticut | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| District of Columbia | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Georgia | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| New York | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Ohio | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Maryland | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Rhode Island | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| South Carolina | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Texas | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| West Virginia | 2 | 0 | 7 | 9 | 22.2% | 77.8% |
| Delaware | 3 | 0 | 9 | 12 | 25.0% | 75.0% |
| Kentucky | 3 | 0 | 9 | 12 | 25.0% | 75.0% |
| Kansas | 3 | 1 | 10 | 14 | 21.4% | 71.4% |
| Missouri | 3 | 1 | 10 | 14 | 21.4% | 71.4% |
| Illinois | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Maine | 2 | 0 | 5 | 7 | 28.6% | 71.4% |
| Massachusetts | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| North Carolina | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Washington | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Arkansas | 3 | 1 | 8 | 12 | 25.0% | 66.7% |
| New Hampshire | 4 | 0 | 8 | 12 | 33.3% | 66.7% |
| Arizona | 4 | 1 | 9 | 14 | 28.6% | 64.3% |
| California | 4 | 1 | 9 | 14 | 28.6% | 64.3% |
| Alabama | 4 | 1 | 8 | 13 | 30.8% | 61.5% |
| Iowa | 5 | 0 | 7 | 12 | 41.7% | 58.3% |
| Oklahoma | 4 | 2 | 8 | 14 | 28.6% | 57.1% |
| New Mexico | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Pennsylvania | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Vermont | 3 | 0 | 4 | 7 | 42.9% | 57.1% |
| Wyoming | 3 | 0 | 4 | 7 | 42.9% | 57.1% |
| Idaho | 3 | 1 | 5 | 9 | 33.3% | 55.6% |
| Colorado | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Minnesota | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Nevada | 7 | 1 | 6 | 14 | 50.0% | 42.9% |
| Oregon | 8 | 0 | 6 | 14 | 57.1% | 42.9% |
| Montana | 5 | 0 | 3 | 8 | 62.5% | 37.5% |
| Utah | 7 | 2 | 5 | 14 | 50.0% | 35.7% |
| Michigan | 8 | 1 | 5 | 14 | 57.1% | 35.7% |
| Alaska | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| Nebraska | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| Wisconsin | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| Hawaii | 8 | 0 | 4 | 12 | 66.7% | 33.3% |
| South Dakota | 6 | 0 | 2 | 8 | 75.0% | 25.0% |
| North Dakota | 6 | 0 | 1 | 7 | 85.7% | 14.3% |
| United States | 202 | 14 | 433 | 649 | 31.1% | 66.7% |

Banks did better in 38 states: FL, LA, MS, NJ, TN, VA, IN, CT, DC, GA, NY, OH, MD, RI, SC, TX, WV, DE, KY, KS, MO, IL, ME, MA, NC, WA, AR, NH, AZ, CA, AL, IA, OK, NM, PA, VT, WY, ID

CUs did better in 11 states: NV, OR, MT, UT, MI, AK, NE, WI, HI, SD, ND

Tied in 2 States: CO, MN

## State Rankings by Lender Advantage
### Home Purchase Lending Trends - Aggregate

| | Credit Unions | No Difference | Banks | No. of Indicators | CU adv./# Indicators | Bank adv./# Indicators |
|---|---|---|---|---|---|---|
| Indiana | 0 | 0 | 42 | 42 | 0.0% | 100.0% |
| Texas | 0 | 0 | 42 | 42 | 0.0% | 100.0% |
| Ohio | 1 | 0 | 37 | 38 | 2.6% | 97.4% |
| Florida | 2 | 0 | 40 | 42 | 4.8% | 95.2% |
| District of Columbia | 2 | 0 | 37 | 39 | 5.1% | 94.9% |
| Missouri | 2 | 0 | 36 | 38 | 5.3% | 94.7% |
| Tennessee | 2 | 0 | 36 | 38 | 5.3% | 94.7% |
| Louisiana | 2 | 0 | 34 | 36 | 5.6% | 94.4% |
| Maine | 1 | 0 | 16 | 17 | 5.9% | 94.1% |
| New Jersey | 3 | 0 | 39 | 42 | 7.1% | 92.9% |
| Oklahoma | 3 | 0 | 35 | 41 | 7.3% | 92.7% |
| Illinois | 3 | 1 | 38 | 42 | 7.1% | 90.5% |
| New York | 3 | 1 | 38 | 42 | 7.1% | 90.5% |
| Georgia | 5 | 0 | 37 | 42 | 11.9% | 88.1% |
| Maryland | 5 | 0 | 37 | 42 | 11.9% | 88.1% |
| Connecticut | 4 | 0 | 29 | 33 | 12.1% | 87.9% |
| Rhode Island | 2 | 1 | 18 | 21 | 9.5% | 85.7% |
| Massachusetts | 6 | 0 | 36 | 42 | 14.3% | 85.7% |
| Virginia | 6 | 0 | 36 | 42 | 14.3% | 85.7% |
| Kansas | 5 | 0 | 26 | 31 | 16.1% | 83.9% |
| Minnesota | 7 | 0 | 31 | 38 | 18.4% | 81.6% |
| Kentucky | 6 | 0 | 19 | 25 | 24.0% | 76.0% |
| Nebraska | 6 | 0 | 17 | 23 | 26.1% | 73.9% |
| Arizona | 10 | 1 | 31 | 42 | 23.8% | 73.8% |
| Michigan | 10 | 1 | 31 | 42 | 23.8% | 73.8% |
| Mississippi | 9 | 0 | 25 | 34 | 26.5% | 73.5% |
| Pennsylvania | 11 | 0 | 30 | 41 | 26.8% | 73.2% |
| South Carolina | 11 | 0 | 29 | 40 | 27.5% | 72.5% |
| California | 12 | 0 | 30 | 42 | 28.6% | 71.4% |
| North Carolina | 12 | 1 | 29 | 42 | 28.6% | 69.0% |
| Colorado | 14 | 0 | 28 | 42 | 33.3% | 66.7% |
| Arkansas | 12 | 0 | 19 | 31 | 38.7% | 61.3% |
| Idaho | 7 | 0 | 11 | 18 | 38.9% | 61.1% |
| Washington | 17 | 0 | 25 | 42 | 40.5% | 59.5% |
| Iowa | 15 | 0 | 22 | 37 | 40.5% | 59.5% |
| Wisconsin | 17 | 0 | 24 | 41 | 41.5% | 58.5% |
| Utah | 14 | 0 | 18 | 32 | 43.8% | 56.3% |
| New Mexico | 16 | 0 | 20 | 36 | 44.4% | 55.6% |
| Hawaii | 13 | 0 | 16 | 29 | 44.8% | 55.2% |
| Nevada | 18 | 0 | 22 | 40 | 45.0% | 55.0% |
| Alabama | 19 | 0 | 19 | 38 | 50.0% | 50.0% |
| Delaware | 4 | 1 | 4 | 9 | 44.4% | 44.4% |
| West Virginia | 12 | 0 | 8 | 20 | 60.0% | 40.0% |
| Wyoming | 9 | 0 | 6 | 15 | 60.0% | 40.0% |
| Montana | 13 | 0 | 7 | 20 | 65.0% | 35.0% |
| Oregon | 26 | 0 | 14 | 40 | 65.0% | 35.0% |
| Vermont | 15 | 0 | 6 | 21 | 71.4% | 28.6% |
| New Hampshire | 18 | 0 | 6 | 24 | 75.0% | 25.0% |
| Alaska | 29 | 0 | 9 | 38 | 76.3% | 23.7% |
| South Dakota | 17 | 0 | 4 | 21 | 81.0% | 19.0% |
| North Dakota | 19 | 0 | 1 | 20 | 95.0% | 5.0% |
| United States | 475 | 7 | 1253 | 1735 | 27.4% | 72.2% |

Banks did better in 40 states: IN, TX, OH, FL, DC, MO, TN, LA, ME, NJ, OK, IL, NY, GA, MD, CT, RI, MA, VA, KS, MN, KY, NE, AZ, MI, MS, PA, SC, CA, NC, CO, AR, ID, WA, IA, WI, UT, NM, HI, NV

CUs did better in 9 states: WV, WY,MT, OR, VT, NH, AK, SD, ND

Tied in 2: AL, DE

## State Rankings by Lender Advantage
### Home Purchase Lending Trends - 2003

| | Credit Unions | No Difference | Banks | No. of Indicators | CU adv./# Indicators | Bank adv./# Indicators |
|---|---|---|---|---|---|---|
| Connecticut | 0 | 0 | 13 | 13 | 0.0% | 100.0% |
| Florida | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Indiana | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Louisiana | 0 | 0 | 12 | 12 | 0.0% | 100.0% |
| Maine | 0 | 0 | 7 | 7 | 0.0% | 100.0% |
| Ohio | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Oklahoma | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Tennessee | 0 | 0 | 12 | 12 | 0.0% | 100.0% |
| Texas | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| District of Columbia | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Georgia | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Missouri | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| New Jersey | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Illinois | 1 | 1 | 12 | 14 | 7.1% | 85.7% |
| Massachusetts | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| New York | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Rhode Island | 1 | 0 | 6 | 7 | 14.3% | 85.7% |
| Colorado | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Kansas | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Maryland | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Minnesota | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Kentucky | 2 | 0 | 7 | 9 | 22.2% | 77.8% |
| Idaho | 2 | 0 | 5 | 7 | 28.6% | 71.4% |
| Nebraska | 2 | 0 | 5 | 7 | 28.6% | 71.4% |
| Pennsylvania | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Virginia | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Hawaii | 3 | 0 | 7 | 10 | 30.0% | 70.0% |
| Mississippi | 4 | 0 | 8 | 12 | 33.3% | 66.7% |
| California | 5 | 0 | 9 | 14 | 35.7% | 64.3% |
| Michigan | 5 | 0 | 9 | 14 | 35.7% | 64.3% |
| Arkansas | 4 | 0 | 7 | 11 | 36.4% | 63.6% |
| South Carolina | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Wyoming | 3 | 0 | 4 | 7 | 42.9% | 57.1% |
| Arizona | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Iowa | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Washington | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| North Carolina | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Montana | 4 | 0 | 3 | 7 | 57.1% | 42.9% |
| Nevada | 8 | 0 | 6 | 14 | 57.1% | 42.9% |
| Vermont | 4 | 0 | 3 | 7 | 57.1% | 42.9% |
| Wisconsin | 8 | 0 | 6 | 14 | 57.1% | 42.9% |
| Utah | 7 | 0 | 5 | 12 | 58.3% | 41.7% |
| Alabama | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| Oregon | 9 | 0 | 5 | 14 | 64.3% | 35.7% |
| New Mexico | 8 | 0 | 4 | 12 | 66.7% | 33.3% |
| South Dakota | 4 | 0 | 2 | 6 | 66.7% | 33.3% |
| Alaska | 10 | 0 | 4 | 14 | 71.4% | 28.6% |
| Delaware | 2 | 1 | 1 | 4 | 50.0% | 25.0% |
| New Hampshire | 8 | 0 | 2 | 10 | 80.0% | 20.0% |
| North Dakota | 6 | 0 | 0 | 6 | 100.0% | 0.0% |
| West Virginia | 7 | 0 | 0 | 7 | 100.0% | 0.0% |
| United States | 188 | 2 | 415 | 605 | 31.1% | 68.6% |

Banks did better in 33 states: CT, FL, IN, LA, ME, OH, OK, TN, TX, DC, GA, MO, NJ, IL, MA, NY, RI, CO, KS, MD, MN, KY, ID, NE, PA, VA, HI, MS, CA, MI, AR, SC, WY

CUs did better in 14 States: MT, NV, VT, WI, UT, AL, OR, NM, SD, AK, DE, NH, ND, WV

Tied in 4: AZ, IA, WA, NC

## State Rankings by Lender Advantage
### Home Purchase Lending Trends - 2002

| | Credit Unions | No Difference | Banks | No. of Indicators | CU adv./# Indicators | Bank adv./# Indicators |
|---|---|---|---|---|---|---|
| Florida | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Illinois | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Indiana | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Ohio | 0 | 0 | 12 | 12 | 0.0% | 100.0% |
| Rhode Island | 0 | 0 | 7 | 7 | 0.0% | 100.0% |
| Texas | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Arizona | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Maryland | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Virginia | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| District of Columbia | 1 | 0 | 12 | 13 | 7.7% | 92.3% |
| Louisiana | 1 | 0 | 11 | 12 | 8.3% | 91.7% |
| Missouri | 1 | 0 | 11 | 12 | 8.3% | 91.7% |
| Kansas | 1 | 0 | 9 | 10 | 10.0% | 90.0% |
| Michigan | 1 | 1 | 12 | 14 | 7.1% | 85.7% |
| New York | 1 | 1 | 12 | 14 | 7.1% | 85.7% |
| Georgia | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Massachusetts | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| New Jersey | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Tennessee | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Oklahoma | 2 | 0 | 11 | 13 | 15.4% | 84.6% |
| Minnesota | 2 | 0 | 10 | 12 | 16.7% | 83.3% |
| South Carolina | 2 | 0 | 10 | 12 | 16.7% | 83.3% |
| Utah | 2 | 0 | 8 | 10 | 20.0% | 80.0% |
| California | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Connecticut | 2 | 0 | 7 | 9 | 22.2% | 77.8% |
| Kentucky | 2 | 0 | 7 | 9 | 22.2% | 77.8% |
| Wisconsin | 3 | 0 | 10 | 13 | 23.1% | 76.9% |
| Maine | 1 | 0 | 3 | 4 | 25.0% | 75.0% |
| Nebraska | 1 | 0 | 6 | 8 | 25.0% | 75.0% |
| Iowa | 3 | 0 | 8 | 11 | 27.3% | 72.7% |
| North Carolina | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Pennsylvania | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| West Virginia | 2 | 0 | 5 | 7 | 28.6% | 71.4% |
| Delaware | 1 | 0 | 2 | 3 | 33.3% | 66.7% |
| Colorado | 5 | 0 | 9 | 14 | 35.7% | 64.3% |
| Arkansas | 3 | 0 | 5 | 8 | 37.5% | 62.5% |
| Alabama | 5 | 0 | 7 | 12 | 41.7% | 58.3% |
| Mississippi | 5 | 0 | 6 | 11 | 45.5% | 54.5% |
| Washington | 7 | 0 | 7 | 14 | 50.0% | 50.0% |
| Hawaii | 5 | 0 | 4 | 9 | 55.6% | 44.4% |
| Nevada | 8 | 0 | 6 | 14 | 57.1% | 42.9% |
| New Hampshire | 4 | 0 | 3 | 7 | 57.1% | 42.9% |
| New Mexico | 7 | 0 | 5 | 12 | 58.3% | 41.7% |
| Montana | 5 | 0 | 2 | 7 | 71.4% | 28.6% |
| Oregon | 10 | 0 | 4 | 14 | 71.4% | 28.6% |
| Idaho | 3 | 0 | 1 | 4 | 75.0% | 25.0% |
| Alaska | 10 | 0 | 2 | 12 | 83.3% | 16.7% |
| South Dakota | 6 | 0 | 1 | 7 | 85.7% | 14.3% |
| Vermont | 6 | 0 | 1 | 7 | 85.7% | 14.3% |
| North Dakota | 7 | 0 | 0 | 7 | 100.0% | 0.0% |
| Wyoming | 6 | 0 | 0 | 6 | 100.0% | 0.0% |
| United States | 154 | 2 | 410 | 566 | 27.2% | 72.4% |

Banks did better in 38 states: FL, IL, IN, OH, RI, TX, AZ, MD, VA, DC, LA, MO, KS, MI, NY, GA, MA, NJ, TN, OK, MN, SC, UT, CA, CT, KY, WI, ME, NE, IA, NC, PA, WV, DE, CO, AR, AL, MS

CUs did better in 12 states: HI, NV, NH, NM, MT, OR, ID, AK, SD, VT, ND, WY

Tied in 1: WA

## State Rankings by Lender Advantage
### Home Purchase Lending Trends - 2001

| | Credit Unions | No Difference | Banks | No. of Indicators | CU adv./# Indicators | Bank adv./# Indicators |
|---|---|---|---|---|---|---|
| District of Columbia | 0 | 0 | 12 | 12 | 0.0% | 100.0% |
| Indiana | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Maine | 0 | 0 | 6 | 6 | 0.0% | 100.0% |
| Mississippi | 0 | 0 | 11 | 11 | 0.0% | 100.0% |
| Missouri | 0 | 0 | 12 | 12 | 0.0% | 100.0% |
| New Jersey | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| New York | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Tennessee | 0 | 0 | 12 | 12 | 0.0% | 100.0% |
| Texas | 0 | 0 | 14 | 14 | 0.0% | 100.0% |
| Wyoming | 0 | 0 | 2 | 2 | 0.0% | 100.0% |
| Maryland | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Oklahoma | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Virginia | 1 | 0 | 13 | 14 | 7.1% | 92.9% |
| Louisiana | 1 | 0 | 11 | 12 | 8.3% | 91.7% |
| New Mexico | 1 | 0 | 11 | 12 | 8.3% | 91.7% |
| Ohio | 1 | 0 | 11 | 12 | 8.3% | 91.7% |
| North Carolina | 1 | 1 | 12 | 14 | 7.1% | 85.7% |
| Florida | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Georgia | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Illinois | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Kansas | 1 | 0 | 6 | 7 | 14.3% | 85.7% |
| Massachusetts | 2 | 0 | 12 | 14 | 14.3% | 85.7% |
| Minnesota | 2 | 0 | 10 | 12 | 16.7% | 83.3% |
| Nevada | 2 | 0 | 10 | 12 | 16.7% | 83.3% |
| Connecticut | 2 | 0 | 9 | 11 | 18.2% | 81.8% |
| Arizona | 2 | 1 | 11 | 14 | 14.3% | 78.6% |
| South Carolina | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Washington | 3 | 0 | 11 | 14 | 21.4% | 78.6% |
| Pennsylvania | 3 | 0 | 10 | 13 | 23.1% | 76.9% |
| Nebraska | 2 | 0 | 6 | 8 | 25.0% | 75.0% |
| Rhode Island | 1 | 1 | 5 | 7 | 14.3% | 71.4% |
| California | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Idaho | 2 | 0 | 5 | 7 | 28.6% | 71.4% |
| Kentucky | 2 | 0 | 5 | 7 | 28.6% | 71.4% |
| Michigan | 4 | 0 | 10 | 14 | 28.6% | 71.4% |
| Alabama | 5 | 0 | 7 | 12 | 41.7% | 58.3% |
| Arkansas | 5 | 0 | 7 | 12 | 41.7% | 58.3% |
| Iowa | 5 | 0 | 7 | 12 | 41.7% | 58.3% |
| Colorado | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Wisconsin | 6 | 0 | 8 | 14 | 42.9% | 57.1% |
| Delaware | 1 | 0 | 1 | 2 | 50.0% | 50.0% |
| Hawaii | 5 | 0 | 5 | 10 | 50.0% | 50.0% |
| Utah | 5 | 0 | 5 | 10 | 50.0% | 50.0% |
| West Virginia | 3 | 0 | 3 | 6 | 50.0% | 50.0% |
| Oregon | 7 | 0 | 5 | 12 | 58.3% | 41.7% |
| Montana | 4 | 0 | 2 | 6 | 66.7% | 33.3% |
| Vermont | 5 | 0 | 2 | 7 | 71.4% | 28.6% |
| Alaska | 9 | 0 | 3 | 12 | 75.0% | 25.0% |
| New Hampshire | 6 | 0 | 1 | 7 | 85.7% | 14.3% |
| North Dakota | 6 | 0 | 1 | 7 | 85.7% | 14.3% |
| South Dakota | 7 | 0 | 1 | 8 | 87.5% | 12.5% |
| United States | 133 | 3 | 428 | 564 | 23.6% | 75.9% |

Banks did better in 40 states: DC, IN, ME, MS, MO, NJ, NY, TN, TX, WY, MD, OK, VA, LA, NM, OH, NC, FL, GA, IL, KS, MA, MN, NV, CT, AZ, SC, WA, PA, NE, RI, CA, ID, KY, MI, AL, AR, IA, CO, WI

CUs did better in 7 states: OR, MT, VT, AK, NH, ND, SD

Tied in 4: DE, HI, UT, WV

| Massachusetts - State v Federal Credit Unions<br>2003 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | State CUs | Perc. Pt. Diff. | Advantage |
| % to Blacks | 1.0% | 2.7% | -1.7% | State CUs |
| % to Hispanics | 1.0% | 1.8% | -0.9% | State CUs |
| % to LMI Borrowers | 28.6% | 30.2% | -1.6% | State CUs |
| % to Women | 15.5% | 17.5% | -2.0% | State CUs |
| % to LMI Minorities | 1.1% | 2.8% | -1.7% | State CUs |
| % to LMI Women | 9.1% | 10.7% | -1.6% | State CUs |
| % to Minority Tracts | 1.0% | 3.1% | -2.1% | State CUs |
| % to LMI Tracts | 10.5% | 14.8% | -4.3% | State CUs |
| % to LMI and/or Minority Tracts | 10.5% | 14.9% | -4.4% | State CUs |
| Denial Disparity Ratios | | | Fed/State Ratio | |
| Blacks to Whites | 3.30 | 4.64 | 0.71 | Fed CUs |
| Hispanics to Whites | 4.55 | 5.14 | 0.88 | Fed CUs |
| Minority to White Tracts | 2.56 | 3.49 | 0.73 | Fed CUs |
| LMI to MUI Borrowers | 3.10 | 2.48 | 1.25 | State CUs |
| LMI to MUI Tracts | 1.14 | 2.59 | 0.44 | Fed CUs |
| Total Advantage | Fed CU Adv. | State CU Adv. | No Difference | Total |
| State CUs | 4 | 10 | 0 | 14 |

| Massachusetts - State v. Federal Credit Unions<br>2002 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 1.0% | 3.0% | -2.0% | State CUs |
| % to Hispanics | 1.1% | 1.6% | -0.6% | State CUs |
| % to LMI Borrowers | 21.6% | 23.8% | -2.2% | State CUs |
| % to Women | 15.3% | 17.0% | -1.7% | State CUs |
| % to LMI Minorities | 1.0% | 2.5% | -1.5% | State CUs |
| % to LMI Women | 7.8% | 9.4% | -1.6% | State CUs |
| % to Minority Tracts | 0.4% | 1.2% | -0.8% | State CUs |
| % to LMI Tracts | 7.4% | 11.0% | -3.7% | State CUs |
| % to LMI and/or Minority Tracts | 7.4% | 11.2% | -3.8% | State CUs |
| Denial Disparity Ratios | | | Fed/State Ratio | |
| Blacks to Whites | 3.75 | 3.66 | 1.03 | State CUs |
| Hispanics to Whites | 4.21 | 5.97 | 0.71 | Fed CUs |
| Minority to White Tracts | 5.26 | 2.73 | 1.93 | State CUs |
| LMI to MUI Borrowers | 1.75 | 3.35 | 0.52 | Fed CUs |
| LMI to MUI Tracts | 1.65 | 2.53 | 0.65 | Fed CUs |
| Total Advantage | Fed CU Adv. | State CU Adv. | No Difference | Total |
| State CUs | 3 | 11 | 0 | 14 |

| Massachusetts - State v. Federal Credit Unions<br>2001 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 1.2% | 1.5% | -0.3% | State CUs |
| % to Hispanics | 1.1% | 3.5% | -2.3% | State CUs |
| % to LMI Borrowers | 21.7% | 21.0% | 0.7% | Fed CUs |
| % to Women | 15.4% | 16.5% | -1.1% | State CUs |
| % to LMI Minorities | 1.1% | 2.5% | -1.4% | State CUs |
| % to LMI Women | 8.1% | 8.3% | -0.2% | State CUs |
| % to Minority Tracts | 0.6% | 1.4% | -0.8% | State CUs |
| % to LMI Tracts | 7.8% | 12.5% | -4.6% | State CUs |
| % to LMI and/or Minority Tracts | 7.9% | 12.6% | -4.7% | State CUs |
| Denial Disparity Ratios | | | Fed/State Ratio | |
| Blacks to Whites | 2.15 | 3.93 | 0.55 | Fed CUs |
| Hispanics to Whites | 0.71 | 4.40 | 0.16 | Fed CUs |
| Minority to White Tracts | 2.17 | 3.16 | 0.68 | Fed CUs |
| LMI to MUI Borrowers | 2.17 | 2.72 | 0.80 | Fed CUs |
| LMI to MUI Tracts | 1.57 | 2.34 | 0.67 | Fed CUs |
| Total Advantage | Fed CU Adv. | State CU Adv. | No Difference | Total |
| State CUs | 6 | 8 | 0 | 14 |

| Massachusetts - State v. Federal Credit Unions<br>2003 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 1.4% | 3.0% | -1.5% | State CUs |
| % to Hispanics | 1.5% | 2.6% | -1.1% | State CUs |
| % to LMI Borrowers | 33.0% | 29.3% | 3.7% | Fed CUs |
| % to Women | 20.3% | 18.4% | 1.9% | Fed CUs |
| % to LMI Minorities | 2.1% | 3.1% | -1.1% | State CUs |
| % to LMI Women | 12.0% | 10.4% | 1.6% | Fed CUs |
| % to Minority Tracts | 0.7% | 2.7% | -1.9% | State CUs |
| % to LMI Tracts | 13.8% | 15.3% | -1.6% | State CUs |
| % to LMI and/or Minority Tracts | 13.8% | 15.4% | -1.6% | State CUs |
| Denial Disparity Ratios | | | Fed/State Ratio | |
| Blacks to Whites | 0.00 | 3.88 | 0.00 | Fed CUs |
| Hispanics to Whites | 1.55 | 4.00 | 0.39 | Fed CUs |
| Minority to White Tracts | 2.24 | 4.54 | 0.49 | Fed CUs |
| LMI to MUI Borrowers | 1.31 | 2.58 | 0.51 | Fed CUs |
| LMI to MUI Tracts | 0.89 | 2.61 | 0.34 | Fed CUs |
| Total Advantage | Fed CU Adv. | State CU Adv. | No Difference | Total |
| Fed CUs | 8 | 6 | 0 | 14 |

| Massachusetts - State v. Federal Credit Unions<br>2002 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 1.4% | 2.9% | -1.6% | State CUs |
| % to Hispanics | 1.1% | 2.2% | -1.1% | State CUs |
| % to LMI Borrowers | 24.4% | 22.3% | 2.2% | Fed CUs |
| % to Women | 20.3% | 15.9% | 4.3% | Fed CUs |
| % to LMI Minorities | 1.2% | 2.8% | -1.6% | State CUs |
| % to LMI Women | 10.4% | 8.7% | 1.7% | Fed CUs |
| % to Minority Tracts | 0.3% | 0.7% | -0.5% | State CUs |
| % to LMI Tracts | 9.7% | 12.5% | -2.8% | State CUs |
| % to LMI and/or Minority Tracts | 9.7% | 12.5% | -2.8% | State CUs |
| Denial Disparity Ratios | | | Fed/State Ratio | |
| Blacks to Whites | 2.89 | 3.48 | 0.83 | Fed CUs |
| Hispanics to Whites | 4.72 | 6.55 | 0.72 | Fed CUs |
| Minority to White Tracts | 6.36 | 7.72 | 0.82 | Fed CUs |
| LMI to MUI Borrowers | 1.36 | 4.11 | 0.33 | Fed CUs |
| LMI to MUI Tracts | 1.54 | 2.62 | 0.59 | Fed CUs |
| Total Advantage | Fed CU Adv. | State CU Adv. | No Difference | Total |
| Fed CUs | 8 | 6 | 0 | 14 |

| Massachusetts - State v. Federal Credit Unions<br>2001 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 1.7% | 3.2% | -1.5% | State CUs |
| % to Hispanics | 1.3% | 1.8% | -0.5% | State CUs |
| % to LMI Borrowers | 24.6% | 18.9% | 5.6% | Fed CUs |
| % to Women | 18.8% | 15.8% | 3.0% | Fed CUs |
| % to LMI Minorities | 1.8% | 2.4% | -0.5% | State CUs |
| % to LMI Women | 9.9% | 7.3% | 2.6% | Fed CUs |
| % to Minority Tracts | 0.5% | 1.0% | -0.5% | State CUs |
| % to LMI Tracts | 9.6% | 11.9% | -2.3% | State CUs |
| % to LMI and/or Minority Tracts | 9.6% | 12.0% | -2.4% | State CUs |
| Denial Disparity Ratios | | | Fed/State Ratio | |
| Blacks to Whites | 2.45 | 3.54 | 0.69 | Fed CUs |
| Hispanics to Whites | 0.00 | 1.88 | 0.00 | Fed CUs |
| Minority to White Tracts | 0.00 | 2.75 | 0.00 | Fed CUs |
| LMI to MUI Borrowers | 2.10 | 2.07 | 1.01 | State CUs |
| LMI to MUI Tracts | 1.85 | 2.86 | 0.65 | Fed CUs |
| Total Advantage | Fed CU Adv. | State CU Adv. | No Difference | Total |
| Tie | 7 | 7 | 0 | 14 |

| Massachusetts - Banks vs. Federal Credit Unions<br>2003 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 1.0% | 2.2% | -1.2% | Banks |
| % to Hispanics | 1.0% | 2.4% | -1.5% | Banks |
| % to LMI Borrowers | 28.6% | 25.9% | 2.8% | Fed CUs |
| % to Women | 15.5% | 17.2% | -1.8% | Banks |
| % to LMI Minorities | 1.1% | 3.0% | -1.9% | Banks |
| % to LMI Women | 9.1% | 8.7% | 0.5% | Fed CUs |
| % to Minority Tracts | 1.0% | 3.7% | -2.7% | Banks |
| % to LMI Tracts | 10.5% | 12.8% | -2.3% | Banks |
| % to LMI and/or Minority Tracts | 10.5% | 12.9% | -2.4% | Banks |
| Denial Disparity Ratios | | | FedCU/Bank Ratio | |
| Blacks to Whites | 3.30 | 2.84 | 1.16 | Banks |
| Hispanics to Whites | 4.55 | 2.64 | 1.72 | Banks |
| Minority to White Tracts | 2.56 | 2.23 | 1.15 | Banks |
| LMI to MUI Borrowers | 3.10 | 1.67 | 1.85 | Banks |
| LMI to MUI Tracts | 1.14 | 1.95 | 0.58 | Fed CUs |
| Total Advantage | Fed CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 3 | 11 | 0 | 14 |

| Massachusetts - Banks vs. Federal Credit Unions<br>2002 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 1.0% | 2.0% | -1.0% | Banks |
| % to Hispanics | 1.1% | 2.3% | -1.3% | Banks |
| % to LMI Borrowers | 21.6% | 20.2% | 1.4% | Fed CUs |
| % to Women | 15.3% | 15.2% | 0.1% | Fed CUs |
| % to LMI Minorities | 1.0% | 2.4% | -1.4% | Banks |
| % to LMI Women | 7.8% | 6.6% | 1.2% | Fed CUs |
| % to Minority Tracts | 0.4% | 2.1% | -1.7% | Banks |
| % to LMI Tracts | 7.4% | 10.9% | -3.5% | Banks |
| % to LMI and/or Minority Tracts | 7.4% | 11.1% | -3.7% | Banks |
| Denial Disparity Ratios | | | FedCU/Bank Ratio | |
| Blacks to Whites | 3.75 | 2.80 | 1.34 | Banks |
| Hispanics to Whites | 4.21 | 2.68 | 1.57 | Banks |
| Minority to White Tracts | 5.26 | 2.15 | 2.45 | Banks |
| LMI to MUI Borrowers | 1.75 | 1.78 | 0.98 | Fed CUs |
| LMI to MUI Tracts | 1.65 | 1.80 | 0.92 | Fed CUs |
| Total Advantage | Fed CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 5 | 9 | 0 | 14 |

| Massachusetts - Banks vs. Federal Credit Unions<br>2001 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Fed CUs | Banks/Thrifts | Perc. Pt. Diff | Advantage |
| % to Blacks | 1.2% | 2.1% | -0.9% | Banks |
| % to Hispanics | 1.1% | 2.6% | -1.5% | Banks |
| % to LMI Borrowers | 21.7% | 20.4% | 1.4% | Fed CUs |
| % to Women | 15.4% | 15.5% | 0.0% | ND |
| % to LMI Minorities | 1.1% | 2.6% | -1.5% | Banks |
| % to LMI Women | 8.1% | 6.9% | 1.2% | Fed CUs |
| % to Minority Tracts | 0.6% | 2.3% | -1.7% | Banks |
| % to LMI Tracts | 7.8% | 11.8% | -4.0% | Banks |
| % to LMI and/or Minority Tracts | 7.9% | 12.0% | -4.1% | Banks |
| Denial Disparity Ratios | | | FedCU/Bank Ratio | |
| Blacks to Whites | 2.15 | 2.84 | 0.76 | Fed CUs |
| Hispanics to Whites | 0.71 | 2.68 | 0.26 | Fed CUs |
| Minority to White Tracts | 2.17 | 2.13 | 1.02 | Banks |
| LMI to MUI Borrowers | 2.17 | 1.82 | 1.20 | Banks |
| LMI to MUI Tracts | 1.57 | 1.81 | 0.87 | Fed CUs |
| Total Advantage | Fed CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 5 | 8 | 1 | 14 |

## Massachusetts - Banks vs. Federal Credit Unions
2003 Home Purchase Lending Trends

| Portfolio Share Indicators | Fed CUs | Banks/Thrifts | Perc. Pt. Diff | Advantage |
|---|---|---|---|---|
| % to Blacks | 1.4% | 3.2% | -1.8% | Banks |
| % to Hispanics | 1.5% | 4.7% | -3.2% | Banks |
| % to LMI Borrowers | 33.0% | 27.1% | 5.9% | Fed CUs |
| % to Women | 20.3% | 20.9% | -0.7% | Banks |
| % to LMI Minorities | 2.1% | 5.1% | -3.0% | Banks |
| % to LMI Women | 12.0% | 10.2% | 1.9% | Fed CUs |
| % to Minority Tracts | 0.7% | 5.9% | -5.2% | Banks |
| % to LMI Tracts | 13.8% | 18.6% | -4.8% | Banks |
| % to LMI and/or Minority Tracts | 13.8% | 18.8% | -5.0% | Banks |
| Denial Disparity Ratios | | | FedCU/Bank Ratio | |
| Blacks to Whites | 0.00 | 2.15 | 0.00 | discard |
| Hispanics to Whites | 1.55 | 2.05 | 0.76 | Fed CUs |
| Minority to White Tracts | 2.24 | 1.70 | 1.32 | Banks |
| LMI to MUI Borrowers | 1.31 | 1.54 | 0.85 | Fed CUs |
| LMI to MUI Tracts | 0.89 | 1.67 | 0.53 | Fed CUs |
| Total Advantage | Fed CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 5 | 8 | 0 | 13 |

## Massachusetts - Banks vs. Federal Credit Unions
2002 Home Purchase Lending Trends

| Portfolio Share Indicators | Fed CUs | Banks/Thrifts | Perc. Pt. Diff | Advantage |
|---|---|---|---|---|
| % to Blacks | 1.4% | 3.2% | -1.8% | Banks |
| % to Hispanics | 1.1% | 4.9% | -3.8% | Banks |
| % to LMI Borrowers | 24.4% | 21.7% | 2.7% | Fed CUs |
| % to Women | 20.3% | 19.3% | 1.0% | Fed CUs |
| % to LMI Minorities | 1.2% | 4.2% | -3.0% | Banks |
| % to LMI Women | 10.4% | 8.0% | 2.4% | Fed CUs |
| % to Minority Tracts | 0.3% | 3.2% | -3.0% | Banks |
| % to LMI Tracts | 9.7% | 16.0% | -6.3% | Banks |
| % to LMI and/or Minority Tracts | 9.7% | 16.2% | -6.5% | Banks |
| Denial Disparity Ratios | | | FedCU/Bank Ratio | |
| Blacks to Whites | 2.89 | 2.22 | 1.31 | Banks |
| Hispanics to Whites | 4.72 | 2.05 | 2.31 | Banks |
| Minority to White Tracts | 6.36 | 1.97 | 3.22 | Banks |
| LMI to MUI Borrowers | 1.36 | 1.87 | 0.73 | Fed CUs |
| LMI to MUI Tracts | 1.54 | 1.70 | 0.91 | Fed CUs |
| Total Advantage | Fed CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 5 | 9 | 0 | 14 |

## Massachusetts - Banks vs. Federal Credit Unions
2001 Home Purchase Lending Trends

| Portfolio Share Indicators | Fed CUs | Banks/Thrifts | Perc. Pt. Diff | Advantage |
|---|---|---|---|---|
| % to Blacks | 1.7% | 3.1% | -1.3% | Banks |
| % to Hispanics | 1.3% | 4.8% | -3.5% | Banks |
| % to LMI Borrowers | 24.6% | 22.6% | 2.0% | Fed CUs |
| % to Women | 18.8% | 19.5% | -0.7% | Banks |
| % to LMI Minorities | 1.8% | 4.7% | -2.8% | Banks |
| % to LMI Women | 9.9% | 8.8% | 1.1% | Fed CUs |
| % to Minority Tracts | 0.5% | 3.2% | -2.6% | Banks |
| % to LMI Tracts | 9.6% | 15.7% | -6.1% | Banks |
| % to LMI and/or Minority Tracts | 9.6% | 15.9% | -6.3% | Banks |
| Denial Disparity Ratios | | | FedCU/Bank Ratio | |
| Blacks to Whites | 2.45 | 2.38 | 1.03 | Banks |
| Hispanics to Whites | 0.00 | 1.96 | 0.00 | discard |
| Minority to White Tracts | 0.00 | 1.98 | 0.00 | discard |
| LMI to MUI Borrowers | 2.10 | 2.05 | 1.02 | Banks |
| LMI to MUI Tracts | 1.85 | 1.79 | 1.04 | Banks |
| Total Advantage | Fed CU Adv. | Bank Adv. | No Difference | Total |
| Banks | 2 | 10 | 0 | 12 |

| Massachusetts - Banks v. State Credit Unions<br>2003 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Banks/Thrifts | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 2.2% | 2.7% | -0.5% | State CUs |
| % to Hispanics | 2.4% | 1.8% | 0.6% | Banks |
| % to LMI Borrowers | 25.9% | 30.2% | -4.3% | State CUs |
| % to Women | 17.2% | 17.5% | -0.3% | State CUs |
| % to LMI Minorities | 3.0% | 2.8% | 0.2% | Banks |
| % to LMI Women | 8.7% | 10.7% | -2.0% | State CUs |
| % to Minority Tracts | 3.7% | 3.1% | 0.6% | Banks |
| % to LMI Tracts | 12.8% | 14.8% | -2.0% | State CUs |
| % to LMI and/or Minority Tracts | 12.9% | 14.9% | -2.0% | State CUs |
| Denial Disparity Ratios | | | Bank/StateCU Ratio | |
| Blacks to Whites | 2.84 | 4.64 | 0.61 | Banks |
| Hispanics to Whites | 2.64 | 5.14 | 0.51 | Banks |
| Minority to White Tracts | 2.23 | 3.49 | 0.64 | Banks |
| LMI to MUI Borrowers | 1.67 | 2.48 | 0.67 | Banks |
| LMI to MUI Tracts | 1.95 | 2.59 | 0.75 | Banks |
| Total Advantage | Bank Adv. | State CU Adv. | No Difference | Total |
| Banks | 8 | 6 | 0 | 14 |

| Massachusetts - Banks v. State Credit Unions<br>2002 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Banks/Thrifts | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 2.0% | 3.0% | -1.0% | State CUs |
| % to Hispanics | 2.3% | 1.6% | 0.7% | Banks |
| % to LMI Borrowers | 20.2% | 23.8% | -3.6% | State CUs |
| % to Women | 15.2% | 17.0% | -1.8% | State CUs |
| % to LMI Minorities | 2.4% | 2.5% | -0.1% | State CUs |
| % to LMI Women | 6.6% | 9.4% | -2.8% | State CUs |
| % to Minority Tracts | 2.1% | 1.2% | 0.8% | Banks |
| % to LMI Tracts | 10.9% | 11.0% | -0.1% | State CUs |
| % to LMI and/or Minority Tracts | 11.1% | 11.2% | -0.1% | State CUs |
| Denial Disparity Ratios | | | Bank/StateCU Ratio | |
| Blacks to Whites | 2.80 | 3.66 | 0.77 | Banks |
| Hispanics to Whites | 2.68 | 5.97 | 0.45 | Banks |
| Minority to White Tracts | 2.15 | 2.73 | 0.79 | Banks |
| LMI to MUI Borrowers | 1.78 | 3.35 | 0.53 | Banks |
| LMI to MUI Tracts | 1.80 | 2.53 | 0.71 | Banks |
| Total Advantage | Bank Adv. | State CU Adv. | No Difference | Total |
| Tie | 7 | 7 | 0 | 14 |

| Massachusetts - Banks v. State Credit Unions<br>2001 Single Family Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Banks/Thrifts | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 2.1% | 1.5% | 0.6% | Banks |
| % to Hispanics | 2.6% | 3.5% | -0.8% | State CUs |
| % to LMI Borrowers | 20.4% | 21.0% | -0.7% | State CUs |
| % to Women | 15.5% | 16.5% | -1.0% | State CUs |
| % to LMI Minorities | 2.6% | 2.5% | 0.2% | Banks |
| % to LMI Women | 6.9% | 8.3% | -1.4% | State CUs |
| % to Minority Tracts | 2.3% | 1.4% | 0.8% | Banks |
| % to LMI Tracts | 11.8% | 12.5% | -0.7% | State CUs |
| % to LMI and/or Minority Tracts | 12.0% | 12.6% | -0.6% | State CUs |
| Denial Disparity Ratios | | | Bank/StateCU Ratio | |
| Blacks to Whites | 2.84 | 3.93 | 0.72 | Banks |
| Hispanics to Whites | 2.68 | 4.40 | 0.61 | Banks |
| Minority to White Tracts | 2.13 | 3.16 | 0.67 | Banks |
| LMI to MUI Borrowers | 1.82 | 2.72 | 0.67 | Banks |
| LMI to MUI Tracts | 1.81 | 2.34 | 0.77 | Banks |
| Total Advantage | Bank Adv. | State CU Adv. | No Difference | Total |
| Banks | 8 | 6 | 0 | 14 |

| Massachusetts - Banks v. State Credit Unions<br>2003 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Banks/Thrifts | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 3.2% | 3.0% | 0.3% | Banks |
| % to Hispanics | 4.7% | 2.6% | 2.1% | Banks |
| % to LMI Borrowers | 27.1% | 29.3% | -2.2% | State CUs |
| % to Women | 20.9% | 18.4% | 2.5% | Banks |
| % to LMI Minorities | 5.1% | 3.1% | 2.0% | Banks |
| % to LMI Women | 10.2% | 10.4% | -0.3% | State CUs |
| % to Minority Tracts | 5.9% | 2.7% | 3.3% | Banks |
| % to LMI Tracts | 18.6% | 15.3% | 3.3% | Banks |
| % to LMI and/or Minority Tracts | 18.8% | 15.4% | 3.4% | Banks |
| Denial Disparity Ratios | | | Bank/StateCU Ratio | |
| Blacks to Whites | 2.15 | 3.88 | 0.55 | Banks |
| Hispanics to Whites | 2.05 | 4.00 | 0.51 | Banks |
| Minority to White Tracts | 1.70 | 4.54 | 0.37 | Banks |
| LMI to MUI Borrowers | 1.54 | 2.58 | 0.60 | Banks |
| LMI to MUI Tracts | 1.67 | 2.61 | 0.64 | Banks |
| Total Advantage | Bank Adv. | State CU Adv. | No Difference | Total |
| Banks | 12 | 2 | 0 | 14 |

| Massachusetts - Banks v. State Credit Unions<br>2002 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Banks/Thrifts | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 3.2% | 2.9% | 0.3% | Banks |
| % to Hispanics | 4.9% | 2.2% | 2.7% | Banks |
| % to LMI Borrowers | 21.7% | 22.3% | -0.6% | State CUs |
| % to Women | 19.3% | 15.9% | 3.4% | Banks |
| % to LMI Minorities | 4.2% | 2.8% | 1.4% | Banks |
| % to LMI Women | 8.0% | 8.7% | -0.7% | State CUs |
| % to Minority Tracts | 3.2% | 0.7% | 2.5% | Banks |
| % to LMI Tracts | 16.0% | 12.5% | 3.5% | Banks |
| % to LMI and/or Minority Tracts | 16.2% | 12.5% | 3.7% | Banks |
| Denial Disparity Ratios | | | Bank/StateCU Ratio | |
| Blacks to Whites | 2.22 | 3.48 | 0.64 | Banks |
| Hispanics to Whites | 2.05 | 6.55 | 0.31 | Banks |
| Minority to White Tracts | 1.97 | 7.72 | 0.26 | Banks |
| LMI to MUI Borrowers | 1.87 | 4.11 | 0.46 | Banks |
| LMI to MUI Tracts | 1.70 | 2.62 | 0.65 | Banks |
| Total Advantage | Bank Adv. | State CU Adv. | No Difference | Total |
| Banks | 12 | 2 | 0 | 14 |

| Massachusetts - Banks v. State Credit Unions<br>2001 Home Purchase Lending Trends | | | | |
|---|---|---|---|---|
| Portfolio Share Indicators | Banks/Thrifts | State CUs | Perc. Pt. Diff | Advantage |
| % to Blacks | 3.1% | 3.2% | -0.1% | State CUs |
| % to Hispanics | 4.8% | 1.8% | 3.0% | Banks |
| % to LMI Borrowers | 22.6% | 18.9% | 3.7% | Banks |
| % to Women | 19.5% | 15.8% | 3.7% | Banks |
| % to LMI Minorities | 4.7% | 2.4% | 2.3% | Banks |
| % to LMI Women | 8.8% | 7.3% | 1.5% | Banks |
| % to Minority Tracts | 3.2% | 1.0% | 2.2% | Banks |
| % to LMI Tracts | 15.7% | 11.9% | 3.8% | Banks |
| % to LMI and/or Minority Tracts | 15.9% | 12.0% | 3.9% | Banks |
| Denial Disparity Ratios | | | Bank/StateCU Ratio | |
| Blacks to Whites | 2.38 | 3.54 | 0.67 | Banks |
| Hispanics to Whites | 1.96 | 1.88 | 1.04 | State CUs |
| Minority to White Tracts | 1.98 | 2.75 | 0.72 | Banks |
| LMI to MUI Borrowers | 2.05 | 2.07 | 0.99 | Banks |
| LMI to MUI Tracts | 1.79 | 2.86 | 0.62 | Banks |
| Total Advantage | Bank Adv. | State CU Adv. | No Difference | Total |
| Banks | 12 | 2 | 0 | 14 |

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Credit Union National Association

# NEWS

. . . from America's Credit Union Movement

**FOR IMMEDIATE RELEASE**
**May 19, 2005**

CONTACT: Patrick Keefe, CUNA Communications/(202) 508-6765; pkeefe@cuna.com

**CLAIMS OF NCRC REPORT REJECTED**
**BY LARGEST CREDIT UNION TRADE GROUP**

WASHINGTON – Claims in a report about credit union growth and lending to underserved communities have been *rejected* by the Credit Union National Association (CUNA) -- the largest credit union advocacy organization, representing more than 90 percent of our nation's approximately 9,000 state and federal credit unions and their 86 million members.

In rejecting the assertions made in the NCRC report released May 19 by the National Community Reinvestment Coalition, CUNA made the following points:

- ✓ The credit union mission and focus remain as true today as in 1934; in fact, as recently as 1998 Congress reaffirmed credit unions' mission and focus.
- ✓ Although credit unions have grown in the more than 100 years of their experience in the United States, they remain a relatively small part of the financial services industry. Further, the vast majority of credit unions remain relatively small institutions.
- ✓ Persons who use only credit unions for their financial services needs are typically people with net incomes, financial assets and net worth below those of persons who use only banks.
- ✓ The annual growth of credit unions pales in comparison to that of large banks, which grow as much as the entire credit union movement in one year.
- ✓ Very large credit unions are among the most committed to the credit union vision and focus, and many of them provide services to members that no bank would ever consider (particularly as the services are not cost effective).
- ✓ Appropriate analysis of data show that low income borrowers are substantially more likely to be approved for a mortgage at a credit union.
- ✓ For 70 years credit unions built their memberships primarily on the working population of the nation. Only recently have credit unions won the ability to serve more people who do not fall into occupationally defined fields of membership. However, in that 70-year period, credit unions developed a stellar reputation for serving ALL of their members; given time, credit unions will do the same with those members it has only recently begun adding to membership rolls.

Following are details of CUNA's response to the NCRC report:

**--more--**

*2-2-2-2-2-2*
***CREDIT UNION/CUNA RESPONSE TO NCRC REPORT***

## CREDIT UNION BACKGROUND

### *MISSION:*

In 1998, Congress passed the Credit Union Membership Access Act (HR 1151), which stated in its preamble that: ""*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.*" Credit unions today continue to meet this mission as outlined by Congress.

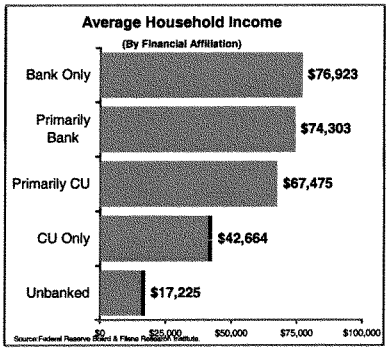
### *SIZE (at year-end '04):*

- ✓ More than three in every five credit unions (61.6 percent) has $20 million or less in assets (more than three out of every four -- 78 percent -- of all CUs had assets of $50 million or less)
- ✓ Only 2.7 percent of all credit unions had assets in excess of $500 million.

### *WHO USES CREDIT UNIONS?*

A Filene Research Institute publication titled "Who Uses Credit Unions" (updated in 2004; originally published in 1999), which uses Federal Reserve data, confirmed that the average net income, financial assets and net worth of people using only (or predominantly) credit unions are ALL below those of people using only (or predominantly) banks.

- ✓ Households with incomes of $200,000 or more are 68 times more likely to do their business ONLY with a bank rather than only with a credit union.
- ✓ Households with incomes between $100,000 and $200,000 are 23 times likely to do their business ONLY with a bank rather than only with a credit union.
- ✓ AVERAGE Household income for those using BANKS only is $77,000
- ✓ AVERAGE Household income for those using CUs only is $43,000




### *COMMITMENT OF LARGE CREDIT UNIONS:*

Large credit unions are among the most dedicated adherents of the credit union philosophy of "people helping people." For example, Navy Federal Credit Union, the world's largest, has approximately 530,000 member checking accounts with a balance of $100 or less, at the end of each month. Navy Federal offers financial education programs, credit counseling, and maintains branch facilities around the world—some of which operate at a financial loss—to better serve Navy and Marine Corps enlisted personnel, who are the heart of its membership.

***3-3-3-3-3-3***
***CREDIT UNION/CUNA RESPONSE TO NCRC REPORT***

## BANK BACKGROUND

*SIZE:*
The NCRC references three large bank holding companies (Citigroup, JP Morgan Chase and Bank of America). To show how outlandish is their comparison of these banks to credit unions, consider: If the assets of these BHCs were combined, the total ($3.07 trillion) would be greater than the individual Gross Domestic Products of **all** but six of the nations on earth (including Germany, the United Kingdom, France, Italy, Brazil, and Russia). (All figures as YE '04).

*GROWTH:*
Between 1992 and 2004, the nation's FDIC-insured banks grew by 140 percent (from $3.7 trillion in assets to $8.4 trillion). In 1992, total credit union assets were equal to 7.7 percent of total FDIC-insured bank assets (5.9 percent of all FDIC-insured institutions). In 2004, bank assets grew by $812 billion – more than 1.2 times the TOTAL ASSETS of credit unions! By 2004, CU assets were equal to 7.9 percent of bank assets (6.6 percent of all FDIC-insured institutions).

**Denial Disparity Ratios: A Poor Indicator of Discrimination**

NCRC says CU mortgage lenders have a higher denial disparity ratio than none-CU lenders and that this proves that CUs are not doing their jobs. But this is a poor indication of discrimination.

**2003 HMDA Data Overview**
(For FHA/VA/FSA/RHS, Conventional, and Refinancings)

| Income analysis | CU Lenders | Non-CU Lenders | CU/Non-CU |
|---|---|---|---|
| **Low income**** | | | |
| Low-income denial rate | 15.6% | 27.0% | 58% |
| Non-low income denial rate | 5.6% | 12.9% | 43% |
| Low/non-low denial disparity ratio | 2.79 | 2.09 | 134% |
| Low-income approval rate | 72.2% | 47.8% | 151% |
| Non-low income approval rate | 84.0% | 62.1% | 135% |
| Low/Non-low approval disparity ratio | 0.86 | 0.77 | 112% |
| Low-inc. apps/Total L&NL apps | 5.1% | 5.5% | 93% |

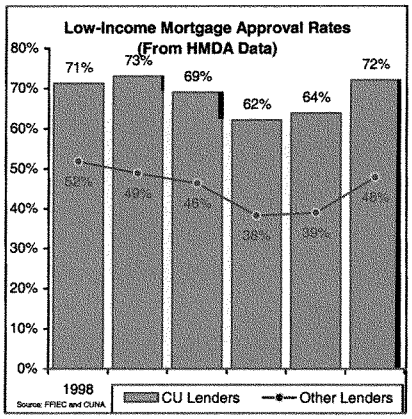
** Low-income: Borrowers with less than 50% of MSA median income. Non-low income: All others except "not available".
Source: FFIEC and CUNA P&S.

Indeed, NCRC methodology fails to recognize that the CU denial rate among low-income borrowers is about 43% lower than at other lenders. And, conversely, that low-income borrowers are substantially more likely to be approved for a mortgage at a CU.

## LOW-INCOME LENDING

*ACCURATE DATA INTERPRETATION:*
NCRC typically uses analysis of denial discrepancies to make their claims about credit unions and banks. Reliance on such analysis is misleading. A more useful analysis is to compare denial or approval rates for given groups across lenders. Data from 2003 HMDA reports show that low income borrowers are substantially more likely to be approved for a mortgage at a credit union.

*APPROVAL/DENIAL RATES:*
In 2003, credit unions approved 72.2 percent of home mortgage loans to low-income borrowers (up from 69 percent in 2000). By contrast, non-CU lenders approved only 47.8 percent of such loans (up from 46 percent in 2002). In 2003, CUs denied 15.6 percent of mortgage loans to low-income borrowers. Non-CU lenders denied 27.7 percent of the loans to low-income borrowers.




*OVER TIME:*
From 1998 to 2003, credit union lender approval rates have outdistanced those of non-CU lenders each year, and never by less than a difference of 19 percent (2003 was the greatest difference – 34 percent).

*STATE-BY-STATE APPROVALS:*
In fact, approval rates in every state by CU lenders (in 2003) were GREATER than that of non-CU lenders, for low-income and non-white members. (See charts at end.)

**CREDIT UNION MEMBERSHIP AMONG LOW INCOME BORROWERS**

*TRADITIONAL FOCUS:*
For 70 years, credit unions built their memberships on the working population of the nation as an expedient organization strategy but mostly because law and regulation sharply restricted CU membership.

*ADDING MORE WORKERS TO MEMBERSHIP:*
Over the past two decades, more working Americans were extended CU services through SEGs. Consequently, credit unions excelled at serving all of their members, including those of modest means, who fall within these relatively restricted membership qualifications.

*OPENING THE DOORS TO UNDERSERVED POPULATIONS:*
Passage of HR 1151 in 1998 gave occupational-based CUs (those serving working people) a streamlined way to add geographic areas to their memberships that are "underserved." This provision gives credit unions an opportunity to expand their experience in serving persons from all walks of life – including the lowest income levels – without those potential members having to fall into an occupationally defined field of membership. In other words, more people (including those who are "unbanked") have only recently become eligible for credit union membership and can avail themselves of credit union services. NCUA reports that more than 20 million more people are now eligible for membership.

-- more --

*5-5-5-5-5-5*
***CREDIT UNION/CUNA RESPONSE TO NCRC REPORT***

**Low Income Mortgage Applicant**
**Approval Rates by State in 2003**

| State | CU Lenders | Non-CU Lenders |
|---|---|---|
| Alaska | 62% | 53% |
| Alabama | 70% | 46% |
| Arkansas | 65% | 51% |
| Arizona | 58% | 50% |
| California | 70% | 46% |
| Colorado | 73% | 49% |
| Connecticut | 79% | 48% |
| District of Columbia | 57% | 56% |
| Delaware | 82% | 44% |
| Florida | 71% | 47% |
| Georgia | 61% | 52% |
| Hawaii | 66% | 57% |
| Iowa | 76% | 49% |
| Idaho | 76% | 56% |
| Illinois | 69% | 49% |
| Indiana | 76% | 52% |
| Kansas | 81% | 49% |
| Kentucky | 77% | 53% |
| Lousiana | 45% | 41% |
| Massachusetts | 80% | 51% |
| Maryland | 62% | 48% |
| Maine | 79% | 49% |
| Michigan | 78% | 49% |
| Minnesota | 81% | 52% |
| Missouri | 80% | 51% |
| Mississippi | 43% | 42% |
| Montana | 71% | 56% |
| North Carolina | 70% | 48% |
| North Dakota | 79% | 63% |
| Nebraska | 82% | 53% |
| New Hampshire | 79% | 47% |
| New Jersey | 71% | 47% |
| New Mexico | 83% | 47% |
| Neveda | 81% | 50% |
| New York | 78% | 42% |
| Ohio | 75% | 50% |
| Oklahoma | 58% | 48% |
| Oregon | 69% | 52% |
| Pennsylvania | 61% | 46% |
| Rhode Island | 75% | 44% |
| South Carolina | 56% | 45% |
| South Dakota | 69% | 60% |
| Tennessee | 70% | 46% |
| Texas | 59% | 35% |
| Utah | 72% | 46% |
| Virginia | 70% | 52% |
| Vermont | 85% | 68% |
| Washington | 77% | 52% |
| Wisconsin | 83% | 55% |
| West Virginia | 80% | 50% |
| Wyoming | 77% | 49% |

Source: FFIEC HMDA data, CUNA E&S.

**Non White Mortgage Applicant**
**Approval Rates by State in 2003**

| State | CU Lenders | Non-CU Lenders |
|---|---|---|
| Alaska | 70% | 55% |
| Alabama | 67% | 45% |
| Arkansas | 76% | 48% |
| Arizona | 60% | 43% |
| California | 64% | 57% |
| Colorado | 69% | 51% |
| Connecticut | 79% | 55% |
| District of Columbia | 75% | 64% |
| Delaware | 78% | 49% |
| Florida | 76% | 61% |
| Georgia | 69% | 56% |
| Hawaii | 78% | 69% |
| Iowa | 81% | 68% |
| Idaho | 73% | 62% |
| Illinois | 74% | 58% |
| Indiana | 80% | 56% |
| Kansas | 85% | 53% |
| Kentucky | 78% | 51% |
| Lousiana | 54% | 49% |
| Massachusetts | 80% | 54% |
| Maryland | 75% | 51% |
| Maine | 71% | 51% |
| Michigan | 74% | 53% |
| Minnesota | 78% | 54% |
| Missouri | 82% | 51% |
| Mississippi | 60% | 44% |
| Montana | 82% | 48% |
| North Carolina | 73% | 49% |
| North Dakota | 74% | 53% |
| Nebraska | 89% | 51% |
| New Hampshire | 79% | 51% |
| New Jersey | 70% | 55% |
| New Mexico | 80% | 53% |
| Neveda | 77% | 52% |
| New York | 78% | 51% |
| Ohio | 73% | 51% |
| Oklahoma | 66% | 50% |
| Oregon | 75% | 57% |
| Pennsylvania | 55% | 48% |
| Rhode Island | 77% | 53% |
| South Carolina | 55% | 44% |
| South Dakota | 78% | 53% |
| Tennessee | 73% | 45% |
| Texas | 71% | 47% |
| Utah | 65% | 40% |
| Virginia | 76% | 57% |
| Vermont | 79% | 48% |
| Washington | 83% | 59% |
| Wisconsin | 88% | 54% |
| West Virginia | 84% | 53% |
| Wyoming | 72% | 52% |

Source: FFIEC HMDA data, CUNA E&S.

**ICBA's Response to the Report by the National Community Reinvestment Coalition (NCRC) entitled "Credit Unions: True to Their Mission?"**

Submitted to the House Financial Services Committee
In Response to a Question from
Rep. Ruben Hinojosa

Independent Community Bankers of America (ICBA)[1] agrees with the conclusions of the 2005 Report by the National Community Reinvestment Coalition ("NCRC") entitled "Credit Unions: True to Their Mission?" NCRC's three year analysis concludes that banks consistently exceed credit unions' performance in lending to women, minorities, and low- and moderate-income borrowers and communities. NCRC scrutinized lenders' performance during the years 2001-2003 on 14 fair lending measures including the percent of loans to different groups of borrowers and the differences in denial rates to minorities versus whites and low- and moderate income borrowers versus middle- and upper-income borrowers. When considering the important category of home purchase lending, credit unions significantly lagged banks in just about every lending measure both on a state and national level.

The NCRC's Report confirms numerous studies that have been published over the years that show that credit unions are not fulfilling their mission of serving low- and moderate-income people. The Federal Reserve's 2001 Survey of Consumer Finances revealed that only 36% of the households that primarily used credit unions had low- and moderate-incomes in contrast to 42% of the households that primarily used banks. In 2003, the Government Accountability Office (GAO) released a report finding that banks provided 34% of their mortgage loans to low- and moderate-income borrowers while credit unions issued just 27% of their loans to these borrowers. Recent independent research by the nonpartisan Tax Foundation estimates a $31 billion tax loss to the U.S. Treasury from the credit unions' special tax subsidy over the next ten years, yet finds no evidence that credit unions used this tax subsidy to better serve low and moderate income people - a prime reason for their special tax status.

Furthermore, the credit union industry is pursuing an expansionist policy that that is not consistent with the credit unions' historic mission, or their favored tax status. Credit unions are actively expanding into the commercial lending business and are

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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.*

*With nearly 5,000 members, representing more than 17,000 locations nationwide and employing over 260,000 Americans, ICBA members hold more than $631 billion in insured deposits, $778 billion in assets and more than $493 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.*

pressing support of H.R. 2317, the Credit Union Regulatory Improvement Act (CURIA), that would raise the current statutory cap on "member business loans" to 20% of a credit union's net worth, up from 12.25%; double the limit on loans exempt from this cap to $100,000 from $50,000; and weaken the restriction on undercapitalized credit unions from making business loans. Community bankers object to expansion of credit union powers so long as they have unfair tax advantages.

The conclusions of the NCRC Report and other studies like it provide ample evidence that unfair credit union expansion should be stopped and that credit unions should be subject to the same laws and regulations that banks and thrifts are subject to, and that includes the obligation to comply with the Community Reinvestment Act and pay taxes.

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