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H.R. 3505, FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005

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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H.R. 3505, FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005

Thursday, September 22, 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, Royce, Kelly, Ryun, Oxley, Biggert, Feeney, Hensarling, Neugebauer, McHenry, Sanders, Maloney, Watt, Sherman, Meeks, Moore of Kansas, Frank, Hooley, McCarthy, and Green.

Chairman BACHUS. [Presiding.] Good morning. The Financial Institutions Subcommittee of the Financial Services Committee will come to order.

We have an esteemed group of panelists today.

Our focus today is on H.R. 3505, the Financial Services Regulatory Relief Act of 2005, which alters or eliminates unduly burdensome or outdated regulatory requirements. It was introduced by Congressman Hensarling and Congressman Moore in July, with numerous bipartisan cosponsors. It seeks to reduce the regulatory burden on our insured depository institutions to benefit customers and the economy by lowering costs and improving productivity.

Let me simply say that this legislation—I know that Congressman Hensarling, Congressman Ryun is here—there are several provisions that he has worked on. He had also introduced legislation, and many of those provisions are incorporated in this legislation. Plus, we will be considering proposals that you have made.

We also have legislation by Mr. Royce and Mr. Kanjorski dealing in particular with the credit unions. I would like to compliment them on their participation.

We have had tremendous cooperation from the ranking member of this committee, Mr. Sanders, in putting this package together. Also, it is my understanding, and I have some knowledge of this, that we have been consulting with not only industry and consumer groups, but also with the regulatory agencies. In one case, my personal staff as a result of both the regulatory agency and the industry expressing for some time that probably clearly one of the most onerous burdens on our financial institutions from a cost standpoint is the $35 billion in regulations.

The complaint that I have heard for years and years was about the currency transaction reports. I heard it time and time again. I have heard Members of the other body in speeches before the Senate and the House express the hope that we could come up with some proposal for seasoned business customers where banks could certify customers and banks would not have to be continually filing these currency transaction reports.

As most of the regulatory agencies before us today have expressed to this committee and to the Senate and law enforcement has many times testified before us that they have not been able to review these. Sometimes these are gone through in 4 years. We have also heard from banking institutions where they would notify law enforcement agencies of a transaction and they simply say that they are so overburdened by the number of these things that they never got back and investigated them and testimony from law enforcement agencies that it is several years before they ever look at these things, if then.

As a result of that, Mr. Fox and I met probably 3 months ago in my office. I expressed to him some of the concerns that I had. He I know talked to Members of the Senate that I was aware of. I talked to Members of the Senate, particularly Mr. Crapo who had expressed on many occasions that it was a priority for him. In working with the regulators over the past month or two and with the banking industry, Mr. Fox and I, and I know Mr. Hensarling has been involved in this on a day-to-day basis, and Mr. Frank also, and members on both sides. I know the Senate was aware of that because I had conversations with them.

We came up with wording that I think advances this issue light years. It is absolutely, of all the provisions in this, I think it has the potential to make law enforcement much more efficient and effective, to take what has been a very burdensome and really outdated and outmoded practice of every time a citizen of this country, whether they are a businessman that deposits $10,000 every day or twice a day, where they have to file a report every day. These things are filed by the hundreds of thousands and never looked at.

I would like to applaud Mr. Fox and FinCEN for their dedication in working with everyone to fashion what I consider a very good provision, which Mr. Hensarling has also worked on, and I know Senator Crapo in the Senate. I would assume that he has kept the other Members of the Senate informed on these actions. To me, it absolutely has no downside and will make law enforcement that much more effective.

With that, I will yield to Mr. Sanders.

[The prepared statement of Hon. Spencer Bachus can be found on page 42 in the appendix.]

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

I would like to welcome our witnesses today as well.

Today, we will be discussing H.R. 3505, the Financial Services Regulatory Relief Act of 2005, introduced by Mr. Hensarling and Mr. Moore. I am delighted that this legislation includes a provision which I authored to provide a Community Reinvestment Act credit to financial institutions to expand employee ownership.

I want to thank Chairman Bachus very much for his strong support for this provision and his working with me for a rather long period of time. Thank you very much, Mr. Chairman.

Providing a CRA credit for the expansion of employee ownership is, I believe, a win-win situation. 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, workers who are also owners will not be shipping their jobs to China or abroad, so those of us who are concerned about the decline of manufacturing in the United States and the loss of good-paying jobs I think will see some improvement if working people in this country are actually able to own the places that they work.

Broad-based employee ownership has been proven to increase employment, increase productivity, increase sales, and increase wages in the United States of America. It gives a lot of pride to people in the fact that they can make decisions in the places that they work. I think it is the essence of what democracy is about as well.

H.R. 3505 also includes 15 important regulatory reforms that will allow credit unions to better serve their members, including a section to allow credit unions to cash checks and wire funds to anyone who is eligible to join their credit union. So long as the employee ownership in credit union provisions are kept in H.R. 3505, I will be strongly supporting this legislation.

Mr. Chairman, as you know, during the 108th Congress I opposed a similar regulatory relief bill because of the absence of meaningful consumer protections, but this year's regulatory relief bill is a major improvement over last year's version and I would like to thank you, Ranking Member Barney Frank, and the authors of the legislation for their excellent work on this bill.

Having said that, Mr. Chairman, I also believe that it is very important for this subcommittee to seriously examine the deceptive and misleading credit card scams perpetrated by some of the largest banks in America. I know you and I have discussed this. I think there is a growing outrage throughout our country when working people are now paying 25 percent or 28 percent interest rates, when there are five billion proposals going out in the mail, many of them misleading. I think when we talk about relief, we also have to talk about relief from consumers who are paying usurious interest rates today.

So, Mr. Chairman, I am supportive of this legislation. Thank you for your good work, but I hope that we can return to the issue of how we protect consumers from outrageously high interest rates on their credit cards.

[The prepared statement of Hon. Bernard Sanders can be found on page 56 in the appendix.]

Chairman BACHUS. I appreciate the ranking member, and I can assure you that I, for one, am very committed to what is a practice. I think it is among a limited number of institutions of pretty blatant bait-and-switch in credit card practices. I hope that we can enlist other members of the committee in this effort.

Chairman Oxley?

Mr. OXLEY. Thank you, Chairman Bachus. We appreciate your holding this hearing on H.R. 3505.

We look forward to hearing today from the Federal and State regulatory authorities charged with ensuring the safety and soundness of our Nation's banking, thrift, and credit union industries.

The financial services industry is operating under a heavy regulatory burden. While many of the regulations imposed on the industry are necessary to protect consumers, combat terrorist financing, or service other worthy public policy objectives, others are clearly outdated or needlessly burdensome.

For this reason, shortly after I assumed the chairmanship of this committee, I asked the financial regulators and industry trade groups to give us their best advice on what this committee could do to ease regulatory requirements faced by depository institutions. The goal was to lessen the regulatory burden and improve productivity, as well as make needed technical corrections to current statutes.

It was clear then, as it is today, that there also needs to be a counter-balance to the significant compliance responsibilities placed on insured depository institutions by the USA Patriot Act, as well as other Government efforts to counter terrorist financing.

In the last Congress, the committee approved a comprehensive regulatory relief bill that passed the House by a vote of 392 to 25. H.R. 1375, which incorporates suggestions for financial regulators, as well as the financial services industry, contained a wide range of provisions that would have relieved unneeded or outdated regulatory restrictions on banks, thrifts, and credit unions.

While the Senate failed to take up H.R. 1375, I am pleased that two respected members of this committee, Mr. Hensarling and Mr. Moore, introduced H.R. 3505, which includes virtually all of H.R. 1375 from last session, a new title that addresses Bank Secrecy Act concerns, and over 20 new provisions.

The Bank Secrecy Act compliance burden reduction title addresses financial institutions' concerns that some of the work they are being asked to do in the fight against financial crimes is unnecessary and overly burdensome. I agree. This title focuses on reducing the number of currency transaction reports, CTRs, that must be filed by institutions involving large sums of cash, as well as eliminating inconsistencies or duplicative requirements in conjunction with the filings of SARs, suspicious activity reports.

I would like to thank FinCEN Director Fox who is testifying today, Mr. Hensarling from Texas, Chairman Bachus, as well as Mr. Frank and Mr. Gutierrez for their efforts in creating Title VII, which balances law enforcement's needs with the industry's very real concern about excessive and unnecessary burdens. I thank the witnesses for appearing here and I look forward to their thoughts on how best to free depository institutions from unduly burdensome regulation so they can better serve their customers and communities.

Mr. Chairman, we are very hopeful that we can move this bill with some alacrity and get it to the other body. Senator Crapo, among others, has expressed a sincere interest in moving this. We think we will get a large vote in the committee, as well as on the floor. We need to push this to its conclusion and get the President's signature. I know you are committed to that effort, along with

other members of this committee. This is critically important legislation.

I thank you for your leadership, and I yield back.

[The prepared statement of Hon. Michael G. Oxley can be found on page 40 in the appendix.]

Chairman BACHUS. I thank the chairman.

I recognize the ranking member of the full committee, Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman.

Let me begin by saying I share Chairman Oxley's hope that we can get this bill quickly to the floor and passed. For that reason, I will be tepid in my endorsement of it because precedent suggests that if I sound enthusiastic about the bill, knees might jerk and then they would not want to pass it.

[Laughter.]

So I will reluctantly acquiesce in sending this bill to the floor, lest I be a poisoned pill.

It does seem to me to hit the appropriate level of regulation. Those of us who believe there is an important role for regulation should be very clear that excessive regulation undoes that case. If you overburden things, you undermine your case. You put costs on society. I am very pleased, and I congratulate all concerned, the people at FinCEN and the people at the American Bankers Association, under the leadership of this committee in a bipartisan way.

Obviously, the Bank Secrecy Act these days, with legitimate concerns about terrorism and the financing of terrorism, we want to make sure that works well. I congratulate those who were willing to say what is true, but could be demagogued against, namely that excessive reporting undercuts law enforcement. If you bury the law enforcement people with a lot of reporting and a lot of paper that really is fairly routine, you make it harder rather than easier to get at what should get it.

So I am very pleased that we appear to be getting to the point where we are prepared to cut back some of the underbrush so we can focus on what should be the real subject. I very much agree with what the ranking minority member of the subcommittee said.

Because I have some other things I will be going to later, I will not be able to be here for all this, but I did want to particularly comment on a couple of points.

I am very pleased, Mr. Chairman, that you included in this panel of our very able Federal regulators a representative of the Conference of State Bank Supervisors. We should be very inclusive here.

I was especially pleased to note a couple of the points that the State bank supervisors made. I was gratified to have them say what I think is a very important point, namely that what we did with the Fair Credit Reporting Act showed how you reach a proper balance between national regulation and States. That is, if we can achieve a reasonable national level of consumer protection, then you can make it a national standard. Yes, there is an argument for national uniformity. It should not be, however, a shield behind which you undercut legitimate protection of consumers.

The Texas regulators said, we urge Congress to apply this approach to as wide a range of banking statutes as possible. I agree. I also very much agree with the point that the State regulator

ought to be a voting member of the FFIEC. I think that is a perfectly reasonable thing. The interactivity of Federal and State regulation is one of the most challenging intellectual and economic and legal issues we have. I think that would be very useful. There is no danger that one voting member is doing to have disproportionate weight with all the other regulators.

Finally, I appreciate also their pointing out what we need to do, namely, ″to review the disparity in the application of State laws to State and nationally chartered banks and their subsidiaries.″ I think as the result of several decisions of the comptrollers and others, we have a situation now where we really have to step in. Technology has been a factor and the global economy.

I think the time has come where this Congress, obviously not for the rest of this year, but next year, ought to take this up. I know there are others who believe that. The gentlewoman from New York, Ms. Kelly, has been very concerned about that as Chair of the Oversight Subcommittee and others. I think it is our responsibility now to frankly straighten out some tangles that only we can straighten out, that only by a statute can it be done. It is just not something that can be done within the existing regulatory framework.

So I thank you, Mr. Chairman. This is a very constructive effort, and I look forward to our being able to complete it.

Chairman BACHUS. Thank you, Mr. Frank.

At this time, I recognize Mr. Ryun, who has several provisions of the bill he has worked very hard on.

Mr. RYUN. Mr. Chairman, thank you. Thank you for your kind comments toward my bill, the Communities First Act. I appreciate your doing this hearing.

Our financial institutions are increasingly overburdened with regulations and reporting requirements. H.R. 3505 is a good bill that provides a comprehensive approach to addressing some of the more cumbersome regulations. I support H.R. 3505 and will look forward to working with this committee to approve its passage.

Specifically, I believe that our community banks face a disproportionate burden due to excessive regulations. These institutions serve our small towns and rural areas and often lack the manpower to readily fulfill all the reporting that is required of them. The result is less time and resources to do the work of serving the communities.

It is with this in mind that I introduced the Communities First Act, which was aimed to provide much-needed regulatory relief to these institutions. To date, 72 of my colleagues on both sides of the aisle have cosponsored this bill. I want to thank Mr. Hensarling and Mr. Moore for including five of the provisions from the Communities First Act in the legislation that we are considering today.

In summary, these provisions provide targeted relief to community banks in the form of adjusted reporting and examination intervals, as well as updated asset limits for certain regulatory requirements. I am pleased to see these provisions incorporated in the bill. As we move forward with this effort, I will work with the committee to make the bill even stronger and will advocate inclusion of additional measures from the Communities First Act.

Specifically, for example I would like to see approved a regulation I believe that agencies should specifically consider the ramifications that it would have upon community banks if approved. Agencies are currently not required to consider this factor, although I am aware that the OCC does have a policy of doing so before its approval process. Section 109 of the Communities First Act would require all regulatory agencies to consider the impact on community banks as they approve new regulations. I hope the committee will consider including this common sense requirement in the final version of H.R. 3505.

Mr. Chairman, thank you very much for holding this hearing. I want to thank our panel for coming today. I look forward to your comments, and I yield back my time.

Chairman BACHUS. Thank you, Mr. Ryun.

Ms. Maloney?

Mrs. MALONEY. I thank Chairman Bachus and Ranking Member Sanders and Chairman Oxley and Ranking Member Frank and all of the authors of the bill, my colleague Mr. Moore and others.

This is a tremendously important bill. The fact that it had so much support when it was introduced today, the fact that it passed, and that we are building support in the Senate I think is extremely important. As a representative of New York City, which is one of the financial centers in our country, I am really very concerned, as are my constituents, about the tremendous burdens and regulation and reporting requirements imposed on our financial institutions, and particularly those financial institutions that are not mega-institutions, but are mid-size and smaller.

This bill is an improvement over the one that we passed overwhelmingly last year. It has new additions in consumer protection, expanding CRA to employee stock ownership. But of special concern to me is the extraordinary burdens of compliance with the new Bank Secrecy Act provisions. Many of them are a duplication. FinCEN supports these changes. The FBI and those that are responsible for tracking money-laundering and anti-terrorism efforts support it because it had become so burdensome that it was no longer effective.

I can tell you that wherever I go in my district, particularly the smaller institutions tell me how very, very hard and how very costly it is to comply with the Bank Secrecy Act, the CTRs, the SARs, and the other new oversight provisions that were put in place after 9/11. Many of them say that the cost of complying is just so incredible that it almost runs them out of business. So this bill includes a new section that addresses these concerns. I feel that it is a very important one.

I want to also note that the provisions from H.R. 2317, the Credit Union Regulatory Improvement Act, which I am a cosponsor and a supporter in several of its incarnations, and I hope that we will also move forward to pass the remaining portions of CURIA, and especially the reforms to the prompt corrective actions system.

So I ask permission to revise and extend my remarks, and I congratulate all who have moved this to this hearing today. Thank you.

[The prepared statement of Hon. Carolyn B. Maloney can be found on page 53 in the appendix.]

Chairman BACHUS. Thank you, Ms. Maloney. I would like to associate myself with your remarks, too. Thank you.

At this time, I recognize the sponsor of the legislation, along with Mr. Moore. Mr. Hensarling?

Mr. HENSARLING. Thank you very much, Mr. Chairman. Thank you for holding this important hearing and thank you for your leadership in helping Congress reduce the regulatory burden on our Nation's financial institutions.

A very special thank you to Chairman Oxley for his leadership and his dogged determination to move this legislation along and to put it on the fast track and especially for allowing me to participate in this process.

As we have learned in our hearings over the past few months, financial institutions are in desperate need of regulatory relief. Most of the regulations we have imposed upon them have costs that are ultimately borne by the consumer in some form or fashion. Many have outlived their purposes. Many have significant unintended consequences.

We do know that these often excessive and duplicative and costly regulations at the end of the day can make credit more expensive and less accessible for the people who need it the most. Outdated regulations can keep Americans from purchasing their first home, buying an automobile for work, financing a child's education, or starting a small business that creates new jobs in an economically disadvantaged area of our Nation.

I believe the bill that Mr. Moore and I have introduced helps remedy a number of these problems and will help banks, credit unions, and thrifts free up more capital to inject into their communities. Action is necessary sooner rather than later. The competitive position and viability of our smaller financial institutions are in question. The regulatory environment has evolved to the point of placing smaller financial institutions at a competitive disadvantage. This, of course, is to the detriment of their primary customers: small businesses, consumers, and the agricultural community.

Previously, we have heard testimony that the regulatory compliance burden averages 12 to 13 percent of a financial institution's non-interest expense. Added to that is a new study that was released Monday by the SBA showing that the smallest businesses in our country face the largest per-employee burden as far as regulatory compliance costs are concerned. Firms with fewer than 20 employees are now spending almost $8,000 per employee to comply with Federal regulations. The study also noted that small businesses face a 45 percent greater burden than their larger business counterparts.

This same report showed that the annual cost of Federal regulations in the U.S. totaled $1.1 trillion in 2004. If only 1 percent of that could be returned to the marketplace, that would be enough money to provide startup capital for almost 500,000 new businesses or pay the annual salaries for 250,000 workers. Since 1989, bank regulators have promulgated over 850 regulations. That is around 50 new regulations a year that banks must comply with.

Can we really expect our small community-based financial institutions to keep up that pace? They are required to send out annual

privacy notices to alert customers to information that oftentimes the institutions do not even share. Is that really necessary? We have heard that community financial institutions are often hiring two to three full-time employees to do nothing but Bank Secrecy Act compliance. Is that really necessary?

I am pleased now that many of our regulators and law enforcement officials have recognized that a reduction in the number of CTRs and SARs that are sent to Washington can actually benefit anti-money-laundering and anti-terrorist financing efforts. I am especially pleased with FinCEN's leadership in this effort. Financial institutions should not have to continuously file paperwork and reports of suspicious activity on the customers they know the best.

The time has come to clean the regulatory barnacles off this ship of commerce and allow our financial institutions to operate at full speed, safely, and soundly.

Thank you, Mr. Chairman. I yield back.

[The prepared statement of Hon. Jeb Hensarling can be found on page 48 in the appendix.]

Chairman BACHUS. Thank you, Mr. Hensarling.

Mr. Moore?

Mr. MOORE OF KANSAS. Thank you.

I would like to thank my good friend Chairman Bachus for scheduling today's hearing on the regulatory relief bill, H.R. 3505, introduced by Congressman Hensarling and myself and cosponsored by approximately 30 members from both sides of the aisle.

I also want to thank Chairman Oxley for his strong support and Ranking Member Barney Frank for his lukewarm support to avoid knee-jerk reactions.

[Laughter.]

The Financial Services Committee has a strong record of bipartisanship and I am glad that that has extended to this bill as well. Reg 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 an important role in expanding homeownership and creating opportunities for businesses and consumers. Small lenders in our communities particularly feel the burden of unnecessary regulations.

As the Federal banking regulators acknowledged in a notice published in the Federal Register, ″When a new regulation is created or an old regulation is changed, small institutions must devote a large percentage of their staff's time to review the regulation to determine if and how it will affect them. Compliance with a regulation also can take large amounts of time that cannot be devoted to serving customers or business planning.″

Strong regulation of our country's financial system is absolutely essential, but Congress and the financial regulators have a responsibility to strike the right balance in this area. I believe H.R. 3505 is an important step in the right direction. Since coming to Congress, and particularly over the last few months, I have heard from depository institutions in my district and throughout the State of Kansas. We have tried to address in H.R. 3505 some of the concerns that I have heard on more than one occasion.

While assets for State-chartered banks in Kansas have reached an all-time high of $27 billion, our community bankers are also

struggling to comply with both old and new regulatory burdens, including some created under the Bank Secrecy Act. H.R. 3505 seeks to provide relief from some of these new burdens to our financial institutions in a way that preserves our ability to effectively track terrorist financing and build upon our success in freezing the funds of terrorists.

Representative Hensarling and I and the bill's bipartisan cosponsors agree that waging a strong war on terror and providing some reg relief to our financial institutions are not incompatible goals. Additionally, H.R. 3505 provides two new sections of reg relief for our credit unions that were not included in the previous version of this measure. This subcommittee and the full committee both passed the reg relief bill by voice vote during the 108th Congress and the House passed it 1 year ago by a wide margin, 392 to 25.

I look forward to continuing the broad bipartisan cooperation on this legislation that we have enjoyed in the past. I also look forward to hearing from our witnesses today on what steps the regulatory agencies have taken to ensure that depository institutions in the areas affected by Hurricane Katrina are able to continue operating both for their benefit and for the benefit of their customers who are going through some of the toughest times in their lives.

Thank you again, Mr. Chairman. I look forward to hearing from our witnesses.

[The prepared statement of Hon. Dennis Moore can be found on page 54 in the appendix.]

Chairman BACHUS. Thank you, Mr. Moore.

Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Chairman Bachus, for holding this important hearing.

I also want to thank Congressman Hensarling and Congressman Moore for bringing this bill forward, H.R. 3505. When you speak in the order that I have, many of the folks I want to attribute myself to their remarks. I think I come from a district that relatively has a lot of small community banks and credit unions. One of the things that I keep hearing over and over and over again is that we are making it more and more difficult for the smaller financial institutions really to remain profitable.

Some people up in Washington think that ″profit″ is a four-letter word, but I will tell you that ″loss″ is a four-letter word. We need to make sure that our financial institutions are profitable, that they are healthy. I was thinking earlier, we have almost gotten to the point now where you go up to the teller cage and the sign there says ″closed; we are filling out paperwork.″ We almost have gotten to the point now where the primary function of our financial institutions is to fill out paperwork for the Federal Government.

We need to get community banks and credit unions back doing what they do best, and that is they know their customers. They take care of their customers; they invest into their communities. The more and more paperwork that we generate and the more and more regulation and the more and more capital that they have to attribute to filling out paperwork and complying with regulation is the less capital that they can invest in those communities.

So I commend the chairman and the two gentlemen for bringing this important legislation. I look forward to supporting it. Hope-

fully, this is just the beginning. This is I think a really good start, but when you think about, as the gentleman said, 851 new regulations since 1989. I got out of banking in 1983 and I thought there was plenty of regulation on the books at that time, so it looks like they have added a little bit more.

So I look forward to the witnesses bringing important testimony for us today.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Neugebauer, for those remarks.

Ms. McCarthy?

Mrs. MCCARTHY. Thank you, Mr. Chairman.

I am waiting to listen to the witnesses. Thank you.

Chairman BACHUS. Ms. Kelly?

Mrs. KELLY. Thank you, Mr. Chairman.

This is an important hearing about regulatory relief for financial institutions and their customers. I look forward to hearing from our witnesses on the steps that this committee could be taking to lower the cost to consumers and to help create jobs in the industry.

I want to thank my colleagues, Mr. Hensarling and Mr. Moore, for their work on the legislation. I note here the presence of the FDIC among the witnesses. I want to draw their attention to the GAO report on industrial loan corporations and urge them to keep that report in mind when they are reviewing requests for coverage by new depository institutions. There are obviously a number of important provisions in this bill. I am very interested in discussions about proposed changes to the Bank Secrecy Act. There are very good reasons for advocating reform for our BSA system.

We have learned the hard way that the system needs work. Failures, such as the Riggs Bank and more recently Arab Bank, have clearly demonstrated that there are weaknesses in our anti-money-laundering protections. The resulting over-reaction and uncertainty about what is expected of financial institutions has led to unnecessary burdens and costs that really must be addressed.

We know financial institutions and their customers want common sense. They want certainty. We in Congress know the system can be made better. We have to work toward solutions that will remove unnecessary burdens from customers and institutions without weakening an important tool for law enforcement and national security officials. Just as we are mindful of the serious, costly inconveniences that have saddled financial institutions and their customers, we are also keeping our eyes on the importance of an effective anti-money-laundering system in our national security.

As this action begins on this legislation, we have to be mindful of what the 9/11 Commission told this committee last year when they sat before the committee about the value of the BSA system in fighting terrorism. We must be mindful of what the FBI and FinCEN Director Fox told this committee earlier this year about the utility of the BSA information in tracking criminals and terrorists.

I look forward to examining these proposals in detail. I look forward to hearing the views of those affected, including the relevant law enforcement and intelligence agencies.

I thank you, Mr. Chairman, very much for holding this hearing. I look forward to this regulatory change and yield back the balance of my time.

Chairman BACHUS. Thank you, Ms. Kelly. Thank you for having your business interest provision, which is also in this bill. I thank you for that.

Mr. Green?

Mr. GREEN. Thank you, Mr. Chairman. I thank you, as well as the ranking member for hosting this hearing.

I would like to thank the members of the panel for being here with us.

I do have to confess that while I am here physically, mentally I am split because we have a monster of a hurricane that is headed toward my district, it seems, in Houston, Texas. We have an evacuation plan that is being implemented. I think it is going well, but just prior to arriving we had to give some assistance with 83 patients that were in a nursing home and they were needing some assistance. Fortunately, our mayor's office was able to render that assistance and they are going to be helped.

I am honored that we will have the opportunity to hear from this august body. Given the things that we have been dealing with with reference to Katrina and now Rita, I will be concerned about what some of the financial institutions will be doing to assist some of the low-income people who are going to need a lot of help, who have been devastated, and what we need to do to help you to help them.

Mr. Chairman, I thank you very much for the time, and I yield back.

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

Chairman BACHUS. Thank you, Mr. Green.

Mr. McHenry?

Mr. MCHENRY. Thank you, Mr. Chairman. I certainly appreciate your holding these hearings. I certainly commend Representative Hensarling and Representative Moore for putting together a very good and balanced regulatory relief bill.

It is important that we as a committee and as Members of Congress encourage economic growth and opportunity through reducing unnecessary and burdensome rules and regulations. We also want to ensure that there is a competitive marketplace that allows our Nation to keep moving forward.

One of the issues that some of my local bankers have brought to my attention, and I have been following recently, is nonfinancial institutions getting into the banking industry. Namely, in my view, it would be inappropriate for the FDIC to act upon the Wal-Mart application until this committee and Congress has had an opportunity to review and consider the GAO report that Representative Leach is unveiling today. I know ILCs are covered in this bill and I think that is very helpful to this measure, but I have not had a chance to read the report yet, but I understand what is going to happen today when it is released.

I think it will bring to attention that we should take a real look at ILC chartering, not only for the banking and commerce question, but whether it is appropriate for a commercial company to own a bank, but additionally the adequacy of regulatory oversight and su-

pervision of owners of ILCs as well, which escape certain provisions by the Federal Reserve. So the Wal-Mart application, I think it highlights another big public policy banking question at the heart of Gramm-Leach-Bliley.

So I just wanted to take this opportunity to bring it to the chairman's attention and to our distinguished panel here as well.

I look forward to the hearing and look forward to us moving this bill forward. Thank you.

Chairman BACHUS. Thank you, Mr. McHenry.

Are there any other opening statements? Not seeing any members that wish to make so, I would like to introduce our distinguished panelists at this time.

Our first panelist is Mr. William J. Fox, Director of the Financial Crimes Enforcement Network.

Our second witness is the Honorable Mark W. Olson, Governor, Board of Governors of the Federal Reserve System. He is experienced with professional testimony before our committee. We welcome you back.

As well as Ms. Julie Williams, the first senior deputy comptroller and chief counsel in the Office of the Comptroller of the Currency. We thank both of you for your fine work and your advice and counsel as we go forward on this bill.

Our next witness is Mr. William Kroener, general counsel of the FDIC. We welcome you back.

Mr. John Bowman, chief counsel of the Office of Thrift Supervision. Thank you, Mr. Bowman.

Mr. Robert Fenner, general counsel of the National Credit Union Administration.

Mr. Randall S. James, commissioner of the Texas Department of Banking, on behalf of the Conference of State Bank Supervisors. I know this is a very trying time for you. You will probably be glad when this hearing is over and you can get back on a plane and head for Texas.

Mr. George Latham is deputy commissioner of the Credit Union Bureau of Financial Institutions, Virginia State Corporation Commission, on behalf of the National Association of State Credit Union Supervisors. You testified before this committee earlier this month; we welcome you back.

At this time, Mr. Fox.

STATEMENT OF MR. WILLIAM J. FOX, DIRECTOR, FINANCIAL CRIMES ENFORCEMENT NETWORK

Mr. FOX. Thank you very much, Chairman Bachus, Ranking Member Sanders, and distinguished members of this subcommittee.

It is truly an honor for me to appear here before you today to discuss your efforts to balance the burdens imposed on the financial industry by the requirements of the Bank Secrecy Act of 1970, specifically to provide the Government with highly relevant information that assists law enforcement in making our financial system more transparent and our country safer.

As you know, the Financial Crimes Enforcement Network administers the Bank Secrecy Act and we bear responsibility for ensuring that the act is implemented in a way that achieves the policy aim intended by the Congress, which is, stated simply, to safeguard the

United States financial system from the abuses of financial crime, to include money-laundering and terrorist and other illicit financing. This is a day-to-day challenge in a financial system where we generally promote the unfettered free flow of commerce and where criminals strive to manipulate the system with the same ingenuity and sophistication of the very best in the industry.

Ensuring that we strike the right balance between the cost and benefit, in my view, is an essential responsibility for my agency. While I do not believe that this cost-benefit analysis can be reduced to a mathematic formula and the benefits of a regime like this are often very difficult, if not impossible, to quantify, I believe we must continually study how we can more effectively tailor this regime to minimize the costs and other burdens imposed on our financial institutions while at the same time ensuring that we receive information that we, both FinCEN and law enforcement, need to combat financial crime and terrorism.

This effort is particularly important because I am more certain than ever that compliance with the Bank Secrecy Act's regulatory regime is a critical component to our country's ability to utilize financial information to combat terrorism, terrorist financing, money-laundering, and other serious financial crime. Achieving this correct balance is frankly an issue of national security.

The focus this morning is on H.R. 3505, the Financial Services Regulatory Relief Act of 2005. I am here to address how that legislation could affect the Bank Secrecy Act. Specifically, I am here to address the provision to reduce the burden imposed on the financial industry of filing currency transaction reports.

Before I discuss this provision, Mr. Chairman, let me reassure you of the value of these reports. Many of these reports are not only valuable, but are critical to law enforcement's and our efforts to deter, detect, and investigate financial crime and to identify, locate, and disrupt terrorist cells operating here in this country. Our colleagues in law enforcement have made significant strides recently in their ability to utilize these reports, marrying them and other data with law enforcement data to maximize their benefit.

We have also enhanced our analytic capability to exploit this data source on both micro and macro levels. In fact, the FBI's terrorist financing operation section has testified before Chairwoman Kelly's Oversight and Investigations Subcommittee about the value of these reports and how they help in their efforts to detect terrorist financing and to disrupt terrorist operations. Such innovations enhance the utility of our analysis as a whole, and it is essential that we do not reduce the flow of useful information just as the technical capabilities to exploit this information is reaching new heights.

That being said, Mr. Chairman, this reporting requirement, like any reporting requirement with objective criteria, results in reporting that has little relevance to the deterrence, detection, and investigation of financial crime. We also know that depository institutions, particularly our community banks, often identify the time and expense of filing these reports, currency transaction reports, as their number one regulatory expense and burden.

So how do we separate the wheat from the chaff, the critical from the irrelevant? The Congress has previously recognized the need to

reduce the number of currency transaction reports that may not have a high degree of usefulness to law enforcement, and you have directed us to find a way to do that. However, it is clear that our efforts to encourage the exemption of routine filings on certain customers have not brought about the reductions in filing that were originally sought. It is not surprising that when this committee undertook the effort to draft the bill providing regulatory relief for financial institutions that such a bill would contain a provision addressing currency transaction reporting.

Mr. Chairman, you and members of this subcommittee from both sides of the aisle requested our assistance in reviewing what had been proposed. You asked us to work with law enforcement in the financial community to see if a solution can be found that would ensure that law enforcement keeps getting the information it needs, while at the same time relieves some of the burden that this reporting requirement places on the industry.

Sir, this committee is now considering language that would amend current exemptions by allowing banks to qualify certain customers as exempt from routine currency transaction reporting. I believe this language addresses many of the issues that were causing the current exemption regime to not have its intended effect. This language seeks to streamline the exemption process by focusing on a one-time notice to FinCEN of an exemption and focusing on the customer's relationship with the bank as grounds for such an exemption.

We believe that these changes will make the exemptions more effective while still ensuring that the currency transaction reporting information critical to identifying criminal financial activity is made available to law enforcement. We hope that our efforts were useful to this committee and we stand ready to continue to work with you and other interested parties to address these issues as the legislation is more fully developed and proceeds.

Mr. Chairman, I would like to recognize the leadership of Congressman Hensarling and Congressman Moore on the work on these provisions. I would also like to recognize the work of their staffs, the work of your staff, and the committee staff on both sides of the aisle for their outstanding work. It has truly been a pleasure to work with all of these individuals.

I would also like to recognize William Langford, who is behind me here, sir. He is FinCEN's associate director for regulatory policy and programs. Mr. Langford was the point man on this issue and did, in my view, terrific work. I am taking some of the credit for it and it was really his work.

In conclusion, Mr. Chairman, Congressman Sanders, distinguished members of this subcommittee, I hope that my testimony today conveys the sense of commitment, energy, and balance with which all of us at the Financial Crimes Enforcement Network are using to address these challenging issues. The importance of your personal and direct support of our efforts cannot be overstated. Your oversight will help us ensure that we meet the challenges that we are facing. I know how critical it is that we do so, and we hope you know how committed we are to meeting those challenges.

Thank you very much. Thank you for your very kind comments earlier, and I would be very pleased to answer any questions you may have.

[The prepared statement of William J. Fox can be found on page 100 in the appendix.]

Chairman BACHUS. Thank you.

Governor Olson?

STATEMENT OF HON. MARK W. OLSON, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. OLSON. Thank you very much, Mr. Chairman and members of the subcommittee, for inviting the Federal Reserve Board to participate in this very worthwhile hearing on H.R. 3505.

As you and others have indicated, this has been a collaborative affair involving many members of the committee on both sides of the aisle. It has involved the participation of the organizations represented here and numerous others. Congressman Frank said earlier that there is a tipping point at which regulation becomes burdensome and ceases to be effective. There also is a tipping point where good ideas seem to translate into law at some point, and if this body is representative of the body as a whole, as I suspect it may be, it seems to me we may be reaching that tipping point toward passing legislation. I commend everybody here involved in this process.

With the permission of the Chair, I would like first to make some comments with respect to Hurricane Katrina, as Congressman Green pointed out, that will suggest what might be effective with Hurricane Rita.

First, our heartfelt sympathy goes to the people that were impacted by Katrina. It was a tragedy of enormous consequence and we have felt some of that as part of the Fed family. As of yesterday, there was still one employee missing from the New Orleans branch, out of 175. All the remainder are accounted for and, thankfully, lived. The Atlanta Fed and other Federal Reserve Districts responded in a significant and a very rapid way, providing the needed cash and the check-clearing servicess necessary to allow the economy to continue to work and provided individuals the opportunity to restore their lives and their possessions.

There was a great deal of flexibility demonstrated in the manner in which the Federal Reserve responded, both by changing the check-clearing, allowing for availability that was consistent with what their anticipation had been. We made extraordinary efforts to get cash into the branches and the banks and made continual contact with the banks in order to assist them in maintaining their operations. The most significant part of how the banks responded, though, had to be done ahead of time. It had to be in terms of their ability to provide for a continuity of operations and, for the most part, the banking industry did that exceptionally well.

We have also worked with other agencies in Washington to serve as a clearinghouse and allow the banks to answer questions or ask questions and to provide some information on the flexibility that already exists with respect, for example, to the BSA provisions with respect to things like cashing checks and opening checking accounts.

Let me turn now to a couple of the provisions of the bill that we are particularly concerned about and particularly interested in, and I would be happy to answer questions on the others. With respect to the de novo interstate branching, we think that that is an important provision, particularly as it impacts banks, smaller banks in particular on State border areas. This is the final provision of the interstate banking, the Riegle-Neal bill that allowed for interstate branching only on a de novo basis. This would affect the remaining 29 States that have not opted in, but would allow for increasing numbers of branches, particularly in smaller areas and by small banks.

So I would point out that just in 2004 alone, there were an additional 2,000 branches of banks that were brought into operation just in 2004 alone. However, we do not want to extend that to industrial loan companies for reasons that we have elaborated on. We applaud the small bank examination flexibility. We think that will relieve some of the burden that was talked about here earlier, and we think that that is an important provision.

My time has expired, Mr. Chairman. I would be very happy to answer any questions on any of the other provisions.

[The prepared statement of Hon. Mark W. Olson can be found on page 166 in the appendix.]

Chairman BACHUS. Thank you, Governor Olson.

At this time, we will hear from Deputy Comptroller Williams.

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

Ms. WILLIAMS. Chairman Bachus and members of the subcommittee, on behalf of the OCC, we welcome the opportunity to participate in the discussion of H.R. 3505, the Financial Services Regulatory Relief Act of 2005. I want to especially commend Representatives Hensarling and Moore for taking the lead in sponsoring this legislation.

Regulatory burden is an issue that affects all our Nation's depository institutions, but it is a matter of special concern for our community banks. My written testimony covers this topic very broadly, and I will just summarize the basic components of it.

First, it describes the OCC's actions to assist banks and their customers affected by Hurricane Katrina. Second, it discusses the work being done by the Federal banking agencies to further the goals of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, fondly known as EGRPRA. Third, my testimony summarizes important initiatives that are being undertaken by the OCC outside the EGRPRA process to reduce needless regulatory burden. Fourth, it summarizes what the OCC sees as priority legislative items in H.R. 3505. Fifth, it offers suggestions for reducing burden and improving the quality of consumer disclosures. And finally, my testimony offers the OCC's suggestions for some additions to H.R. 3505.

In the interests of time, let me touch on just a couple of those points this morning.

All of us have been greatly moved by the devastation and suffering caused by Hurricane Katrina. The banking system is playing

a crucial role in helping individuals and their communities get back on their feet, and the Federal and State bank regulatory authorities are working in close cooperation and have been making every effort to minimize customers' disruption and the burden on banks involved in the recovery and reconstruction effort.

To that end, Comptroller Dugan, as Chairman of the Federal Financial Institutions Examination Council, established a special Katrina Working Group to facilitate this coordination and communication on the bank supervision issues that have arisen in Katrina's aftermath. We are very pleased that Commissioner John Allison of Mississippi will participate in this working group as the FFIEC's State representative.

The OCC and the other agencies have issued guidance on a wide range of questions that bankers and their customers are raising, and we will continue to do our part to help those affected by these events.

Even without the extraordinary events of Hurricane Katrina, which prompted focus on relief from particular regulatory requirements, we should be finding ways to provide relief from unnecessary regulatory burden more broadly. These burdens can arise from regulations, and here we as regulators have a responsibility to ensure that the rules that we adopt are no more burdensome than necessary and to correct rules on the books that do not meet that test.

In this connection, I would mention the OCC's participation in the ongoing EGRPRA-mandated regulatory review that is being conducted under OTS Director Reich's able leadership. We have also undertaken another scrub of our regulations, the regs that are unique to OCC, and we have participated in several interagency initiatives outside of the EGRPRA process in order to identify opportunities to reduce regulatory burden. Recent amendments to the Community Reinvestment Act regulations and the currently ongoing project to develop clearer, shorter and more effective privacy notices are two examples of this.

Some regulatory burden is derived from Federal legislation and, thus, change requires action by Congress. In past testimonies before this subcommittee, the OCC has provided detailed summaries of our recommended legislative changes. Most of those items are included in H.R. 3505, and they are discussed in detail in my written testimony. Several other items that are not part of H.R. 3505 are noted in my testimony as well with our recommendation that the subcommittee consider them as this legislation moves forward.

We also support efforts being led by FinCEN to identify ways to reduce burdens arising from BSA-related requirements without compromising tools that are valuable to law enforcement.

In conclusion, Mr. Chairman, on behalf of the OCC, let me express my appreciation to you and the subcommittee for these hearings. We strongly support responsible burden reduction initiatives. We are committed to assisting those whose lives and businesses were disrupted by Hurricane Katrina and those who may be similarly impacted by Hurricane Rita. We express our sincere sympathies to all the people affected in the disaster areas and the families who have lost loved ones.

We look forward to working with you and your staff and our regulatory colleagues on all of these efforts. Thank you very much.

[The prepared statement of Julie L. Williams can be found on page 184 in the appendix.]

Chairman BACHUS. Thank you, Comptroller.

General Counsel Kroener?

STATEMENT OF MR. WILLIAM F. KROENER, III, GENERAL COUNSEL, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. KROENER. Chairman Bachus and members of the subcommittee, I appreciate the opportunity to present the views of the FDIC on H.R. 3505, the proposed legislation to provide regulatory burden relief. The FDIC shares the subcommittee's continuing commitment to this important endeavor to eliminate unnecessary burden and streamline and modernize laws and regulations as the financial industry evolves.

The Federal bank and thrift regulatory agencies have been working together over the last few years to identify regulatory requirements that are outdated, unnecessary, or unduly burdensome in accordance with the requirements of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The agencies have identified numerous proposals to reduce regulatory burden, and the FDIC is pleased that quite a few of them are included in H.R. 3505. The FDIC continues to work with the other agencies in an effort to achieve further consensus and, as required by law, we will be submitting a final report to Congress with legislative recommendations next year.

Before discussing our general regulatory burden relief efforts, with the consent of the Chair I would like to take a moment to update the subcommittee on recent activities by the FDIC and other Federal agencies in response to Hurricane Katrina. As you know, all the Federal banking agencies recognize the challenges faced by financial institutions in the aftermath of Hurricane Katrina and the need for discretion and flexibility in enforcement of regulatory requirements and the exercise of supervisory responsibilities. We have provided timely information regarding the availability of banking services and posted information for consumers and bankers in the affected States on our Web site.

The FDIC has asked insured financial institutions to consider all reasonable and prudent steps to meet the financial needs of their customers and communities. In cooperation with the other Federal agencies, we have also provided banks with written guidance on check-cashing and opening new accounts. The banking regulators have encouraged banks to meet the financial needs of the hurricane victims in a number of ways, including waiving ATM fees, easing restrictions on check-cashing, and being flexible in their approach to verifying the identity of displaced individuals. Examiners, like bankers, are fully aware that this is the right thing to do under the circumstances. With Hurricane Rita on its way, you can expect similar actions by the regulators.

In previous natural disasters, Congress temporarily relaxed prompt corrective action requirements for affected institutions that had an influx of deposits from flood-related insurance proceeds and Government assistance. Due to the widespread nature and severity

of the damage, as well as the dollar-volume of relief funds that will be flowing to the area, we believe many banks would avail themselves of similar relief if it were offered by the Congress in response to Katrina.

Turning to general regulatory burden relief, the interagency EGRPRA effort led by our former vice chairman, John Reich, who is now Director of the OTS, has resulted in an interagency consensus on 12 regulatory burden relief proposals. As outlined in my written statement, five of these proposals currently are included in H.R. 3505, as well as a variation on the sixth. The FDIC joins with the other Federal banking agencies in supporting inclusion of the remaining six proposals in the current regulatory relief legislation. Those are identified and described in detail in my written statement.

The last item among that enumeration, increased flexibility for flood insurance, was agreed upon among the agencies. In light of the Gulf Coast hurricane damage, we will continue to work to develop this and seek additional ideas to improve the flood insurance program. The FDIC has worked closely with the subcommittee in developing several of the provisions contained in the proposed legislation that will help the FDIC become more efficient and effective in the regulation of insured institutions. We appreciate the inclusion of these proposals in H.R. 3505.

The FDIC respectfully recommends that the subcommittee consider certain additional regulatory relief items in the bill that would help us improve our supervisory efforts. The appendix to my written testimony contains the relevant language.

In conclusion, I thank you for the opportunity to present the FDIC's views on these issues. The FDIC supports the subcommittee's continued efforts to reduce unnecessary burden on insured depository institutions, and I look forward to the subcommittee's questions.

Thank you.

[The prepared statement of William F. Kroener, III can be found on page 119 in the appendix.]

Chairman BACHUS. Thank you, General Counsel Kroener. Please convey to Chairman Powell—as well, Ms. Williams, if you will, to Comptroller Dugan—I know of their work in this regard, but convey to Chairman Powell the many compliments we have gotten from banks in the area of Alabama, Mississippi, and Louisiana.

Mr. KROENER. Thank you, Mr. Chairman. I will do so, and we will continue our hard efforts in light of impending events.

Chairman BACHUS. Thank you.

At this time, the chief counsel for the Office of Thrift Supervisions, Mr. John Bowman.

STATEMENT OF MR. JOHN E. BOWMAN, CHIEF COUNSEL, OFFICE OF THRIFT SUPERVISION

Mr. BOWMAN. Good morning, Chairman Bachus, Ranking Member Sanders, and members of the subcommittee, as well as Chairman Oxley and Ranking Member Frank of the full committee.

I want to thank you, Mr. Chairman, for holding this hearing. I want to thank Congressmen Hensarling and Moore, the sponsors of H.R. 3505, for their leadership and focus in this area.

Regulatory relief is an important issue for our director, John Reich, who has led the interagency EGRPRA project. Director Reich is continuing his work on this project and is committed to see it through to a successful completion. Director Reich has asked me to convey to you our full support and to make available our full resources to assist you in your efforts to enact legislation to address the issues we discuss today.

It is always important to remove unnecessary regulatory obstacles in our financial services industry that hinder profitability, innovation, and competition and, in turn, job creation and economic growth. In the aftermath of Hurricane Katrina, these issues take on even greater significance with the need to make sure that we do what is necessary to carry out the laws and policies of Congress, while also providing maximum assistance and flexibility to institutions and customers in the areas affected by the hurricane.

From a bank regulatory perspective, economic recovery requires patience, good communications with our institutions, a significant degree of regulatory common sense to do what is necessary and forego what is not, and lots of hard work. With your permission, I will forego the rest of my discussion regarding OTS's efforts on behalf of the Hurricane Katrina interagency task force, given the discussion by my colleagues.

Today you will hear about numerous proposals to eliminate old laws that while originally well intended no longer serve a useful purpose. While many of these items are not directly relevant to hurricane relief efforts, even marginal measures of relief may be helpful in the long run and should not be overlooked.

Before addressing these issues, it is important to note that there are two areas in particular that our institutions have identified as unduly burdensome: the Bank Secrecy Act requirements and the rules under Sarbanes-Oxley. Virtually all institutions raised these two issues as regulatory relief priorities. However, the impact of these statutory provisions is often most acute for smaller community-based institutions.

One proposal discussed today provides BSA relief via a filing exception for certain currency transaction reports of so-called ″seasoned″ customers. OTS is fully supportive of efforts to provide meaningful BSA relief to the institutions we regulate that are consistent with the requirements of the BSA and the needs of law enforcement. We will strongly support any burden reduction proposal to streamline existing BSA requirements, provided it is supported by FinCEN, not objected to by law enforcement, and it provides meaningful relief that fully outweighs any diminished utility to the BSA.

In my written statement, I describe a number of proposals that would significantly reduce regulatory burden on savings associations. Four things that we believe provide the most significant relief for savings associations are eliminating duplicative regulation of savings association under the Federal securities laws, eliminating the existing arbitrary limits on savings association consumer lending activities, updating commercial and small business lending limits for savings associations, and establishing a statutory succession authority for the position of the OTS Director.

Currently, banks and savings associations may engage in the same types of activities covered by the investment adviser and broker-dealer requirements of the Federal securities laws. These activities are subject to supervision by the banking agencies that is more rigorous than that imposed by the SEC. Yet, savings associations are subject to an additional layer of regulation and review by the SEC that yields no additional supervisory or consumer benefit.

While the bank and thrift charters are tailored to provide powers focused on different business strategies, in areas where powers are similar, the rules should be similar. No sound public policy rationale is served by imposing additional and unwarranted administrative costs on a savings association to register as an investment adviser or as a broker-dealer under the Federal securities laws. OTS strongly supports Section 201 of H.R. 3505 to exempt savings associations from these duplicative investment adviser and broker-dealer registration requirements.

Another important proposal for OTS is eliminating a statutory anomaly that subjects the consumer lending authority of Federal savings associations to a 35 percent of assets limitation, but permits unlimited credit card lending. This exists even though both types of credit may be extended for the same purpose. Removing the 35 percent cap on consumer lending will permit savings associations to engage in secured consumer lending activities to the same extent as unsecured credit card lending. This makes sense for regulatory burden reduction and for reasons of safety and soundness.

Consistent with this, we support expanding the scope of Section 208 of H.R. 3505 to include all consumer loans, not just auto lending. We also support Section 212 of H.R. 3505 updating statutory limits on the ability of Federal thrifts to make small business and other commercial loans. In the interests of time, legislation removing the current limit on small business lending and increasing the cap on other commercial lending will provide savings associations greater flexibility to promote safety and soundness through diversification, more opportunities to counter the cyclical nature of the mortgage market, and additional resources to manage their operations safely and soundly.

A final but important issue is the statutory succession authority for the position of OTS Director. This issue is as important to the thrift industry as it is to OTS. We strongly urge consideration of provisions authorizing the Treasury Secretary to appoint a succession of individuals within OTS to serve as OTS acting Director in order to assure agency continuity. It is also important to modernize the existing statutory appointment authority for the OTS Director by providing every appointee a full 5-year term.

Finally, OTS is committed to reducing regulatory burden wherever it has the ability to do so, consistent with safety and soundness and consumer protections. We look forward to working with the subcommittee to address these and the other regulatory burden reduction items addressed in my written statement. I would be happy to answer your questions.

Thank you.

[The prepared statement of John E. Bowman can be found on page 59 in the appendix.]

Chairman BACHUS. Thank you very much.

At this time, General Counsel Robert Fenner from the National Credit Union Administration.

STATEMENT OF MR. ROBERT M. FENNER, GENERAL COUNSEL, NATIONAL CREDIT UNION ADMINISTRATION

Mr. FENNER. Thank you, Mr. Chairman, Representative Hensarling, other members of the subcommittee. I appreciate the opportunity to be here today to present NCUA's views on H.R. 3505.

At the start, and without going into all of the details of our Hurricane Katrina relief and recovery efforts, let me just mention that in the immediate aftermath of the hurricane, we had 131 credit unions whose operations were at least partially disrupted, a number of single-office credit unions in the City of New Orleans where their office and their records were literally underwater. I am pleased to report that as of the end of last week, all of these credit unions were again at least partially operational, providing access to funds and other services to their members.

I will focus in the remainder of my oral remarks on Title III of H.R. 3505, the credit union provisions. I want to start by saying NCUA does strongly support these provisions. We believe they will remove unnecessary regulatory restraints and enable credit unions to provide better, more efficient, and lower-cost service to their membership.

As one example, Section 307 will allow Federal credit unions to provide check-cashing and wire transfer services to anyone in their field of membership. This provision is especially important to Federal credit unions in serving individuals of limited income or limited means. Individuals who do not have mainstream financial services available to them are often forced to pay excessive fees for services such as check-cashing, money orders, and wire transfers. Allowing Federal credit unions to provide these services to anyone in their field of membership will provide lower-cost alternatives for the unbanked and foster familiarity with and trust in conventional financial institutions.

Other important provisions include Section 305, which will allow Federal credit unions the flexibility to invest up to 3 percent of their assets in credit union service organizations, providing financial-related services to both credit unions and their members; Section 303, which will allow Federal credit unions to diversify their assets and improve their earnings by making limited investments in corporate debt securities; and Section 314, which will clarify that when two credit unions decide to voluntarily merge, the statutory net worth of both credit unions is combined to form the net worth of the continuing credit union.

Mr. Chairman, with respect to this issue, I would like to acknowledge and thank both you and Ranking Member Sanders for your support and for the separate introduction of H.R. 1042, which would specifically address and correct this inconsistency between the federal Credit Union Act and pending changes in accounting rules.

Finally, while not included in H.R. 3505, we respectfully urge the subcommittee's consideration of reform of the prompt corrective action capital requirements for federally insured credit unions. The current statutory capital regime for credit unions establishes an unnecessarily high leverage ratio that penalizes low-risk credit unions, that deprives credit unions of the ability to use excess capital in the manner that best serves the interests of their members, and that makes it difficult for NCUA to use risk-based capital as an effective supervisory tool.

Our proposed solution, which is set forth as Title I of the CURIA bill, H.R. 2317, addresses these concerns we believe in a manner that is consistent with the capital standards for FDIC-insured institutions, that reflects the unique capitalization structure of the national credit union share insurance fund, and that ensures the continued safety and soundness of both insured credit unions and our fund.

Again, thank you for the opportunity to be here today. I look forward to answering your questions.

[The prepared statement of Robert M. Fenner can be found on page 92 in the appendix.]

Chairman BACHUS. Thank you.

Now, we will hear from the commissioner of the Texas Department of Banking, Mr. Randall James.

STATEMENT OF MR. RANDALL S. JAMES, COMMISSIONER, TEXAS DEPARTMENT OF BANKING, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS, INC.

Mr. JAMES. Good morning, Chairman Bachus, members of the committee. For the record, I am Randall James, Texas banking commissioner, and I am pleased to be here today on behalf of the Conference of State Bank Supervisors.

Thank you for inviting CSBS here today to discuss strategies for reducing the unnecessary regulatory burden on banks, specifically H.R. 3505, as set forth by Congressman Hensarling and Congressman Moore. Our members are the chartering authorities and primary regulators of the majority of our Nation's financial institutions, including the vast majority of our community banks.

Chairman Bachus, we do applaud your longstanding commitment to ensuring that regulations serve the public interest without imposing unnecessary compliance burdens on financial institutions. At the State level, we are constantly balancing the need for oversight and consumer protection with the need to encourage competition and entrepreneurship. We see continuing opportunities for Congress to streamline and rationalize regulatory burden, especially for community banks. This testimony will review and update several issues that we have previously discussed in this forum.

Our current regulatory structure and statutory framework may recognize some differences between financial institutions, but too often mandates a one-size-fits-all requirement. CSBS endorses approaches that recognize and encourage the benefits of diversity within our banking system. New Federal requirements are often unduly burdensome on smaller or community-based institutions, as has been referenced here frequently this morning. Therefore, my colleagues and I are especially pleased to see provisions in the cur-

rent bill that recognize the growing disparity in our financial services industry and the impact that this has on our economy.

Targeted relief for community banks is an essential component of any regulatory reform bill, and we strongly endorse several new provisions of H.R. 3505 that provide this relief. These new provisions taken from Congressman Ryun's Communities First Act will reduce burden on these community-based institutions without creating new risks to safety and soundness.

We are also pleased to see that H.R. 3505 seeks to address the industry's concerns about the Bank Secrecy Act, also alluded to frequently this morning. Currency transaction reports and suspicious activity reporting requirements are reducing collection requirements and making them more consistent. We definitely want to acknowledge the efforts of FinCEN and the Federal banking agencies with whom we have worked to develop clear risk-based BSA examination procedures. We welcome the additional study on these issues that H.R. 3505 calls for.

We ask that the committee include several additional regulatory burden relief provisions in any legislation it approves. First, CSBS believes that a State banking regulator should have a vote on the Federal Financial Institutions Examination Council, the coordinating body of banking agencies. We recommend that Congress change the State position in FFIEC from one of observer to that of a full voting member.

CSBS also favors a provision that would give the Federal Reserve the necessary flexibility to allow State-chartered member banks to exercise the powers granted by their charters, as long as these activities pose no significant risk to the deposit insurance fund. Current law limits the activities of State-chartered Fed member banks to those activities allowed for national banks.

In addition, CSBS strongly support FDIC's recent rule making Federal deposit insurance available to State-chartered banks that organize as limited liability corporations, or LLCs. Only a handful of States now allow banks to organize as LLCs, including Maine, Nevada, Vermont, Texas and most recently, Utah. More States may consider this option, however, because the structure offers the same tax advantages as Subchapter S corporations, but with greater flexibility. Unfortunately, an Internal Revenue Service regulation currently blocks pass-through tax treatment for State-chartered banks. We ask this committee to encourage the IRS to reconsider its interpretation of the tax treatment of LLCs.

In conclusion, as you consider additional ways to reduce burden on our financial institutions, we urge you to remember that the strength of our banking system is its diversity. While some Federal intervention may be necessary to reduce burden, relief measures should allow for further innovation and coordination at both the State and the Federal levels and among community-based institutions, as well as among the largest providers. A responsive and innovative State banking system that encourages community banking is essential to creating local economic opportunities.

We commend you, Mr. Chairman and the members of the subcommittee, for your efforts in this area. We urge you to move this bill through the House of Representatives in this session of Congress. We thank you for the opportunity to testify, and I look for-

ward to responding to any questions that you or members of the committee might have.

Thank you.

[The prepared statement of Randall S. James can be found on page 104 in the appendix.]

Chairman BACHUS. Thank you, Commissioner James.

At this time, Deputy Commissioner George Latham from the Bureau of Financial Institutions of Virginia State Corporation Commission.

STATEMENT OF MR. GEORGE LATHAM, DEPUTY COMMISSIONER, CREDIT UNIONS, BUREAU OF FINANCIAL INSTITUTIONS, VIRGINIA STATE CORPORATION COMMISSION, ON BEHALF OF THE NATIONAL ASSOCIATION OF STATE CREDIT UNION SUPERVISORS

Mr. LATHAM. Thank you, Chairman Bachus. I an deputy commissioner of financial institutions for the Commonwealth of Virginia. Thank you and the committee for the opportunity to be here. I do want to add that I am a past chairman of the Board of the National Association of State Credit Union Supervisors, or NASCUS, who I am here on behalf of today.

NASCUS is pleased to have this opportunity to share our thoughts about H.R. 3505, the Financial Services Regulatory Relief Act of 2005. Capital reform continues to be a critical concern for the Nation's credit unions. The first important provision is the amendment to the definition of ″net worth″ in this bill. Such a change would cure the unintended consequences for credit unions of the Financial Accounting Standards Board's business combination accounting rules. This provision amends the definition of ″net worth″ to include the retained earnings of a merging credit union with that of a surviving credit union. NASCUS believes this provision is imperative to preserve the option of mergers for regulators who use this as a safety and soundness tool.

NASCUS also appreciates that the bill includes a provision that allows privately insured credit unions to access the Federal Home Loan banks. Moreover, NASCUS supports a provision that amends FDICIA so that State supervisors have the examination and enforcement oversight of privately insured credit unions. This authority ensures that State regulators could enforce compliance with disclosure requirements for privately insured credit unions.

NASCUS believes another important capital reform should be an amendment to prompt corrective action or PCA. Such an amendment should broaden the definition of ″net worth″ and also provide flexibility. The Federal Credit Union Act establishes mandatory PCA requirements for credit unions. However, it does not provide flexibility to temporarily waive these requirements. It also limits the net worth of a credit union to just its retained earnings.

Hurricane Katrina provides an excellent example of the need for flexibility. Although State credit union regulators helped ensure that operations would continue in a safe and sound manner in those States that were affected, these regulators are soon going to be shifting their concerns to credit unions meeting PCA standards. Many credit unions affected by Hurricane Katrina will need retained earnings to rebuild.

It is also predicted that many members will walk away from loan obligations because their car or home, which secured their loan, no longer exists. As retained earnings are depleted for relief efforts, regulators will be faced with downgrading credit unions for not meeting PCA requirements. This demonstrates how viciously this cycle hurts American consumers.

I would like to add that NASCUS and its State regulatory members have done quite a bit to support the efforts to relieve the conditions brought about by Katrina. State credit union regulators have offered manpower and computers and other resources to their colleagues in the affected States. NASCUS has a reserve examination program which recruits former examiners who are retired or even examiners who are active at this time to go in and do examinations in affected areas.

NASCUS has been working with NCUA in a number of ways, teleconferencing and briefings. We also have information on our Web site. So NASCUS stands ready to assist in the relief efforts for the victims of Hurricane Katrina.

NASCUS also has a longstanding policy supporting risk-based capital for credit unions. A risk-based capital solution should be included in H.R. 3505. Risk-based net worth and alternative capital are complementary capital reforms. In July, a team of NASCUS regulators and credit union executives created a white paper presenting both equity and debt models for alternative capital. The instruments presented are designed to preserve the not-for-profit, mutual, member-owned and cooperative structure of credit unions. We shared the white paper with the credit union community for study and for feedback. Additionally, it is attached to our written testimony and we appreciate the subcommittee's consideration of it.

We believe further regulatory relief is needed in H.R. 3505 for member business lending. The statutory limit on credit union member business loans should be raised to 20 percent of total assets. We further support language that would amend the current definition of ″member business loans″ by granting NCUA the authority to exempt loans of $100,000 or less.

NASCUS appreciates the importance of the Bank Secrecy Act, or BSA, and thus supports those provisions in the bill as well. State credit union regulators believe they have the safety and soundness responsibility to encourage State-chartered credit unions to comply with all applicable BSA laws and regulations. We are pleased that the bill provides further flexibility to the secretary of the treasury to grant currency transaction report exemptions.

NASCUS believes the enforcement of the program section of H.R. 3505 should be modified to reference State regulators as contributing members of FFIEC. The partnership between State and Federal regulators is important to ensure enforcement and monitoring of BSA and anti-money-laundering compliance. The BSA provisions in the bill are a step in the right direction of balancing the reporting burden with information needed by enforcement agencies.

In the interests of time, please refer to the last page of our written testimony for other issues of importance to NASCUS which I will not highlight at this time.

NASCUS appreciates the opportunity to testify on the provisions of H.R. 3505. We welcome further participation in the discussion

and deliberation of this legislation, and certainly I am open to answering any questions that you may have.

[The prepared statement of George Latham can be found on page 145 in the appendix.]

Chairman BACHUS. Thank you. We appreciate that.

At this time, I might say to members of the committee we have many Members of Congress, of course Galveston is in Gene Green's district, but the district of our fellow member, Mr. Al Green, is right to the left of that as you look at a map. And also, Mr. Hinojosa's and Mr. Paul's districts are impacted, as well as several other members.

At this time, I am going to yield my 5 minutes to Mr. Green because obviously he needs to get back to the more pressing needs of his district, for questioning.

Mr. GREEN. Thank you, Mr. Chairman. I greatly appreciate your consideration. On behalf of the many Members who will be traversing the distance back to our districts to attend to the needs of our constituents, I thank you on their behalf as well. While they are not members of the committee necessarily, they appreciate your kind words.

I would like to indicate that I am most appreciative of some of the information that I received with reference to how lending institutions will work with people who have loans. My understanding is that some institutions will have a moratorium for approximately 3 months on foreclosures, late fees, and other aspects of loans that might involve some penalties. I compliment you for this.

I have talked to a number of persons, persons who were in goodstanding in their communities. In fact, one is a banker. They tell me that 3 months may not be enough, given that they cannot get to their homes. These are people who are victims of Katrina. They cannot get adjusters out to look at some of the concerns that have to be addressed, and they are just not sure what their fate is right now.

Can someone give me an indication as to how you would recommend that we handle this? I know that a case-by-case basis is ultimately what will be said, but how can we encourage something a little bit more standardized, if you will, to address some of these concerns? I welcome anyone's comment.

Ms. WILLIAMS. Congressman, let me just start by addressing one of the points that you just made: that individual circumstances may differ and that 3 months may not be enough. The guidance that the banking agencies issued very shortly after Katrina hit urging the institutions that we supervise to be flexible and to be responsive to their customers' needs is fully applicable to longer-term needs, and it will be fully applicable if, unfortunately, it is necessary to apply it in the circumstances of Hurricane Rita.

Certain customers may be able to get back on their feet more quickly than others. We are strongly urging the institutions that we supervise to work with all their customers, to recognize the needs of those customers, and to be flexible, to forbear, to look for opportunities to restructure based on the needs presented by the particular customers.

Mr. GREEN. Yes, sir?

Mr. OLSON. Congressman, I will associate with what Julie Williams said, but add one other part to that. The bankers that work in branches or in bank locations operate under a set of rules. Some of which are the institution's own internal guidelines, and some of which are laws and regulations. In some cases, we have found following Katrina there are some bankers that have had no reason in the past to try to sort those out as to which is which.

The significance of it is that we have had questions from time to time regarding policies that that person has always been operating under that in fact is an internal policy as opposed to a regulation, but they have always thought of it as a regulation. What we have made an effort to do is try to help the bankers understand where there is flexibility. Many of the things that you have talked about which are important, there perhaps is flexibility within the institution's own standards under the regulations to comply with.

Mr. GREEN. Thank you.

Quickly, because I know time is of the essence, the CRA, the Federal Reserve Board, the Office of the Comptroller of the Currency and the FDIC recently promulgated a new CRA regulation. Pursuant to this regulation, certain institutions will receive CRA credit for making loans.

While this is a good thing, the concern is if we have persons who are displaced and they receive loans, can these institutions get CRA credit for making loans to displaced individuals, as opposed to displaced businesses? Does anyone have a comment on that?

Ms. WILLIAMS. Congressman, again, I think that we would look for ways to try to provide some flexibility in that respect. We have pending in draft form a series of interagency questions and answers that are designed to provide some elaboration on the recently revised CRA regulation. Your queston is an excellent one for us to see if we can provide some clarification on.

Mr. GREEN. As you do so, I would encourage you to be as flexible as you can so that the banks can get the credit, which is an incentive to make the loans to the individuals who have been displaced. We are talking about people who really need these bootstraps. They will pull themselves up if they are given the bootstraps. This would provide that opportunity for them to have bootstraps.

I thank you very much, Mr. Chairman, for the time.

Chairman BACHUS. Thank you, Mr. Green.

At this time, we are going to recess. There are votes on the floor and we will reconvene at approximately 12:10 p.m., if that is okay. Mr. Hensarling will be in the chair when we reconvene. I think there are two other members who wish to answer questions. So we will recess until that time.

Thank you. The committee is temporarily adjourned.

[Recess.]

Mr. HENSARLING. [Presiding.] The subcommittee will come to order.

I appreciate the indulgence of our panelists. However, if history is our guide, you will see the proceedings move rather rapidly, given that it is the lunch hour. So hopefully, we will not hold you too long.

At this time, the Chair would recognize himself for 5 minutes. Mr. Fox, I would like to give my first question to you. First, I want

to thank you. In your testimony I cannot help but see the phrase ″cost and benefit.″ As you say, we must strike the right balance between cost and benefit. I assure you that that is a phrase that is rarely heard within the halls of Congress. As a graduate with a degree in economics from Texas A&M University, it is certainly music to my ears. I appreciate the good work that you have done with industry and with law enforcement on the issue of BSA relief.

Clearly, and in another part of your testimony, I think you indicate it is a question of balance, and indeed it is. I remember sometime after 9/11 a CEO of an airline came up to me and said that finally we had discovered the perfect security measure for passenger air travel, and that was that passengers will no longer be allowed on commercial airlines.

[Laughter.]

Indeed, there is a balance and clearly the terrorists win when we lose our essential freedoms, including the freedom of commerce. In looking at some of your earlier testimony, I think you indicated that just within the last year there was a 37 percent increase in SARs and that a number of these reports I think you characterized as being in the nature of a defensive filing. I think you said, and let me quote from your earlier testimony of May before our oversight committee, ″If these trends continue, consumers of the data, law enforcement, regulatory agencies, and intelligence agencies will suffer,″ and that ″we are concerned as financial institutions spend time and resources on increased filing, the quality of reporting on truly suspicious activity will degrade.″

Can you go into a little bit of detail on how the language, the exemption dealing with seasoned customers, will address this issue?

Mr. FOX. Congressman, I am not actually sure it will get to the suspicious activity report issue that you raised, which is an incredibly important issue. The seasoned customer language have really addresses currency transaction reporting, which is a more objective reporting requirement.

I think the cause of defensive filing of suspicious activity reporting, in other words the reporting that is required when an institution comes across financial activity that it judges to be suspicious under our regulatory scheme and reports to the Government, was caused in large measure by institutions perceiving a very grave regulatory and reputational risk from running afoul of this regulatory regime.

I think that we have, sir, worked incredibly well with my colleagues at the table, the five Federal banking agencies in particular, but also the Conference of State Bank Supervisors, to sort of tamp that concern down. What we are hearing, sir, and this is anecdotal right now and I do not have stats, is that institutions are getting that message. They are really not as nervous, I guess, as they might have been a year ago.

Mr. HENSARLING. If I could, though, over roughly 30 years, we have developed this regime and quite often in Congress we put new regulations on top of old regulations. Is there still some overlap between the SARs, the CTRs, the Patriot Act, customer identification programs? If you were designing this program from scratch, is this what you would end up with? Is there further work we can do?

Mr. FOX. I think there is further work we can do, and the work that you, sir, have done on the currency transaction reports is an example of that. But I would say, sir, that these reporting requirements and the customer identification programs that were implemented by the Patriot Act, while clearly a burden, do fit well together to weave a very sound anti-money-laundering program not only for the institution, but for our financial system. It makes it more clean, more transparent, frankly safer.

Mr. HENSARLING. Again, thank you for your help and your work in this area.

Mr. FOX. My pleasure.

Mr. HENSARLING. Five minutes travels rapidly.

Mr. James, you and I have a hurricane headed toward our home State. What have we learned in the last few weeks? What should this committee know and do?

Mr. JAMES. Mr. Hensarling, the first item on the agenda is always people, taking care of the people. The second item on the agenda that I think this committee needs to be aware of is the extensive communication efforts that have existed among the Federal and State regulators of the affected areas resulting from Katrina. That communication has assisted in numerous ways among the regulators in easing up in areas where we could ease up and in providing some comfort to the institutions.

Following right on the heels of that, the communication has already begun with regard to Hurricane Rita. That communication has started with the regulators and then I would like to place on the record that yesterday afternoon the Independent Bankers of Texas and the Texas Bankers Association got together and hosted a call that included the area regulators, as well as some 300 financial institutions, to go over immediate issues. That call is going to be occurring again tomorrow morning at 9 o'clock. That communication, I believe, is extremely important to discuss issues of cash availability, of cash letter direction, of liquidity issues, or branch openings issues, of where people are issues, of how to deal with situations, and how to proceed.

I would suggest to this committee that the bankers in the State of Texas, along with the Federal and State regulators, are working everything we can to make sure everything gets back up and running, because this hurricane will come, but it will be also pass. And we are very interested in what comes next.

Mr. HENSARLING. Thank you. Please know that I am sure that on behalf of this committee and on behalf of the Texas delegation, we stand ready to help in any way that we can.

My time has expired. The Chair would now recognize Ms. Maloney from New York.

Mrs. MALONEY. Thank you very much for your leadership on this.

I would like to ask Mr. Bill Fox, you said in your testimony that technology is just catching up with the filing requirements. I would like to know how FinCEN is doing this in more detail. Last spring, the Treasury IG reported that FinCEN was not able to process the Bank Secrecy Act filings effectively. I understand that you are trying to address this. Can you explain where FinCEN is regarding this issue?

Mr. FOX. Thank you, Congresswoman. We are working very hard to develop and implement a new cornerstone system, a system that we are calling BSA Direct. This system will have an electronic filing component, a very modern data warehouse, as well as a very modern Web-based secure way to disseminate the information that we collect to law enforcement.

We are working on this very, very diligently right now. It is very close to deployment and testing. We are very excited about it. It will replace a system that was cutting-edge in 1990. We are thrilled that law enforcement, and I think our colleagues in the reulationg agencies, are very supportive of this effort. I think it is going to make a great difference.

Mrs. MALONEY. Does FinCEN support this bill that we have before us?

Mr. FOX. I would like to discuss the one Bank Secrecy Act issue, the currency transaction reporting provision. We will have some thoughts on the other Bank Secrecy Act provisions; however, we have not focused as much on them because we were working so diligently on the currency transaction reporting provision. We will continue to work with the staff from both sides of the aisle.

Mrs. MALONEY. On the idea of having seasoned customers, those that the bank knows, that they have conducted business with, that they trust, exempting them from all this paperwork, do you support that? This is an idea we are doing also with the airports. Those people who fly often—they know who they are—can have certain cards so they can go through faster. Because we are so conscious about security, and as one who represents target number one, New York City, I am concerned about it.

Do you support that philosophically? Do you support that direction?

Mr. FOX. Yes, ma'am. I think the technical assistance that we have provided to the committee in developing the language will satisfy us, law enforcement, and the industry. It will eliminate some of the reports that are maybe not as relevant or as highly relevant to the detection of financial crime.

From an intelligence perspective, ma'am, I will tell you that all information is valuable. I think law enforcement will also tell you all information is valuable. I think it is our job at FinCEN to try to balance the reporting requirements with the burdens that we are putting on the industry, and I think, frankly, this language is one way to reach that balance.

Mrs. MALONEY. I think that is important, also the testimony we have gotten in prior hearings where there is so much information that no one is even looking at it, which we saw in the 9/11 report. A lot of this information was in certain places, but no one was looking at it. So if you are so overburdened with information you cannot even process it, we are not helping combat the terrorism, the money laundering, and we certainly are overburdening particularly these smaller and mid-size firms to the point they say that the financial burden and time burden is almost unbearable.

On the theme of balance, I would like to raise a challenge that we have in the district that I represent for financial service centers which serve a large number of unbanked workers, particularly in areas that are poverty-designated areas. There are many unbanked

workers. They have expressed serious concern about banks discontinuing their accounts. Many of them, the banks say that OCC had guidelines that told them they had to discontinue these accounts.

One of the things we do not want to do is cut off banking services for people. I know that you have taken this seriously. We have talked to your office about it and recognize that banks' disruption of services will force these check cashers underground or in other ways which we do not want. Can you tell us what has happened on this front since last summer when FinCEN held its conference on the issue and it appeared that positive steps were being taken? I have heard since that little improvement has actually happened, despite the right things being said.

I will tell you some of the larger institutions that are trying to do absolutely everything right. They are hiring consultants and everyone else to help them make sure they are doing everything right. They have the best intentions. Everyone wants to do everything right. Some of these consultants will say, well, just get rid of any questionable area. You just do not need to deal with it. So they are closing down these services. They are not participating and it is causing now in New York City we only have one bank that will support unbanked workers.

So could you comment please on this? It is an access to financial services issue. I think it is important because if we do not have access, then the Government has to come in and create another program to provide access.

Mr. FOX. It is important, ma'am. It is actually one of the big issues we are wrestling with right now. The banking of money services businesses is critically important. The Treasury Department has historically and continues to take the position that these entities, or this part of the financial services sector, are critical to not only the Nation's economy, but to the world economy, particularly for folks who are unbanked or who are perhaps not as well off as other folks.

We take this very seriously. I do not believe it is fair to say that the reason for this is by OCC guidance. That just simply is not there. I am sure Julie could address that as well. But I think it did result from a misperception, perhaps, by institutions about the level of risks associated with banking money services businesses, and couple that with concerns about what could happen if one of these services was found to be there. The banks actually thought they had to be perceived, that they had to be this sector's regulator. One of the things we did together was issue interagency guidance, which made it clear that we are not expecting that of depository institutions.

I think they have to keep in mind as well that this sector is a regulated sector. They are part of the Bank Secrecy Act milieu, if you will. They are subject to the same requirements that depository institutions are under the Bank Secrecy Act, including reporting and program requirements. Frankly, they have a regulator, and that is FinCEN, the IRS, and the Department of the Treasury. So I think what we are trying to do, ma'am, is educate, I guess, and talk with the financial services sector to ensure that they understand that.

Finally, I think that guidance has helped in parts of the country. Your area, ma'am, the Northeast in particular, is one part of the country that we are very concerned about because we are getting feedback that it has not helped. We are going to continue to work with folks on all sides of this issue to try to address it. It is critical that we get it right. We do not want them underground.

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

The Chair now recognizes Mr. Sherman from California.

Mr. SHERMAN. Thank you, Mr. Chairman.

Mr. Kroener, Gramm-Leach-Bliley enshrines the idea we have had in this country for a long time that commerce needs to be kept separate from business. If you read the books that were popular in the 1980s, this was the decade in which Japan was supposed to overtake the United States in world economic importance. That has not happened, perhaps because we have done a good job, but moreover because Japan has decided to mix banking and commerce.

I am concerned that the industrial loan companies idea, which was always a small side-light in our overall financial world, is perhaps going to be exploited by those who wish to combine commerce and banking. Wal-Mart, of course, has an application to charter an ILC. I wonder if you at the FDIC are moving cautiously, whether we in Congress should be holding hearings. What do we do to avoid the mixing of commerce and business?

Mr. KROENER. Congressman Sherman, the FDIC basically insures banks as an entity. Banks have a number of relationships with other companies in the same group. We have been insuring banks for the 80 years of our history, including ILCs. There are a number of sorts of banks, such as credit card banks and ILCs, that have been long operated independently and separately from their affiliated organizations. Our experience with those institutions suggests to us that they present no more safety and soundness problems to our insurance fund than do any other sort of institution.

Mr. SHERMAN. But if we were to take the Japanese model where you had interlocking directorates, interlocking loans, one commercial group the banker for the other commercial group, the second the banker for the first, that Japanese model is I do not think one that would be conducive to a strong insurance system. Do you see a risk in Wal-Mart's application or in other developments that we are moving beyond the very small traditional role of the ILCs toward that being the backdoor to the Japanese model?

Mr. KROENER. In terms of our function as insurer, we have a series of statutory criteria which we apply in making an insurance determination, that is, whether someone will be insured. Those seven criteria do not differ for ILCs or for any other sort of institution. We will be applying precisely the same criteria to the pending Wal-Mart application that we apply to all other institutions.

Mr. SHERMAN. I thank you for your answer. It is probably more important that we hold hearings here about what could be a loophole in the whole Gramm-Leach-Bliley. Obviously, you have your regulations and you are going to apply them. I hope you apply them with an understanding of the purposes of Gramm-Leach-Bliley, but I do need to move on to other questions.

Perhaps Mr. Fenner could explain in greater detail why prompt corrective action reform is important.

Mr. FENNER. Thank you, Congressman.

Currently, the minimum statutory net-worth level, non-risk-weighted leverage level that a credit union needs to achieve in order to be well capitalized is 7 percent, net worth equaling 7 percent of assets or greater. That is a full 200 basis points higher than the standard that exists for the rest of our federally insured financial institutions. We see at least three problems with that at NCUA.

One is that we think it is unfair to credit unions, especially under circumstances where credit unions operate with relatively less risky asset portfolios. We think it restricts the use of credit unions' earnings that could be better used for other purposes to serve the members. We think it creates a one-size-fits-all system that makes it difficult for us to use the risk-based net worth requirement side of the PCA scheme to effectively supervise risk.

So we think the solution that we have proposed that we are happy is contained in Title I of CURIA is to lower that leverage requirement, and do it in a way that accounts for the unique capitalization of insurance fund and then allow that system to work in tandem more effectively with the risk-based system that is comparable to what is in place for other institutions.

Mr. SHERMAN. But you have designed a risk-based system so that if a credit union had a particularly risky portfolio, it would have to have capital above the 7 percent required today.

Mr. FENNER. That is correct.

Mr. SHERMAN. So this is not just a lower capital standard. It is a more sophisticated one; higher for some, lower for others.

Mr. FENNER. That is correct. The system that is spelled out in some detail in CURIA would do exactly that. It would establish a set of risk-based requirements that very closely parallel what are in place for other insured financial institutions.

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

The Chair now recognizes Mr. Meeks of New York.

Mr. MEEKS. Thank you, Mr. Chairman.

I will have just real brief questions, and I would like to direct the first one to all three, Mr. Olson, Mr. Bowman, and Ms. Williams. I am wondering what your opinion is on increasing the reporting requirements of HMDA data such as credit scores and loan-to-value ratio. Just give me your opinion on that, if you will.

Mr. OLSON. Congressman, we looked at that issue very carefully when we were looking to change the HMDA reporting requirements. We talked about balance earlier, and there is a balance required between the amount of information that comes on HMDA and the amount of additional or incremental information that could have privacy implications.

For example, every additional bit of information you attach to the HMDA reporting comes that much closer to revealing the individual because you are doing it on a property-specific reporting basis, so that is part of the issue.

On the other hand, where we have seen in predatory lending, the critical issue involves pricing. It has been clear for some time that it is not the approval-denial decision that results in the most egregious forms of predatory lending. It is in the pricing. So with the combination of the HOEPA and HMDA new requirements and

identifying the loans where the mischief, if you will, in pricing could be identified, at that point we would have the ability to go after the institutions where there was the possibility for predatory lending or discriminatory lending.

So that is where the cut-line was made.

Also, in terms of if you were to truly evaluate whether an institution has a pattern of discrimination, you have to go into 50 and 60 and 70 data points. So you really have to look at the credit files themselves in order to ultimately make that evaluation. So we are very comfortable that where we are now can have us focus on the institutions that we would need to look at further.

Mr. MEEKS. Ms. Williams?

Ms. WILLIAMS. I would basically second that. There is an important issue of balance here. You would have to require the collection of an enormous amount of information from lenders in order to begin to approach being able to have data that you could just run automatically to get close to being able to draw any conclusions. What we have now is data that we use to screen and to identify institutions that are high-risk institutions. Then we apply a variety of other risk factors to home in on those institutions where we go in and we do the types of file reviews that Governor Olson is talking about. So I would second his remarks.

Mr. MEEKS. Mr. Bowman?

Mr. BOWMAN. I would third that as well. The information, the balance that has been struck by the regulations promulgated by the Fed do provide us as a regulator the necessary information or identification marks which would allow our examiners to go in and look at a particular institution and perhaps the particular files within that institution to dig further. To the extent that what we come up with is something that is of great concern, we would then proceed accordingly. So I think the Fed has found the balance.

Mr. MEEKS. Mr. Bowman, let me stay with you for a second. I just want to jump in, and I am just about done.

I think in reading your testimony, you indicated that small banks are concerned about the cost of compliance with the Bank Secrecy Act and Sarbanes-Oxley. What I want to know is, does Sarbanes-Oxley become less expensive as better internal controls are put in place? Are the smaller banks still using tier one accounting firms instead of tier two, as was mentioned in the hearing of the PCAOB?

Mr. BOWMAN. Our experience has been that given the loss of the larger accounting firms, and also given the nature of a lot of our institutions, they use smaller accounting firms, auditing firms to provide them with the support they need. Unfortunately, the experience of the smaller institutions has been that some of the costs that they incur as a result of that employment are not necessarily distinguishable from some of the costs that the larger institutions would be charged by the larger accounting firms and others.

The difficulty with and I think one of the points we make in our testimony is that the size of the institution, given regulations that are out there and statutory obligations that are imposed upon them, does not seem to make a difference. The largest institutions in the country are subjected to the same regulatory requirements as are the smaller ones. The ability to make a profit the smaller

you get becomes more difficult. The continuing costs that the smaller institutions are subjected to really causes, I think, in many cases the kinds of complaints that we do hear from our institutions.

Mr. MEEKS. Thank you.

Mr. HENSARLING. The gentleman yields back.

Seeing no other members in the hearing room who have not been recognized, I want to thank the panel for coming today and providing us with your testimony.

The Chair notes that some members may have additional questions for this 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 the witnesses and to place their responses in the record.

This hearing is adjourned.

[Whereupon, at 12:40 p.m., the subcommittee was adjourned.]

A P P E N D I X

September 22, 2005

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit
H.R. 3505, Financial Services Regulatory Relief Act of 2005
September 22, 2005

I want to thank Chairman Bachus for holding this hearing on H.R. 3505, the Financial Services Regulatory Relief Act of 2005. We look forward to hearing today from the Federal and State regulatory authorities charged with ensuring the safety and soundness of our nation's banking, thrift, and credit union industries.

The financial services industry is operating under a heavy regulatory burden. While many of the regulations imposed on the industry are necessary to protect consumers, combat terrorist financing, or serve other worthy public policy objectives, others are clearly outdated or needlessly burdensome.

For this reason, shortly after I assumed the chairmanship of this Committee, I asked the financial regulators and industry trade groups to give us their best advice on what this Committee could do to ease regulatory requirements faced by depository institutions. The goal was to lessen the regulatory burden and improve productivity, as well as make needed technical corrections to current statutes. It was clear then, as it is today, that there also needs to be a counterbalance to the significant compliance responsibilities placed on insured depository institutions by the USA PATRIOT Act as well as other government efforts to counter terrorist financing.

Last Congress, the Committee approved a comprehensive regulatory relief bill (H.R. 1375) that passed the House by a vote of 392-25. H.R. 1375, which incorporated suggestions from financial regulators as well as the financial services industry, contained a wide range of provisions that would have relieved unneeded or outdated regulatory restrictions on banks, thrifts and credit unions.

While the Senate failed to take up H.R. 1375, I am pleased that two respected members of the committee, Mr. Hensarling and Mr. Moore, have introduced H.R. 3505, which includes virtually all of H.R. 1375, a new title that addresses Bank Secrecy Act concerns, and over 20 new provisions.

The Bank Secrecy Act Compliance Burden Reduction title addresses financial institutions' concerns that some of the work they are being asked to do in the fight against financial crimes is unnecessary and overly burdensome. This title focuses on reducing the number of currency transaction reports (CTRs) that must be filed by institutions involving large sums of cash, as well as eliminating inconsistencies or duplicative requirements in conjunction with the filing of suspicious activity reports (SARs).

I would like to thank FinCEN Director Fox, who is testifying today, Mr. Hensarling, Chairman Bachus, as well as Mr. Frank and Mr. Gutierrez, for their efforts in creating Title VII, which balances law enforcement's needs with the industry's very real concerns about excessive and unnecessary burdens.

I thank the witnesses for appearing here and I look forward to their thoughts on how best to free depository institutions from unduly burdensome regulation, so they can better serve their customers and communities.

OPENING STATEMENT OF
CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
"H.R. 3505, FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005"
SEPTEMBER 22, 2005

Good morning. Today's hearing will focus on H.R. 3505, the Financial Services Regulatory Relief Act of 2005, which alters or eliminates unduly burdensome or outdated regulatory requirements. Introduced by Congressman Hensarling and Congressman Moore in July, H.R. 3505 — which I have cosponsored — seeks to reduce the regulatory burden on insured depository institutions to benefit consumers and the economy by lowering costs and improving productivity. This legislative hearing follows two earlier hearings in which the Subcommittee received regulatory relief recommendations from both the regulators and industry trade groups. I want to commend Congressman Hensarling and Congressman for their tireless efforts on this important piece of legislation and look forward to working with them to move H.R. 3505 through the legislative process.

At today's hearing we will hear from a distinguished panel of regulators, including Financial Crimes Enforcement Network Director William J. Fox, Federal Reserve Governor Mark W. Olson, First Senior Deputy Comptroller and Chief Counsel of the Office of the Comptroller of

the Currency Julie L. Williams, General Counsel of the Federal Deposit Insurance Corpor.ation William F. Kroener III, Chief Counsel of the Office of Thrift Supervision John E. Bowman, General Counsel of the National Credit Union Administration Robert Fenner, Texas Department of Banking Commissioner Randall S. James on behalf of the Conference of State Bank Supervisors and Virginia Bureau of Financial Institutions Deputy Commissioner George Latham on behalf of the National Association of State Credit Union Supervisors. I look forward to hearing from today's witnesses and thank them for taking time from their busy schedules to join us.

In particular, I want to thank Director Fox for his efforts on new Title VII of the reg. relief bill on reducing regulatory burden caused by the Bank Secrecy Act. I recognize that finding consensus on these issues is no small feat and appreciate his working with us. Title VII seeks to make a number of changes, some statutory and other directing swift regulatory changes, to reduce the burdens without eliminating information valuable to law enforcement. Last week, Director Fox and a group of bipartisan Committee members including myself agreed on a draft proposal to significantly ease Currency Transaction Report (CTR) filing requirements for seasoned customers. This proposal will ease the burden on our financial institutions and at the same time allow the law enforcement agencies to more effectively and efficiently combat money laundering.

The banking industry estimates that is 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 so that they can more effectively 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 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. Unfortunately, the Senate took no action on H.R. 1375.

On July 28, 2005, Mr. Hensarling and Mr. Moore introduced H.R. 3505, a regulatory relief bill that draws from and supplements the provisions of the earlier 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. On May 12, 2005, 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

September 22, 2005

Hearing entitled: *"H.R. 3505, Financial Services Regulatory Relief Act of 2005"*

I want to thank Chairman Bachus for calling this hearing today. There is no doubt that our financial 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 rules and regulations, the markets can be dragged down by unnecessary costs. Last Congress, the House passed H.R. 1375 with bipartisan support and it is my hope that in the 109th Congress, our Committee will again pass measures to 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 mandated internal control standards, small banks have faced enormous, and perhaps unnecessary, new cost in complying with these cumbersome regulations.

I am pleased to see that the Hensarling bill incorporates my compromise with Ranking Member Frank regarding so called industrial loan companies, or ILCs. It remains my belief that these institutions need to be reigned in and that the historic wall separating banking from commerce must remain intact. I am aware of the fact that not all financial holding companies are supportive of our efforts to reduce the powers of the industrial loan charter, but requiring them to fit a Gramm-Leach-Bliley type test for *de novo* branching privileges is modest reform.

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.

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Opening Statement
Congressman Al Green
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
H.R. 3505, Financial Services Regulatory Relief Act of 2005
September 22, 2005

I would like to thank Chairman Bachus and Ranking Member Sanders for holding this important hearing on regulatory relief. I would also like to thank our panel for joining us today.

Let me begin by saying that while I am here fulfilling my role as a Member of Congress, my heart and mind are with my fellow Houstonians and others who stand in the path of Hurricane Rita, which has now reached a Category 5 level. It is expected to hit the Texas coast sometime early Saturday morning. Already, more than 1.3 million residents in Texas and Louisiana have fled their homes, hoping to avoid a deadly repeat of Hurricane Katrina. I will be returning to Houston immediately after the last votes today to help Mayor White, the American Red Cross, and my fellow Houstonians in any way I can. I know all of our thoughts and prayers are with them.

As the Gulf Coast area is about to be hit by yet another Hurricane, I would like to hear from our witnesses about their efforts, and the efforts of the financial institutions they regulate, to help the victims of Hurricane Katrina. Katrina also pointed out to the nation the plight of our nation's poor. I would like to learn more about the efforts of financial institutions to serve low income and minority communities, particularly in light of the Federal Reserve HMDA study released last week analyzing lending practices.

Again, I want to thank our panel for coming before our Committee today. I look forward to working with you to address these important matters.

Representative Jeb Hensarling
Opening Statement for Financial Institutions Hearing
"H.R. 3505, Financial Services Regulatory Relief Act of 2005"
Thursday, September 22, 2005

Thank you for holding this important hearing and thank you for your leadership in helping Congress reduce the regulatory burden on our nation's financial institutions.

As we learned in our hearings over the last few months, our financial institutions are in desperate need of regulatory relief.

Many of these regulations have costs that are passed on to the consumer in one form or fashion. Many outlive their purposes and have significant unintended consequences.

What we do know is that excessive, duplicative and costly regulations make credit more expensive and less accessible for the people who need credit the most.

Outdated regulations can keep Americans from purchasing their first home, buying an automobile for work, financing a child's education, or starting a small business that creates new jobs in a small town.

I believe the bill Mr. Moore and I have introduced remedies many of these problems, and will help banks, credit unions and thrifts free up more resources to inject into their communities.

And action is necessary sooner rather than later. The competitive position and viability of smaller financial institutions are in question, because the regulatory environment has evolved to the point of placing small banks at an

artificial disadvantage. This, of course, is to the detriment of their primary customers—small business, consumers and the agricultural community.

A study released by SBA on Monday shows that the smallest businesses in our country face the largest per employee burden for regulatory compliance costs. Firms with fewer than 20 employees are now annually spending $7,647 per employee to comply with federal regulations. The study also noted that small businesses face a 45 percent greater burden than their larger business counterparts.

Further, this same report shows that the annual cost of federal regulations in the U.S. totaled $1.1 trillion in 2004. If only *one percent* of that amount could be returned to the marketplace, that would be enough money to provide start up capital for more than 400,000 new small businesses or pay the annual salaries for more than 270,000 workers!

We heard that often times as institutions are faced with a new regulation, staff must be trained or a new employee must be hired, taking valuable time and resources away from customer service.

Hundreds of thousands of dollars are spent for regulatory compliance - Reg B, Reg E, Reg D, CRA, HMDA, HOEPA, Reg O and the list goes on and on.

Since 1989, bank regulators have promulgated over 850 regulations. That's around 50 new regulations a bank has to comply with every year. Can we really expect a small community-based institution to continue to adapt and comply with regulatory changes at this pace?

Financial institutions are required to send out annual privacy notices to alert customers to information that often times these institutions do not even share. Assuming a bank has

not changed its policies, why would we continue to ask them to spend their capital and resources on notification documents that are of no use to their customers? H.R. 3505 will ensure that financial institutions are not forced to send useless disclosure statements to their customers when their privacy policies have not changed and when the institution does not share the personal information of consumers.

We heard that community banks are hiring 2 or 3 full-time employees to do nothing but Bank Secrecy Act compliance. I am pleased that the regulators and law enforcement have recognized that a reduction in the number of CTRs and SARs that financial institutions send to Washington can actually benefit anti-money laundering and anti-terrorist financing efforts. I am especially pleased with FinCEN's leadership in this matter.

Financial institutions should not have to continuously file paperwork and reports of suspicious activity on the customers that they know best.

I believe with meaningful regulatory relief, we can get more capital into our communities without undermining safety and soundness.

The time has come to clean the barnacles off this ship, and allow our financial institutions to operate at full speed, safely and soundly.

I look forward to continue to work with my friend from Kansas, Mr. Moore, as we consider the Financial Services Regulatory Relief Act of 2005.

Mr. Chairman, I again want to applaud you for holding these hearings and I thank you for keeping this issue at the forefront of the committee's agenda.

I yield back.

Statement of the Honorable Sue Kelly

Thank you Chairman Bachus for holding this important hearing on providing regulatory relief for financial institutions and their customers.

I look forward to hearing from our witnesses on the steps this committee should be taking to lower costs to consumers and create jobs.

I want to thank my colleague Mr. Hensarling for his hard work on this legislation, and also Mr. Moore from Kansas.

I note the presence of the Federal Deposit Insurance Corporation among the witnesses, and wish to draw their attention to the imminent release of a GAO report on Industrial Loan Corporations, and urge them to keep that report in mind when reviewing requests for coverage by new depository institutions.

There are obviously a number of important provisions in this bill.

I am very interested in discussions about proposed changes to the Bank Secrecy Act.

There are very good reasons for advocating reform for our BSA system. We have learned the hard way that the system needs work.

Failures such as Riggs Bank and, more recently Arab Bank, have clearly demonstrated that there are weaknesses in our anti-money laundering protections.

And the resulting over-reaction and uncertainty about what is expected of financial institutions have led to unnecessary burdens and costs that must be addressed.

We know financial institutions and their customers want common sense. They want certainty. And we in Congress know the system can be made better.

We have to work towards solutions that will remove unnecessary burdens from customers and institutions without weakening an important tool for law enforcement and national security officials.

Just as we are mindful of the serious, costly inconveniences that have saddled financial institutions and their customers, we are also keeping our eyes on the importance of an effective anti-money laundering system to our national security.

As action begins on this legislation, we must be mindful of what the 9/11 Commission told this committee last year before this committee about the value of the BSA system in fighting terrorism.

We must be mindful of what the FBI and FinCEN Director Fox told this committee earlier this year about the utility of BSA information in tracking criminals and terrorists.

I look forward to examining these proposals in detail and hearing the views of those affected, including the relevant law enforcement and intelligence agencies.

Thank you, I yield back.

Opening Statement
Rep. Carolyn Maloney
Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
"Financial Service Regulatory Relief: Private Sector Perspectives"
September 22, 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 look forward to the testimony.

Opening Statement of Rep. Dennis Moore
Hearing on H.R. 3505, the Financial Services Regulatory Relief Act of 2005
September 22, 2005

- I would like to thank my good friend, Chairman Bachus, for scheduling today's hearing on regulatory relief legislation, H.R. 3505, introduced by Congressman Hensarling and me and cosponsored by approximately 30 members from both sides of the aisle.

- The Financial Services Committee has a strong record of bipartisanship, and I'm glad that that has extended to this bill.

- 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.

- Small lenders in our communities particularly feel the burden of duplicative and unnecessary regulations.

- As the federal banking regulators acknowledged in a notice published in the Federal Register, "when a new regulation is created or an old regulation is changed, small institutions must devote a large percentage of their staffs' time to review the regulation to determine if and how it will affect them. Compliance with a regulation also can take large amounts of time that cannot be devoted to serving customers or business planning."

- Strong regulation of our country's financial system is absolutely essential, but Congress and the financial regulators have a responsibility to strike the right balance in this area, and H.R. 3505 is an important step in the right direction.

- Since coming to Congress, and particularly over the past few months, I have heard from depository institutions in my district and throughout Kansas, and have tried to address in H.R. 3505 some of the concerns that I have heard on more than one occasion.

- While assets for state-chartered banks in Kansas have reached an all-time high of $27 billion, our community banks are also struggling to comply with both old and new regulatory burdens, including some created under the Bank Secrecy Act.

- H.R. 3505 seeks to provide relief from some of these new burdens to our financial institutions in a way that preserves our ability to effectively track terrorist financing and build upon our success in freezing the funds of terrorists. Rep. Hensarling and I, and the bill's bipartisan cosponsors, agree that waging a strong war on terror and providing some regulatory relief to our financial institutions are not incompatible goals.

- Additionally, H.R. 3505 provides two new sections of regulatory relief for our credit unions that were not included in the previous version of this measure, H.R. 1375.

- 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 look forward to continuing the broad bipartisan cooperation on this legislation that we have enjoyed in the past.

- I also look forward to hearing from our witnesses today on what steps the regulatory agencies have taken to ensure that depository institutions in the areas affected by Hurricane Katrina are able to continue operating, both for their benefit and for the benefit of their customers who are going through some of the toughest times in their lives.

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

STATEMENT BY REP. BERNARD SANDERS AT THE REGULATORY RELIEF HEARING (ALSO FOCUSING ON ESOPS) THURSDAY, SEPTEMBER 22, 2005 AT 10AM IN 2128 RHOB

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

Today, we will be discussing H.R. 3505, the Financial Services Regulatory Relief Act of 2005, introduced by Mr. Hensarling and Moore.

I am delighted that this legislation includes a provision that I authored to provide a Community Reinvestment Act Credit to financial institutions to expand employee ownership. I would like to thank the Chairman and the authors of H.R. 3505 for working with me to include this important provision in the Reg. Relief bill.

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. 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 5 years, the United States has lost more than 2.8 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.

H.R. 3505 also includes 15 important regulatory reforms that will allow credit unions to better serve their members, including a section to allow credit unions to cash checks and wire funds to anyone who is eligible to join their credit union.

So long as the employee ownership and credit union provisions are kept in H.R. 3505, I will strongly support this legislation.

Mr. Chairman, as you know, during the 108th Congress, I opposed a similar Regulatory Relief bill because of the absence of meaningful consumer protections. But, this year's regulatory relief bill is a major improvement over last year's version, and I would like to thank you, Ranking Member Frank, and the authors of the legislation for their excellent work on this bill.

Having said that, Mr. Chairman, I also believe that it is very important for this Subcommittee to seriously examine the deceptive and misleading credit card scams perpetrated by some of the largest banks in America.

To address these problems, I have introduced H.R. 3492 with Ranking Member Frank, entitled the Credit Card Consumer Protection Act.

This legislation would:

- Prohibit "bait and switch" scams that raise consumers' interest rates for events wholly unrelated to the consumer's credit card account. Mr. Chairman, I have enjoyed working with you on this issue in the past, and I look forward to working with you in the future. With Ranking Member Frank's support on this issue, I believe we have picked up a very important ally.

- This legislation would also require credit card companies to provide ***real*** notice to consumers ***before*** raising interest rates or charging fees (not hiding rate increases in the small font of a "terms agreement") and waiting for consumers to notice that their rates have jumped or that they have been charged an astronomical fee.

- And, H.R. 3492 would prohibit credit card issuers from raising interest rates on preexisting balances for "fixed rate" cards. New terms would apply only to new purchases.

Mr. Chairman, charging economically vulnerable Americans outrageous interest rates and fees is simply not acceptable. The time is long overdue for Congress and the White House to stand up for American consumers and take on the modern-day loan sharks in the credit card industry. I look forward to working with you on these issues and I look forward to hearing from our witnesses.

Embargoed until
September 22, 2005, at 10:00 am

Statement of

John E. Bowman, Chief Counsel
Office of Thrift Supervision

concerning

Regulatory Burden Relief

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

House Financial Services Committee

September 22, 2005

Office of Thrift Supervision
Department of the Treasury

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Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on Regulatory Burden Relief
before the
Subcommittee on Financial Institutions and Consumer Credit
of the
House Financial Services Committee

September 22, 2005

John E. Bowman, Chief Counsel
Office of Thrift Supervision

I. Introduction

Good morning, Mr. Chairman, Ranking Member Sanders, and members of the Subcommittee. Thank you for the opportunity to discuss H.R. 3505, the Financial Services Regulatory Relief Act of 2005, the regulatory burden relief legislation introduced by Congressmen Hensarling and Moore. I will discuss several of the regulatory burden relief priorities of the Office of Thrift Supervision (OTS) that are included in this bill, as well as ongoing OTS efforts pursuant to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA).

Removing unnecessary regulatory obstacles that hinder profitability, innovation, and competition in our financial services industry, and that also impede job creation and economic growth in the general economy, is an important and continuing objective of OTS. Although we have accomplished much in recent years to streamline and eliminate some of the burdens faced by the thrift industry, there remain many other areas for improvement. We are fully committed to work with you, Mr. Chairman, and the Members of the Subcommittee and full Committee to address these issues.

A. The EGRPRA Process

Before proceeding to my testimony, Mr. Chairman, I want to recognize the tireless efforts of you, Mr. Hensarling, Mr. Moore, and your staffs in pursuing regulatory burden reduction legislation. I know you are all familiar with our Director, John Reich, who has spearheaded the interagency EGRPRA regulatory burden reduction effort. As you know, Director Reich came over to the OTS in August, and he will continue to oversee the interagency EGRPRA effort. We look forward to working with the other agencies participating in the EGRPRA process to move this project forward. Director Reich has asked all of the agencies to identify those items from other agencies that can be supported via an interagency

consensus. In this regard, the Director has asked each of the agencies to identify other agency items that they can support consistent with existing standards of safety and soundness, consumer protection, and sound public policy. The hope is that common agency consensus will facilitate enactment of H.R. 3505 or similar regulatory relief legislation.

As part of the EGRPRA outreach effort, in the past two years Director Reich attended ten outreach meetings with banks and thrifts, three meetings with consumer/community groups, and three meetings with both industry and consumer/community groups in attendance. Joining him at these meetings have been representatives of all of the federal banking agencies, the National Credit Union Administration, the Conference of State Bank Supervisors, various industry trade associations, and community representatives from a wide array of organizations.[1] In each of these meetings he has asked participants to identify regulatory requirements that they believe are outdated, unnecessary or unduly burdensome. Consistent with the review requirements of EGRPRA, this request includes consideration of both regulatory changes that can be made at the agency level and recommended legislative fixes to reduce regulatory burden.

As a result of these efforts, a growing number of legislative items and issues have gained support, and we hope to continue to add more as the participating agencies identify consensus provisions.

B. Hurricane Katrina Relief Efforts

A more immediate aspect of the regulatory burden reduction effort has been action the last several weeks by the financial regulators, both individually and collectively, to identify areas where we can take immediate steps to assist institutions affected by Hurricane Katrina to better serve their customers. Unlike previous natural disasters, the needs and issues presented by Hurricane Katrina are unprecedented and will take significantly longer time to address and resolve. For our part, in addition to participating in various interagency relief efforts, we have communicated with all of our institutions in the affected area and continue to do so to determine any additional resources that we can provide or actions that we can take to assist their short-term and longer term recovery. Attached to my statement is a press release that we issued that highlights some of the more immediate actions that institutions can take to assist their customers.

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1. For additional information on the EGRPRA process, please refer to the attached "EGRPRA Fact Sheet."

Among these actions are helping institutions to restore branch facilities, including temporary facilities, and encouraging thrifts in the affected areas to work with their customers and communities by:

- Considering temporarily waiving late payment charges and early withdrawal of savings penalties;
- Reassessing the current credit needs of their communities and offering prudent loans to help rebuild damaged property;
- Restructuring borrowers' debt obligations, where appropriate, by altering or adjusting payment terms;
- Soliciting state and federal guarantees and other means to help mitigate excessive credit risks; and
- Considering all available programs offered by the Federal Home Loan Banks.

In addition, in order to facilitate rebuilding efforts in the areas affected by Hurricane Katrina, among other things, we are working with institutions to grant emergency exceptions to applicable appraisal standards, and to provide for allowance of reasonable loan documentation deficiencies necessitated by thrift office relocation or personnel shortages. There are numerous other actions we have taken and that we continue to consider to assist thrift institutions to serve their customers and non-customers in the affected areas, as well as to educate institutions and the public on how to obtain the financial services they require and to avoid potentially fraudulent situations.

C. Most Pressing Industry Needs

Before discussing OTS's top legislative priorities, it is important to note that there are two areas not detailed in this statement that many of our institutions have identified as unduly burdensome—the Bank Secrecy Act (BSA) requirements and the rules under the Sarbanes Oxley (SOX) Act. Virtually all institutions raise these two issues as regulatory relief priorities; however, the impact of these statutory provisions is often most acute for smaller, community-based institutions that do not have the resources and wherewithal to implement the type of cost-effective, global programs required to address the monitoring of activities under these laws. While these laws are also problematic for larger institutions, smaller institutions are significantly more burdened by virtue of their size to develop and implement cost-effective solutions to address BSA and SOX requirements. This,

in turn, imposes greater competitive stresses on smaller institutions relative to their larger competitors.

A recent BSA development is a proposal that we understand is supported by the Financial Crimes Enforcement Network (FinCEN) to except from filing certain currency transaction reports (CTRs) of so-called "seasoned customers." Eligible customers would include corporations and organizations that have maintained a depository account at an institution for at least 12 months and that includes activity that triggered a CTR filing within the 12-month period.

OTS is fully supportive of efforts to provide meaningful BSA relief to the institutions we regulate that are consistent with the requirements of the BSA and the needs of law enforcement. We will support any burden reduction proposal to streamline existing BSA requirements, provided it is supported by FinCEN and it provides meaningful relief that outweighs any diminished utility to the BSA.

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

D. OTS Legislative Priorities

OTS's highest priority items for regulatory burden relief legislation are:

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

Of these four items, two are included in H.R. 3505. Section 201 of H.R. 3505 provides relief to savings associations under the federal securities laws. Section 212 of H.R. 3505 updates the commercial and small business lending authority of savings associations. In addition, section 208 of H.R. 3505 provides partial relief to savings associations (for auto loans) with respect to the existing consumer lending limits imposed on thrifts. I will explain all of these items in more detail and describe several other initiatives that we are recommending for enactment.

II. Revising the Federal Securities Laws to Eliminate Duplicative Regulatory Burdens for Savings Associations

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

Although the Securities and Exchange Commission (SEC) has issued several proposals purportedly to address the duplicative burden imposed on savings associations, the application of the federal securities laws in these two areas remains a needless additional burden with no additional supervisory benefit for savings associations. Significant disparities remain under the IAA, with savings associations subject to an entirely duplicative SEC oversight regime. Equally significant, it remains uncertain how the SEC will ultimately treat savings associations for purposes of the broker-dealer exemption. In the SEC's most recent iteration on this issue, it indicated that it would roll back an interim rule that had extended equal treatment to savings associations vis-à-vis banks for purposes of the broker-dealer exemption.[2] While these issues remain in flux, there has been nothing to indicate that we are heading in the direction of reducing needless duplicative oversight for savings associations under the federal securities laws.

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

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

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

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

The existing inequity under the federal securities laws undermines our collective efforts to maintain a strong and competitive banking system. Eliminating the unnecessary costs associated with the IAA and 1934 Act registration requirements—as set forth in section 201 of H.R. 3505—would free up significant resources for savings associations in local communities. It would also avoid the regulatory burden and substantial costs associated with a duplicative regulatory structure that has already dictated some institutions' charter choice—an issue recognized by former SEC Chairman Donaldson in the context of the discussion on the SEC's IAA proposal.[3]

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

A. Investment Adviser Registration

Prior to enactment of the Gramm-Leach-Bliley Act (GLB Act) in 1999, banks—but not savings associations—enjoyed a blanket exemption under the IAA. While the GLB Act slightly narrowed the bank exemption, banks may still provide investment management and advisory services to all types of accounts without registering as an investment adviser. The one exception is that a bank (or a department of the bank) must register when it advises a registered investment company, such as a mutual fund.

On May 7, 2004, the SEC issued a proposal providing a narrow exemption from IAA registration to savings associations that limit their investment management and advisory services to a limited range of accounts. Under the proposal, savings association fiduciary accounts are segregated into two categories. Savings associations that provide services to accounts that include only traditional trust, estate, and guardianship accounts would be exempt from registration. Savings associations providing services to accounts that include investment management, agency accounts and other accounts that the SEC has defined as not being for a fiduciary purpose would continue to be required to register as an investment adviser.[4]

The practical effect of this approach is that it provides an extremely limited exemption that does not provide meaningful regulatory relief for savings associations. This fact was made clear to the SEC Commissioners at a meeting last year when the SEC staff advised the Commissioners that none of the savings associations currently registered under the IAA—there are 44 savings associations currently registered (and 3 registered operating subsidiaries)—would be able to take advantage of the proposed exemption since all provide investment management and advisory services for both account categories.

While the SEC wants to apply the federal securities laws in two different manners depending on the business operations of a savings association, there is no distinction between these two categories of accounts under the HOLA and OTS regulations applicable to savings associations. The accounts in both categories are fiduciary accounts that receive the same protections under the HOLA and OTS regulations and are subject to similar examination scrutiny. There is no logical

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

basis why savings associations, unlike banks, need duplicative regulatory oversight by the SEC of account activities that OTS already supervises and examines. This is far from functional regulation, but rather over-regulation that accomplishes nothing in the way of a legitimate policy objective.

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

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

Ironically, many of these same themes were cited as the basis for the SEC's recent rule exempting certain broker-dealers from the IAA registration requirements.[5] Minimizing duplicative regulation, changes reflecting developments and advances in industry practices, acknowledging underlying Congressional intent to carve out certain types of entities from IAA registration because of parallel federal oversight, and ensuring and maintaining consistent consumer protections are all reasons supporting the SEC's exemption for broker-

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

dealers under the IAA. These same reasons support an IAA exemption for savings associations.

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

In addressing this issue, it is important to recall that in July 2000 an amendment was offered by Senator Bayh (on regulatory burden reduction legislation then pending before the Senate Banking Committee (SBC)) to extend the IAA exemption to savings associations so that savings associations and banks could compete equally in the provision of investment management and advisory services. During consideration of the amendment, the SEC represented to the SBC that legislation was not needed to resolve this problem since the SEC would be able to resolve the issue by regulation.[6] More than five years later the issue remains unresolved with virtually no likelihood of this changing given that the SEC's May 2004 proposal offers no relief to existing IAA-registered savings associations. This fact, alone, underscores why nothing short of a legislative solution is adequate to resolve this issue going forward.

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

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

B. Broker-Dealer Registration

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

The SEC postponed the effective date of the interim rule several times. It published proposed amendments to the interim dealer rule on October 20, 2002, and the final dealer rule on February 24, 2003. The final dealer rule gives savings associations the same exemptions as banks. On June 30, 2004, the SEC published in the Federal Register a new proposed rule (Regulation B) governing when a bank or savings association must register as a broker. Originally scheduled to go into effect on September 30, 2005, the SEC recently extended the effective date for Regulation B until September 30, 2006 in order to afford time to fully consider the comments received from the industry and other interested parties.[7]

Unlike the SEC's final dealer rule and interim broker rule, the new broker proposal would no longer treat savings associations the same as banks in all respects. Although savings associations would be treated the same as banks for purposes of the 11 statutory activities they may engage in without registering as a broker with the SEC, as provided by the GLB Act, three non-statutory exemptions provided banks would not be extended to savings associations. The SEC describes the three non-statutory exemptions as targeted exemptions that recognize the existing business practices of some banks. We understand that the SEC staff does not believe savings associations are engaged in the exempted securities activities

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7. SEC Final Rule: Certain Broker-Dealers Deemed Not To Be Investment Advisers, Extension of Compliance Date, Release No. 34-52407 (September 12, 2005).

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

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

III. Removing Disparate Standards in Savings Association Consumer Lending Authority

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

Currently, section 208 of H.R. 3505 removes the 35 percent cap for auto loans made by savings association. For the reasons stated above, we believe eliminating the 35 percent cap makes good policy sense for all types of consumer

loans, including auto loans, and we urge that the provision be amended accordingly.

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

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

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

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

to achieve the economies of scale necessary to engage in this activity safely and profitably.

Small business lending is an integral component of job growth and employment in the United States.[8] This proposal would increase competition for, and the availability of, small business and other commercial loans now and in the future as savings associations develop this line of business. This will be particularly welcome to smaller businesses that have experienced difficulty in obtaining relatively small loans from large commercial banks that set minimum loan amounts as part of their business strategy—a problem that may increase with industry consolidation.[9] Finally, the proposal will also assist businesses that prefer borrowing from entities like savings associations that meet the needs of borrowers with personal service.

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

OTS urges Congress to authorize the Treasury Secretary to appoint one or more individuals within OTS to serve as OTS Acting Director in order to assure agency continuity. Similarly, it is important to modernize the existing statutory appointment authority for the OTS Director by permitting an appointee a new five-year term.

The first proposal would revise the current procedure of relying on the Vacancies Act to fill any vacancy that occurs during or after the term of an OTS Director or Acting Director. This would eliminate potential concerns and time constraints imposed by the Vacancies Act process under which OTS currently operates. The latter proposal would eliminate reliance on an antiquated appointment process that currently requires a new OTS Director to fill out the expiring term of a predecessor, rather than receiving a new five-year term.

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

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

We believe that both of these revisions are important and should be added to H.R. 3505 given our continuing focus on the stability of the financial system and the regulatory oversight agencies in the event of a national emergency. For example, existing uncertainty about succession authority for an OTS Acting Director could impair the ability of OTS to act effectively and decisively in a crisis if an existing OTS Director or an Acting Director, such as me, suddenly was incapacitated as a result of an event arising from a national emergency.

The OCC has long-standing authority for appointing Deputy Comptrollers,[10] and both the FDIC and Federal Reserve Board have succession authority built into their operative authorizing statutes. One approach to ensure OTS continuity would be to amend HOLA to permit the Treasury Secretary to make the OTS appointments so each potential OTS Acting Director would qualify as an "inferior officer" under the Appointments Clause of the Constitution.

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

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

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10. 12 U.S.C. § 4.

VI. Other Regulatory Burden Reduction Proposals

OTS also recommends enactment of other important regulatory burden relief initiatives. We appreciate the opportunity to work with the Subcommittee staff on these and other provisions that will benefit the thrift industry.

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

OTS favors section 203 of H.R. 3505, which provides federal savings associations the authority to merge with one or more of their non-depository institution affiliates, equivalent to authority enacted for national banks at the end of 2000.[11] The Bank Merger Act would still apply, and the new authority does not give savings associations the power to engage in new activities.

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

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

Two amendments to ILSA that we previously proposed would promote greater consistency among U.S. regulators in supervising the foreign activities of insured depository institutions and should be added to H.R. 3505.

1. Applying ILSA to Savings Associations

OTS recommends making federal and state savings associations (and their subsidiaries and affiliates) subject to ILSA on the same basis as other banking institutions. This will eliminate regulatory burden by promoting the uniform

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

supervision of insured depository institutions. OTS is already covered by ILSA along with the other FBAs, but savings associations are not. In enacting ILSA, Congress sought to assure that the economic health and stability of the United States and other nations would not be adversely affected by imprudent lending practices or inadequate supervision. A depository institution subject to ILSA must, among other things:

- Establish special reserves necessary to reflect risks of foreign activities; and

- Submit to the appropriate FBA quarterly reports on its foreign country exposure.

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

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

2. OTS Representation on the Basel Committee on Bank Supervision

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

family residential mortgage loan originations in 2004, this market stands as the largest credit market in the world, currently with over $9 trillion in outstanding loans.[12]

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

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

Pursuant to federal diversity jurisdiction, a federal savings association may sue or be sued in federal court if the claim exceeds $75,000 and the parties are citizens of different states. OTS supports section 213 of H.R. 3505, which clarifies that, for purposes of determining diversity jurisdiction, a federal savings association is a citizen of its home state and, if different, the state in which its principal place of business is located.

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

D. Enhancing Examination Flexibility

Current law requires the FBAs to conduct a full-scale, on-site examination for the depository institutions under their jurisdiction at least every 12 months. There is an exception for small institutions that have total assets of less than $250

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

million and are well-capitalized and well-managed and meet other criteria. Examinations of these small institutions are required at least every 18 months.

When originally enacted in 1991, the small institution examination exception was available to institutions with assets less than $100 million (assuming the other statutory criteria were satisfied). This statutory threshold was raised to $250 million in 1994 for institutions in outstanding condition and meeting the other statutory criteria. In 1996, the FBAs were authorized to extend the $250 million threshold to institutions in good condition. Given the fact that the current threshold has been in place for more than eight years, OTS recommends considering whether the $250 million cap should once again be raised. If so, we support section 607 of H.R. 3505, which is endorsed by all of the FBAs, to increase the small institution threshold to $500 million for well-capitalized, well-managed institutions.

Section 607 would reduce regulatory burden on low-risk, small institutions and permit the FBAs to more effectively focus their resources on the highest risk institutions.

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

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

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

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

associations. Under the HOLA, a SLHC cannot charter or acquire a limited purpose credit card savings association, but can charter or acquire a limited purpose credit card bank without triggering the multiple SLHC restrictions or being treated as a BHC under BHC Act.

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

G. Modernizing the Community Development Investment Authority of Savings Associations

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

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

Section 202 closely tracks the existing authority for banks. Under this provision, savings associations may make investments primarily designed to promote the public welfare, directly or indirectly by investing in an entity primarily engaged in making public welfare investments. There is an aggregate limit on

investments of 5 percent of a savings association's capital and surplus, or up to 10 percent on an exception basis.

H. Eliminating Geographic and Ownership Limits on Thrift Service Companies

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

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

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

Currently, section 406 of H.R. 3505 would provide authority for savings associations to invest in bank service companies, and section 503 would eliminate geographic limits on thrift service companies. We support these provisions and will continue to work with Subcommittee staff to ensure that implementation of these provisions provides for a streamlined and efficient regulatory framework.

I. Streamlining Agency Action under the Bank Merger Act

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

VIII. Conclusion

OTS is committed to reducing regulatory burden wherever it has the ability to do so, consistent with safety and soundness and compliance with law, and without undue impact on existing consumer protections. We support proposed legislation—such as H.R. 3505—that advances this objective. I want to thank you, Mr. Chairman, Mr. Hensarling, Mr. Moore, and the other Members who have shown leadership on this issue. We look forward to working with the Subcommittee to shape the best possible regulatory burden relief legislation.

EGRPRA Fact Sheet

- **The Law:** The Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA") requires the Federal Financial Institutions Examination Council (FFIEC), and each of its member agencies—the Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision (OTS)—to review their regulations at least once every 10 years, in an effort to eliminate regulatory requirements that are outdated, unnecessary or unduly burdensome. The law requires FFIEC and its members to consider both regulatory changes that can be done at the agency level and recommending possible legislative fixes to reduce regulatory burden.

- **John Reich is Taking the Lead:** In 2003, when FDIC Chairman Don Powell was Chairman of the FFIEC, he asked then FDIC Vice Chairman John Reich (now OTS Director) to head up this interagency effort. As FDIC Vice Chairman, he took the lead on this project for the past two years, working with the FDIC, FRB, OCC, OTS, and NCUA (although the NCUA is on a different track), and he has brought the project with him to OTS. The FFIEC members kicked off this project in June of 2003, with a press conference, in which all of the agency principals participated, as well representatives from the major industry trade groups.

- **Banker Outreach Meetings:** The agencies have been conducting banker outreach meetings around the country:

  - Over the last two and a half years, ten banker outreach sessions were held in Orlando, St. Louis, Denver, San Francisco, New York, Nashville, Seattle, Chicago, Phoenix and New Orleans.
  - The purpose of the meetings was to hear directly from bankers about the regulatory burden issues that most concern them and try to identify solutions.
  - More than 500 bankers (mostly CEOs), as well as representatives of the American Bankers' Association (ABA), the Independent Community Bankers of America (ICBA), America's Community Bankers (ACB), and the Conference of State Bank Supervisors (CSBS) and a number of state trade associations, participated in the ten meetings.

- More than 70 representatives from the FDIC, FRB, OCC, OTS and NCUA also participated in these meetings, including then FDIC Vice Chairman Reich, FDIC Chairman Powell, FDIC Director Curry, former Comptroller Hawke, Acting Comptroller Williams, and FRB Governors Olson and Bies.
- Agendas for each outreach meeting, as well as summaries of all of the issues raised, are available on the EGRPRA.gov website.

- Consumer Group Meetings: We have held three consumer and community group outreach sessions as well. The first one was on February 20, 2004, at the L. William Seidman Center in Arlington, Virginia. The second one was on June 24, 2004, in San Francisco, and the third one was on September 24, 2004, in Chicago. About 100 people participated in the three meetings. Agendas and summaries of the issues discussed at those meetings are posted on the EGRPRA.gov website.

- Banker/Consumer Focus Group Meetings: The agencies also sponsored three joint banker and consumer/community group focus group meetings in an effort to develop greater consensus among the parties on legislative proposals to reduce regulatory burden. The three meetings were held on August 25, 2005, in Washington, D.C., September 1, 2005, in Los Angeles, and September 8, 2005, in Kansas City.

- First Request for Public Comment: In June, 2003, the FFIEC agencies issued a request for comment on our overall regulatory review plan and the first three categories of regulations—Applications and Reporting, Powers and Activities, and International Operations. In response to this request, we received 19 comments letters with more than 150 recommendations to change various rules and regulations.

- Second Request for Public Comment: On January 20, 2004, the agencies issued a second notice requesting comments on the lending-related consumer protection regulations, which include the rules on Truth-in-Lending (Regulation Z), the Equal Credit Opportunity Act (ECOA), the Home Mortgage Disclosure Act (HMDA), and others. That comment period closed on April 20, 2004. We received almost 600 comment letters and e-mails in response to that notice, mostly from bankers.

- Third Request for Public Comment: On July 20, 2004, the agencies published their third request for public comment, which was on the consumer

protection regulations that are related to deposit accounts/relationships and all of the other consumer protection rules (except those related to lending). The regulations were put out for a 90-day comment period, which closed on October 18, 2004.

- **Fourth Request for Public Comment:** On January 18, 2005, the FDIC Board of Directors authorized the publication of the fourth request for public comment, which is on the money laundering, safety & soundness and securities regulations. This notice was published on February 3, 2005, for a 90-day comment period, which closed on May 4, 2005.

- **Fifth Request for Public Comment:** On August 11, 2005, the agencies published the fifth request for public comment, which is on banking operations, officers & directors as well as rules of procedure. The regulations are out for a 90-day comment period that will close on November 9, 2005.

- **Ongoing Analysis of Regulatory Burden Issues:** Dialogues among the regulators are underway to determine how we can best respond to industry concerns and fulfill our obligations under EGRPRA to eliminate outdated, unnecessary, or unduly burdensome rules. Agency staff is currently analyzing all of the comments/suggestions received to date and will recommend appropriate changes to the regulations and/or underlying legislation.

- **Taking Action with the Other Agencies to Reduce Regulatory Burden:** Since launching the EGRPRA effort in June 2003, progress has been made on several fronts. Over the past year, we have accomplished the following on an interagency basis:

  - Raised the CRA small bank threshold from $250 million to $1 billion, eliminating consideration of holding companies, but including a new community development test (for FDIC, FRB and OCC).
  - Issued an Advanced Notice of Proposed Rulemaking soliciting comment on ways to improve the Privacy Notices required under the Gramm-Leach-Bliley Act. This comment period closed on March 29, 2004. Staff is now conducting some consumer testing on possible short-form notices.

- Issued guidance to bankers on how to structure Customer Identification Programs to meet the requirements of the USA Patriot Act, with more guidance to follow.
- Significant work and development with the Financial Crimes Enforcement Network (FinCEN) and various law enforcement agencies to streamline the filing requirements for Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs).

- Congressional Action:
  - On May 12, 2004, and again on June 9, 2005, then Vice Chairman Reich testified before the House Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services. The Vice Chairman expressed his views concerning the effect of regulatory burden on community banks.
  - On June 22, 2004 and again on June 21, 2005, the Vice Chairman testified before the Senate Banking Committee (SBC), along with representatives from the other federal banking agencies (FBAs), on a number of specific regulatory relief proposals.
  - On July 28, 2005, Congressman Jeb Hensarling introduced H.R. 3505, the Financial Services Regulatory Relief Act of 2005.
  - Senator Crapo is working on a regulatory relief bill that he is targeting to introduce some time this fall.
  - The agencies are working closely with staff from the appropriate House and Senate committees to craft appropriate regulatory relief bills hopefully to be enacted during this Congress.

- Legislative List: As part of then Vice Chairman Reich's Senate testimony last year, he mentioned a number of possible legislative proposals, including:
  - Exempting certain merger transactions from a competitive factors review by the Department of Justice and other agency review processes as well as from post-approval waiting periods.
  - Shortening the post-approval waiting time on mergers for 15 to 5 days when there are no adverse effects on competition.

- Eliminating the requirement that, in certain merger transactions, each FBA must request a competitive factors report from the other three banking agencies as well as the Attorney General.
- Eliminating the requirement for prior written consent to establish branches for well-managed, well-capitalized and highly-rated institutions.
- Eliminating the annual privacy notice requirement for institutions that do not share personal information with third parties.
- Allowing consumers additional flexibility to waive their 3-day right of rescission in certain real estate transactions.
- Providing increased flexibility under the Flood Insurance program by making certain amendments to the Flood Insurance Act.
- Repealing the CRA Sunshine law.

- **Legislative Matrix:** At the end of the SBC hearing, Senator Crapo asked then Vice Chairman Reich to prepare a matrix of all of the legislative recommendations made at the hearing and get back to him with the positions of the agencies on those recommendations. We have completed the matrix and it has been provided to SBC staff.

- **EGRPRA Website:** For more information about this interagency regulatory burden reduction project, please visit our EGRPRA website at: www.EGRPRA.gov

Federal Financial Institutions Examination Council

3501 Fairfax Drive, Room 3086, Arlington, VA 22226 – (703) 516-5588 – FAX (703) 516-5487

Press Release

For Immediate Release **September 19, 2005**

FFIEC FORMS WORKING GROUP TO ADDRESS FINANCIAL INDUSTRY ISSUES AFTER HURRICANE KATRINA

WASHINGTON, D.C. (Sept. 19, 2005) — The Federal Financial Institutions Examination Council (FFIEC) is announcing the formation of an interagency working group to enhance the agencies' coordination and communication on, and supervisory responses to, issues facing the industry in the aftermath of Hurricane Katrina. The group, composed of senior level supervision officials from each member agency and the FFIEC's State Liaison Committee, will build upon the cooperative efforts, already in place, among the federal and state financial institution regulators.

In announcing the formation of the working group, FFIEC Chairman John C. Dugan noted that one of the clear lessons learned from the initial days following Hurricane Katrina is the need to provide institutions with clear, timely, and consistent information on issues of concern. "The FFIEC is committed to working with the industry and affected institutions to respond to issues that may arise as the industry continues its efforts to facilitate recovery to communities and customers in the Gulf Coast area affected by Hurricane Katrina," Chairman Dugan noted. "My colleagues and I have instructed the working group to call upon any needed resources across our respective agencies and the FFIEC's established task forces to accomplish this goal."

For additional information concerning the formation of this working group, please contact Tamara J. Wiseman, Executive Secretary for the FFIEC, at 703-516-5590.

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	Board of Governors of the Federal Reserve System
	Conference of State Bank Supervisors
	Federal Deposit Insurance Corporation
Joint Release	**National Credit Union Administration**
	Office of the Comptroller of the Currency
	Office of Thrift Supervision

For immediate release **September 1, 2005**

Agencies Encourage Insured Depository Institutions to Assist Displaced Customers

The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (the agencies), and the Conference of State Bank Supervisors are asking insured depository institutions to consider all reasonable and prudent steps to assist customers' and credit union members' cash and financial needs in areas affected by Hurricane Katrina. The agencies are working with state regulatory agencies, financial industry trade groups, and affected financial institutions to identify customer needs and monitor institutions' restoration of services.

The agencies remind the public that deposit insurance is in full force and that money in FDIC- or NCUA-insured accounts is protected by federal deposit insurance. The agencies also note that a priority is to provide customer access to deposit accounts and other financial assets. Many financial institutions are implementing contingency plans, including procedures for consumers to have access to ATMs and use of their debit cards.

The financial services community through its various trade associations is working together to assist affected institutions. The agencies encourage financial institutions to assist affected institutions and consider all reasonable and prudent actions that could help meet the critical financial needs of their customers and their communities. To the extent consistent with safe and sound banking practices, such actions may include:

- Waiving ATM fees for customers and non-customers
- Increasing ATM daily cash withdrawal limits
- Easing restrictions on cashing out-of-state and non-customer checks
- Waiving overdraft fees as a result of paycheck interruption
- Waiving early withdrawal penalties on time deposits
- Waiving availability restrictions on insurance checks
- Allowing loan customers to defer or skip some payments
- Waiving late fees for credit card and other loan balances due to interruption of mail and/or billing statements or the customer's inability to access funds
- Easing credit card limits and credit terms for new loans
- Delaying delinquency notices to the credit bureaus

The agencies, in consultation with FinCEN, also encourage depository institutions to be reasonable in their approach to verifying the identity of individuals temporarily displaced by Hurricane Katrina. Under the Customer Identification Program requirement of the Bank Secrecy Act, depository institutions must obtain, at a minimum, an individual's name, address, date of birth and taxpayer identification number or other acceptable identification number before opening an account. The Customer Identification Program requirement provides depository institutions with flexibility to design a program that uses documents, non-documentary methods or a combination to verify a customer's identity. Moreover, the regulation provides that verification of identity may be completed within a reasonable time after the account is opened. Recognizing the urgency of this situation, the agencies encourage depository institutions to use non-documentary verification methods for affected customers that may not be able to provide standard identification documents, as permitted under the regulation. A depository institution in the affected area, or dealing with new customers from the affected area, may amend its Customer Identification Program immediately and obtain required board approval for program changes as soon as practicable.

The agencies note that these measures could help customers recover their financial strength and contribute to the health of the local community and the long-term interest of financial institutions and their customers when undertaken in a prudent manner. The agencies recognize that the needs and situation of each financial institution and its community and customers are unique. The actions above may not be feasible or desirable for all institutions and many institutions may provide additional services from those identified.

The agencies will continue to monitor closely the situation and needs of insured depository institutions and their customers and will provide additional guidance, as required, to help address those needs. Institutions in need of assistance in dealing with customers affected by the hurricane should contact their primary supervisors.

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FDIC	David Barr	(202) 898-6992
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OCC	Kevin Mukri	(202) 874-5770
OTS	Chris Smith	(202) 906-6677

Regulatory Burden of SEC Proposed Exemptive Relief

Investment Advisor Registration

Type of Account or Service Provided	National or State Charter Banks and Trust Companies Exemptive Relief	SEC Proposed Exemptive Relief for Savings Associations
Accounts without Investment Management or Advice Responsibilities ▪ Trust Accounts ▪ Court Accounts ▪ Agency/Custodial Accounts	Yes Have exemptive relief	Yes Have exemptive relief – did not previously have to register
Trust Accounts (with investment management or advice responsibilities) ▪ Personal Trust ▪ Employee Benefit Trust ▪ Charitable Trust	YES Have exemptive relief	**NO** **Savings associations will not have exemptive relief or burden reduction**
Court Accounts (with investment management or advice responsibilities) ▪ Executor ▪ Administrator ▪ Guardian ▪ Conservator	YES Have exemptive relief	**NO** **Savings associations will not have exemptive relief or burden reduction**
Agency Accounts (with investment management or advice responsibilities) ▪ Individuals ▪ Personal Trusts ▪ Employee Benefit Plans and Trusts ▪ Corporate Entities ▪ Charities ▪ Mutual Funds ▪ Hedge Funds ▪ Common Trust Funds ▪ Collective Investment Funds	YES Have exemptive relief (unless providing investment advice to a mutual fund, in which case the department or division of the bank or trust company providing the advice must register as an investment adviser)	**NO** **Savings associations will not have exemptive relief or burden reduction**

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

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

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

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

August 18, 2000

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

Dear Chairman Levitt:

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

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

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

Sincerely,

Evan Bayh

For release on delivery

STATEMENT

OF

ROBERT M. FENNER
GENERAL COUNSEL
NATIONAL CREDIT UNION ADMINISTRATION

"H.R. 3505 FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005"

BEFORE THE

SUBCOMMITTEE
ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
UNITED STATES HOUSE OF REPRESENTATIVES

SEPTEMBER 22, 2005

Chairman Bachus, Ranking Member Sanders, Representative Hensarling, Representative Moore, and Members of the Subcommittee: on behalf of the National Credit Union Administration (NCUA) I am pleased to be here today to present NCUA's views on H.R. 3505, "The Financial Services Regulatory Relief Act of 2005." This legislation will benefit the consumer and the economy by enabling all financial intermediaries and their regulators to better perform the role and functions required of them.

The Subcommittee on Financial Institutions and Consumer Credit has been taking the lead over the last several years in many areas of interest to consumers and financial institutions, including credit unions and their members. In June of 2005 our Chairman testified in favor of several recommendations made by NCUA and others affecting federally insured credit unions. NCUA is pleased to see that H.R. 3505 includes many of them and that they are being considered by this Subcommittee. I would like to address the NCUA recommendations first.

CREDIT UNION PROVISIONS OF THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005

Section 307: Check Cashing, Wire Transfer and Other Money Transfer Services

The Federal Credit Union Act authorizes federal credit unions to provide check cashing and money transfer services and international remittances to members (12 USC 1757(12)). To reach the "unbanked," Section 307 of H.R. 3505 authorizes federal credit unions to provide these services to anyone eligible to become a member. This is particularly important to federal credit unions in furthering their efforts to serve those of limited income or means. These individuals, in many instances, do not have mainstream financial services available to them and are often forced to pay excessive fees for check cashing, wire transfer and other services. Allowing federal credit unions to provide these limited services to anyone in their field of membership would provide a lower-fee alternative for these individuals and encourage them to trust conventional financial organizations. Representative Gerlach introduced this provision as H.R. 749 in the 109th Congress and it has been passed by the House of Representatives on April 26, 2005.

Section 304: The Twelve-Year Maturity Limit on Loans

Federal credit unions are authorized to make loans to members, to other credit unions and to credit union organizations. The Federal Credit Union Act imposes various restrictions on these authorities, including a twelve-year maturity limit that

is subject to only limited exceptions (12 USC 175(5)). This maturity limit should be eliminated. It is outdated and unnecessarily restricts federal credit union lending authority. Section 304 of H.R. 3505 permits Federal credit unions to make loans for second homes, recreational vehicles and other purposes, not to exceed 15 years or such longer periods determined appropriate by the NCUA Board. NCUA rulemaking authority would also be used for safety and soundness considerations.

Section 305: Increase One Percent Investment Limit in CUSOs to Three Percent

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 one percent of its shares and undivided earnings in these organizations (12 USC 1757(7)(I)). These organizations, commonly known as credit union service organizations or "CUSOs," provide important services. Examples are data processing and check clearing for credit unions, as well as services such as estate planning and financial planning for credit union members. When these services are provided through a CUSO, any financial risks are isolated from the credit union, yet the credit unions that invest in the CUSO retain control over the quality of services offered and the prices paid by the credit unions or their members. The one percent aggregate investment limit is unrealistically low and forces credit unions to either bring services in-house, thus potentially increasing risk to the credit union and the NCUSIF, or turn to outside providers and lose control. Section 305 of H.R. 3505 increases the one percent limit to three percent and NCUA supports the change.

Section 303: Expanded Investment Options

The Federal Credit Union Act limits the investment authority of federal credit unions to loans, government securities, deposits in other financial institutions and certain other very limited investments (12 USC 1757(7)). This limited investment authority restricts the ability of federal credit unions to remain competitive in the rapidly changing financial marketplace. The Financial Services Regulatory Relief Act of 2005, Section 303 amends the Federal Credit Union Act to provide such additional investment authority conditioned upon limiting such authority to investment in corporate debt securities (as opposed to equity) and further specific percentage limitations and investment grade standards are set out in the legislation. The NCUA Board could still add additional conditions for safety and soundness protections.

Section 308: Voluntary Merger Authority

The Federal Credit Union Act, as amended by the Credit Union Membership Access Act, allows voluntary mergers of healthy federal credit unions, but requires that NCUA consider a spin-off of any group of over 3,000 members in the merging credit union (12 USC 1759(d)(2)(B)(i)). When two healthy federal credit unions wish to merge, and thus combine their financial strength and

improve service to their members, they should be allowed to do so. There is no reason to require in connection with such mergers that groups over 3,000, or any group for that matter, be required to spin off and form a separate credit union. A spin-off would most likely undermine financial services to the affected group and may create safety and soundness concerns. These groups are already included in a credit union in accordance with the statutory standards, and that status should be unaffected by a voluntary merger. Section 308 of H.R. 3505 accomplishes these purposes.

Section 313: Regulatory Relief from SEC Registration Requirements
NCUA is seeking a provision to provide relief from the requirement that credit unions register with the Securities and Exchange Commission as broker-dealers when engaging in certain de minimus securities activities. The Gramm Leach Bliley Act, enacted in 1999, created exemptions from the broker-dealer registration requirements of the Securities and Exchange Act of 1934 for certain bank securities activities. Banks are also exempt from the registration and other requirements of the Investment Advisers Act of 1940. The principle established by these exemptions is that securities activities of an incidental nature to the bank do not have to be placed into a separate affiliate. The provision would provide similar exemptions for federally insured credit unions. NCUA supports these exemptions. Because of significant differences between broker-dealer capital requirements and depository institution capital requirements, it is virtually impossible for depository institutions, including credit unions, to register as a broker-dealer and submit to broker-dealer requirements. Without an exemption credit unions may find that although they are authorized under their chartering statutes to engage in particular securities-related activities, their inability to register as a broker-dealer would keep them from engaging in these activities. Recently, the Securities and Exchange Commission proposed a rule that would exempt credit unions from the definition of broker and dealer for a few of the activities exempted for banks under Gramm Leach Bliley, including third party brokerage arrangements and sweep account arrangements. NCUA supports the SEC proposal. We believe, however, that the SEC's proposal did not go far enough, and we continue to support legislative relief. The relief sought for credit unions would be more limited in scope and application than that which is available to banks and requested by thrifts. Credit union powers are limited by their chartering statutes, and credit unions do not have certain powers, such as general trust powers, that are available to banks and thrifts. The requested parity relief for credit unions, included in Section 313 of H.R. 3505, would apply only to those activities otherwise authorized for credit unions under applicable credit union chartering statutes, currently including third-party brokerage arrangements, sweep accounts, and certain safekeeping and custody activities.

Section 314: Clarification of Definition of Net Worth Under Certain Circumstances For Purposes of Prompt Corrective Action

NCUA anticipates that the Financial Accounting Standards Board (FASB) will act in 2006 to lift the current deferral of the acquisition method of accounting for credit union mergers, thereby eliminating the pooling method and requiring the acquisition method beginning in 2007.[1] When this change to accounting rules is implemented it will require that, in a merger, the net worth of the merging credit union be carried over as "acquired equity," a term not recognized by the" Federal Credit Union Act.

This FASB policy has been in place since mid-2001 for most business combinations and the delay by FASB in implementing it for credit unions has allowed all of us to explore how credit unions could conform to the new financial reporting standards.

Without the changes to the Federal Credit Union Act, only retained earnings of the continuing credit union will count as net worth after a merger. This result would seriously reduce the post-merger net worth ratio of a federally insured credit union, because this ratio would be the retained earnings of only the continuing credit union stated as a percentage of the combined assets of the two institutions. A lower net worth ratio has adverse implications under the statutory prompt corrective action requirements. This result will discourage voluntary mergers and on occasion make NCUA assisted mergers more difficult and costly to the National Credit Union Share Insurance Fund (NCUSIF). Without a remedy, an important NCUA tool for reducing costs and managing the fund in the public interest will be lost.

Chairman Bachus and Ranking Member Sanders, you acted very quickly in 2005 to address this issue by introducing H.R. 1042, the "Net Worth Amendment for Credit Unions Act" which has been approved by House of Representatives on June 13, 2005. NCUA supports including it as Section 314 of H.R. 3505, too, and looks forward to its early enactment.

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[1] Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations, requiring the acquisition method for business combinations and effectively eliminating the pooling method. The pooling method has typically been used by credit unions to account for credit union mergers. The standards became effective for combinations initiated after June 30, 2001. Paragraph 60 of the standard deferred the effective date for mutual enterprises (i.e., credit unions) until the FASB could develop purchase method procedures for those combinations. In the interim, credit unions have continued to account for mergers as poolings (simple combination of financial statement components).

Section 802: Technical Corrections to the Federal Credit Union Act

This section of the "Financial Services Regulatory Relief Act of 2005" includes twenty-eight needed updates to the Federal Credit Union Act that are not substantive in any way. They have been previously approved by the Subcommittee, Committee on Financial Services and the House of Representatives in H.R. 1375 last Congress. They are purely drafting, numerical and incorrect references without any policy impact.

ADDITIONAL CREDIT UNION PROVISIONS—NO SAFETY OR SOUNDNESS CONCERNS

The "Financial Services Regulatory Relief Act of 2005" includes a number of other provisions that affect federally insured credit unions and/or the NCUA that did not originate with NCUA. NCUA has reviewed all of these additional credit union provisions and the agency has no safety and soundness concerns with these provisions.

Among these are provisions that address leases of land on Federal facilities for credit unions (Section 302); member business loans for non-profit religious organizations Section 306); criteria for continued membership of certain member groups in community charter conversions (Section 309) ; credit union governance changes (Section 310); revising the economic factors the NCUA Board must use when considering adjustments to the statutory 15% interest rate that can be charged by federal credit unions on loans (Section 311); and an exemption from pre-merger notification requirements of the Clayton Act (Section 312).

No Position On Section 301 and Section 315
NCUA takes no position on these two provisions that address privately insured credit unions. Privately insured credit unions are outside the purview of this agency since they are neither federally chartered nor federally insured. References to NCUA in Section 301 (b) should be removed because NCUA has no legal authority with regard to privately insured credit unions and there is no legal basis for NCUA to receive audits or examination reports of privately insured credit unions.

Prompt Corrective Action Reforms – Regulatory Relief and Improvement

Reforming the way current law requires federally insured credit unions to comply with Prompt Corrective Action, or regulatory capital standards might also be appropriate in any regulatory relief legislation proceeding through Congress. That is because lower risk federally insured credit unions are required to keep more capital ("net worth") now than they would if their risk profiles were accurately measured under comparable bank-like leverage <u>and</u> risk weighting

systems. Excess capital in the credit union system is a regulatory burden that could be used to better serve credit union members, their communities and the American economy.

The guiding principle behind PCA is to resolve problems in federally insured credit unions at the least long-term cost to the National Credit Union Share Insurance Fund (NCUSIF). This mandate is good public policy and consistent with NCUA's fiduciary responsibility to the insurance fund. While NCUA supports a statutorily mandated PCA system, the current statutory requirements for credit unions are too inflexible and establish a structure based primarily on a "one-size-fits all" approach, relying largely on a high leverage requirement of net worth to total assets. This creates inequities for credit unions with low-risk balance sheets and limits NCUA's ability to design a meaningful risk-based system.

For the leverage requirement, NCUA supports a reduction in the standard net worth (i.e., leverage) ratio requirement for credit unions to a level comparable to what is required of FDIC insured institutions. The minimum leverage ratio for a well-capitalized credit union is currently set by statute at 7 percent, compared to the threshold of 5 percent for FDIC-insured institutions. There are important reasons why the leverage ratio for credit unions ratio should be lowered to work in tandem with a risk-based requirement.

First, credit unions should not be placed at a competitive disadvantage by being held to higher capital standards when they are not warranted to protect the insurance fund. For FDIC insured institutions, a 5% leverage requirement coupled with a risk-based system has provided adequate protection for their insurance fund. In comparison, the credit union industry has a relatively low risk profile, as evidenced by our low loss history. This is largely due both to the greater restrictions on powers of credit unions relative to other financial institutions and credit unions' conservative nature given their member-owned structure. In fact, our experience has shown that given economic needs and their conservative nature, the vast majority of credit unions will operate with net worth levels well above whatever is established as the regulatory minimum.

In addition, the current 7% leverage requirement is excessive for low risk institutions and overshadows any risk-based system we design, especially if you consider that under BASEL the risk-based capital requirement is 8% of risk assets. A meaningful risk-based system working in tandem with a lower leverage requirement provides incentives for financial institutions to manage the risk they take in relation to their capital levels, and gives them the ability to do so by reflecting the composition of their balance sheets in their risk-based PCA requirements. The current high leverage requirement provides no such ability or incentive and, in fact, it can be argued could actually contribute to riskier behavior to meet these levels given the extra risk isn't factored into the dominant leverage requirement.

NCUA recognizes, however, that achieving comparability between the federal insurance funds does require us to factor in the NCUSIF's deposit-based funding mechanism. Thus, our reform proposal incorporates a revised method for calculating the net worth ratio for PCA purposes by adjusting for the deposit credit unions maintain in the share insurance fund. However, our proposed treatment of the NCUSIF deposit for purposes of regulatory capital standards in no way alters its treatment as an asset under generally accepted accounting principles, or NCUA's steadfast support of the mutual, deposit-based nature of the NCUSIF.

Enabling NCUA to adopt a PCA system that remains relevant and up-to-date with emerging trends in credit unions and the marketplace provides safety, efficiency, and benefits to the credit union consumer.

Title I of H.R. 2317, the "Credit Union Regulatory Improvements Act of 2005" sets out the specifics required to achieve these goals. It has been introduced by your colleagues, Representative Ed Royce and Representative Paul Kanjorski and many Members on and off the Committee on Financial Services.

Conclusion

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

STATEMENT OF WILLIAM J. FOX
DIRECTOR, FINANCIAL CRIMES ENFORCEMENT NETWORK
UNITED STATES DEPARTMENT OF THE TREASURY

BEFORE THE
HOUSE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

SEPTEMBER 22, 2005

Chairman Bachus, Ranking Member Sanders and distinguished members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss your efforts to balance the burdens imposed on the financial industry by the requirements of the Bank Secrecy Act of 1970, specifically, providing the government with highly relevant information that assists law enforcement in making our financial system more transparent and our country safer. I am the Director of the Financial Crimes Enforcement Network, which has been delegated the responsibility by the Secretary of the Treasury to administer the Bank Secrecy Act. The Financial Crimes Enforcement Network is part of Treasury's new Office of Terrorism and Financial Intelligence, led by Under Secretary Stuart Levey. The creation of this office has greatly enhanced Treasury's efforts and accomplishments on issues relating to money laundering, terrorist financing and other financial crime.

As the administrator of the Bank Secrecy Act, we bear responsibility for ensuring that the Bank Secrecy Act is implemented in a way that achieves the policy aim intended by the Congress, which is, simply stated, to safeguard the United States financial system from the abuses of financial crime, including money laundering and terrorist or other illicit financing. This is a day-to-day challenge in a financial system where we generally promote the unfettered, free-flow of commerce and where criminals strive to manipulate the system with the same ingenuity and sophistication of the very best in the industry.

Ensuring that we strike the right balance between the cost and benefit of this regulatory regime is, in my view, a central responsibility for my agency. While I do not believe this cost / benefit analysis can be reduced to a mathematical formula, I believe we must constantly study how we can more effectively tailor this regime to minimize the costs and other burdens imposed on our financial institutions while at the same time ensuring that the law enforcement community receives the information it needs to combat financial crime and terrorism.

This effort is particularly important because I am more certain than ever that compliance with the Bank Secrecy Act's regulatory regime is a critical component to our country's ability to utilize financial information to combat terrorism, terrorist financing, money laundering, and other serious financial crime. Moreover, the systems and programs that are mandated by the Bank Secrecy Act make our financial system safer and more transparent.

Over the past year I have traveled quite a bit around the country listening to the frustrations members of the financial industry have with the Bank Secrecy Act. Many of those frustrations relate to how the Act is being implemented. Many in the financial industry complained about the lack of clarity in requirements and consistency in examination. At the same time, the Congress has questioned the effectiveness of our collective ability to implement this regime in light of several highly publicized and significant regulatory failures by certain financial institutions. Mr. Chairman, I am pleased to report that by working diligently with my colleagues at this table, we have made significant progress on these issues. In the past year:

- We have signed groundbreaking information-sharing agreements with the five Federal Banking Agencies, the Internal Revenue Service and thirty-three (33) state authorities. We are working to finalize similar agreements with the Securities and Exchange Commission and the Commodities Futures Trading Commission.

- We have assisted the Federal Banking Agencies with the development of a comprehensive Bank Secrecy Act examination manual that we believe will ensure greater consistency in examinations for depository institutions, and will provide a significant source of guidance and help for those institutions.

- We are together issuing more and better guidance to ensure greater clarity and consistency of regulatory policy. A good example of this is the recent guidance we issued jointly with the Federal Banking Agencies on the provision of banking services to money services businesses.

- We have created and staffed an Office of Compliance within our Regulatory Division to ensure better clarity and consistency in how the Bank Secrecy Act is implemented and provide us with an assessment of the overall success of our Bank Secrecy Act Regulatory Program.

- We are – for the first time – devoting nearly 25% of our analytic muscle to regulatory issues and programs. These analysts are not only identifying compliance problems and targeting problematic institutions for examination, they will also develop and provide information to the financial industry to help them better understand and assess the risks posed by their business lines and customer base.

We believe these steps and the steps we have planned have helped improve the overall implementation and effectiveness of the Bank Secrecy Act. Ensuring that we present the financial industry with regulatory requirements that are both clear and consistent is, in my view, one of the best ways we can reduce the burden associated with Bank Secrecy Act compliance.

Consistency is a crucial element of the effective implementation of the Bank Secrecy Act, and, indeed, is one of our core objectives. While we, of course, stand ready to assist the Committee and this Congress by examining any aspect of the Bank Secrecy Act, I would emphasize that over the past year, the level of cooperation between my agency and the Federal Banking Agencies has grown significantly. As reflected in the steps we have taken together, we all recognize the need for a consistent voice on these important regulatory issues, and are building the necessary coordination mechanisms.

The focus of my testimony before the subcommittee today is on HR 3505, specifically, how that bill would affect the Bank Secrecy Act. I would like to focus on one key concept in this legislation; your effort to reduce the burden imposed on the financial industry of filing Currency Transaction Reports. We have been grappling with the issue of how to improve the Currency Transaction Report regime for some time. We know that Currency Transaction Reports are valuable to law enforcement. These reports – often coupled with other information – are used every day to identify and locate criminals and terrorists. However, we also know that some of the Currency Transaction Reports filed by financial institutions are of little relevance in the investigation of financial crime. We also know that depository institutions, especially our community banks, identify the time and expense of filing Currency Transaction Reports as the number one regulatory expense. Indeed, the Congress has in the past recognized the need to reduce the number of Currency Transaction Reports that may not have a high degree of usefulness to law enforcement, ordering us to find a way to do so. However, it is clear that our efforts to encourage the exemption of routine filings on certain customers have not brought about the reductions in filing that were sought.

Two years ago we turned to the Bank Secrecy Act Advisory Group, bringing in the viewpoints of the industry, law enforcement, and regulatory communities, to address this question. Through this process, we learned that our colleagues in law enforcement have made significant strides recently in their ability to utilize currency transaction reporting data, marrying this data with other law enforcement data to maximize its benefit. We also have enhanced our analytic capability to exploit this data source on both micro and macro levels. Such innovations enhance the utility of our analysis, and it is essential that we not reduce the flow of critical information just as the technical firepower to exploit this information is reaching new heights.

This Committee now is considering language that would amend current exemptions by allowing banks to qualify certain customers as exempt from routine currency transaction reporting. We believe this language addresses many of the issues with our current exemption regime that were causing it not to have its intended effect. Due to its complexity and the burden involved in exempting customers, financial institutions were not taking advantage of the exemption regime. This proposal seeks to streamline the exemption process by focusing on a one-time notice to my agency of an exemption and focusing on the customer's relationship with the bank as the grounds for such exemption. We believe that these changes will make the exemptions more effective

while still ensuring that currency transaction reporting information critical to identifying criminal financial activity is made available to law enforcement.

However, we also recognize that we need to monitor these changes to ensure that they do not result in a reduction in information that would be highly useful to our law enforcement clients, and accordingly the proposal contains a wise requirement to conduct a study after some time has elapsed to ensure that we are striking the proper balance.

In conclusion, Mr. Chairman, I hope that my testimony today conveys the sense of commitment, energy, and balance with which all of us at the Financial Crimes Enforcement Network are addressing the challenging issues that confront our administration of the Bank Secrecy Act. The importance of your personal and direct support of these efforts cannot be overstated. Your oversight will ensure that we meet the challenges that we are facing. I know how critical it is that we do so, and we hope you know how committed we are to meeting those challenges. Thank you.

TESTIMONY OF

RANDALL JAMES

TEXAS COMMISSIONER OF BANKING

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

UNITED STATES HOUSE OF REPRESENTATIVES

September 22, 2005

Good morning, Chairman Bachus, Representative Sanders and members of the Subcommittee. I am Randall S. James, Texas Banking Commissioner, and I am pleased to be here today on behalf of the Conference of State Bank Supervisors (CSBS). Thank you for inviting CSBS to be here today to discuss strategies for reducing unnecessary regulatory burden on our nation's financial institutions.

CSBS is the professional association of state officials who charter, regulate and supervise the nation's approximately 6,251 state-chartered commercial banks and savings institutions, and nearly 400 state-licensed foreign banking offices nationwide.

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

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

CSBS and the state banking departments have been working closely with the federal banking agencies, through the Federal Financial Institutions

Examination Council, to implement the Economic Growth and Regulatory Paperwork Reduction Act of 1996. While this legislation made necessary and beneficial changes, we see continuing opportunities for Congress to streamline and rationalize regulatory burden, especially for community banks. This testimony will review and update several issues that we have previously discussed in this forum, and before the Senate Banking Committee.

Principles for Regulatory Burden Relief

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

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

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

excessive federal regulatory measures, and a means of promoting a wide diversity of financial institutions.

Second, our current regulatory structure and statutory framework may recognize some differences between financial institutions, but too often mandate overarching "one size fits all" requirements for any financial institution that can be described by the word "bank." These requirements are often unduly burdensome on smaller or community-based institutions.

Regulatory burden always falls hardest on smaller institutions. Although many of the nation's largest banks hold state charters, state charters make up the vast majority of these smaller institutions. We see this impact on earnings every day among the institutions we supervise. Community banks represent a shrinking percentage of the assets of our nation's banking system, and we believe that compliance costs are a major factor driving mergers. Even where laws officially exempt small, privately-held banks, as in the case of Sarbanes-Oxley, the principles behind these laws hold all institutions to increasingly more expensive compliance standards.

My colleagues and I are especially pleased to see provisions in the current bill that recognize this growing disparity in our financial services industry, and the impact this bifurcation has on our economy. Targeted relief for community banks is an essential component of any regulatory reform bill, and we strongly endorse several new provisions of H.R. 3505 that provide this relief.

The streamlining of reports of condition, including short-form reporting for certain community banks; the expansion of healthy community banks' eligibility for an 18-month examination cycle; and the new exemptions in Gramm-Leach-Bliley's annual privacy notice requirement will all reduce burden on these institutions without creating new risks to safety and soundness.

The Conference of State Bank Supervisors endorses approaches that recognize and encourage the benefits of diversity within our banking system. Our dual banking system exists because one size is not appropriate for every customer, and one system is not appropriate for every institution.

The nation's community banking industry is the fuel for the economic engine of small business in the United States. Although I speak as a state bank supervisor, I recognize that federally-chartered community banks are as important to small business as state-chartered banks. Stifling economic incentives for community banks with excessive statutory burdens slows the economic engine of small business in the U.S. Regulatory burden relief for community banks would be a booster shot for the nation's economic well-being.

We suggest that Congress and the regulatory agencies seek creative ways to tailor regulatory requirements for institutions that focus not only on size, but on a wider range of factors that might include geographic location, structure, management performance and lines of business. As the largest banks are pushing for a purely national set of rules for their evolving multistate and increasingly retail operations, this regulatory scheme will also impose new requirements on

state-chartered banks operating in the majority of states that do not have similar rules in place, because they are not experiencing the kinds of problems these new requirements are trying to address.

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

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

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

Shared technology allows the state and federal banking agencies to work together constantly to improve the examination process, while making the process less intrusive for financial institutions. Technology helps examiners target their

examinations through better analysis, makes their time in financial institutions more effective, and expedites the creation of examination reports.

The fact that technology makes it so much easier to gather information, however, should not keep us from asking whether it is necessary to gather all of this information, or what we intend to do with this information once we have it. Information-gathering is not cost-free.

Our Bankers Advisory Board members expressed particular concern about Bank Secrecy Act requirements, Currency Transaction Reports and Suspicious Activity Reports. We are especially pleased to see that H.R. 3505 seeks to address these concerns by reducing collection requirements and making them more consistent. We also want to acknowledge the efforts of FinCEN and the federal banking agencies, with whom we have worked to develop clear, risk-based BSA examination procedures. We hope these procedures will improve the effectiveness of BSA compliance procedures, while reducing unnecessary burden on the institutions we supervise. We welcome the additional study on these issues that H.R. 3505 calls for.

Finally, although regulators constantly review regulations for their continued relevance and usefulness, many regulations and supervisory procedures still endure past the time that anyone remembers their original purpose.

Many regulations implement laws that were passed to address a specific issue. These regulations often stay on the books after the crisis that spurred new

legislation has passed. Recognizing this, many state banking statutes include automatic sunset provisions. These sunset provisions require legislators and regulators to review their laws at regular intervals to determine whether they are still necessary or meaningful.

We could hardly do that with the entire federal banking code, but the passage of the Fair Credit Reporting Act amendments showed how valuable this review process can be. We urge Congress to apply this approach to as wide a range of banking statutes as possible.

We applaud this committee's willingness to revisit and amend legislation to ensure that our laws fulfill Congressional intent. One example of this in the current bill are the changes to federal law that would allow all banks to cross state lines by opening new branches. While Riegle-Neal intended to leave this decision in the hands of the states, inconsistencies in federal law have created a patchwork of contradictory rules about how financial institutions can branch across state lines.

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

Section 401 of H.R. 3505 helps restore competitive equity by allowing *de novo* interstate branching for most federally-insured depository institutions.

Recommendations for Additional Changes

Through extensive discussions among ourselves and with state-chartered banks, and in addition to the concepts and ideas expressed in the Communities First Act, we recommend further specific changes to federal law that will help reduce regulatory burden on financial institutions, without undue risk to safety and soundness. We ask that the Committee include these provisions in any legislation it approves.

Federal Financial Institutions Examination Council

CSBS believes that a state banking regulator should have a vote on the Federal Financial Institutions Examination Council (FFIEC), the coordinating body of federal banking agencies.

The FFIEC's State Liaison Committee includes state bank, credit union, and savings bank regulators. The chairman of this Committee has input at FFIEC meetings, but is not able to vote on policy or examination procedures that affect the institutions we charter and supervise.

Improving coordination and communication among regulators is one of the most important regulatory burden relief initiatives. To that end, we recommend that Congress change the state position in FFIEC from one of observer to that of full voting member.

State bank supervisors are the primary regulators of approximately 74% of the nation's banks, and thus are vitally concerned with changes in federal regulatory policy and procedures.

Regulatory Flexibility for the Federal Reserve

CSBS also favors a provision that would give the Federal Reserve the necessary flexibility to allow state-chartered member banks to exercise the powers granted by their charters, as long as these activities pose no significant risk to the deposit insurance fund.

A major benefit of our dual banking system has always been the ability of each state to authorize new products, services and activities for their state-chartered banks. Current law limits the activities of state-chartered, Fed member banks to those activities allowed for national banks. This restriction stifles innovation within the industry, and eliminates a key dynamic of the dual banking system.

We endorse an amendment to remove this unnecessary limitation on state member banks, which has no basis in promoting safety and soundness. Congress has consistently reaffirmed state authority to design banking charters that fit their unique market needs. FDICIA, in 1991, allowed states to continue to authorize powers beyond those of national banks. Removing this restriction on state member banks would be a welcome regulatory relief.

Limited Liability Corporations

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

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

The FDIC has determined that state banks organized as LLCs are eligible for federal deposit insurance if they meet established criteria designed to insure safety and soundness and limit risk to the deposit insurance fund.

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

It is not clear, however, that federal law allows pass-through taxation status for state banks organized as LLCs. An Internal Revenue Service regulation currently blocks pass-through tax treatment for state-chartered banks. We ask the

Committee to encourage the IRS to reconsider its interpretation of the tax treatment of state-chartered LLCs.

Deposit Insurance for Branches of International Banks Licensed to do Business in the United States

Finally, CSBS urges the Committee to review the statutory prohibition on the establishment of additional FDIC-insured branches of international banks.

Since Congress enacted this prohibition in 1991, cooperation and information sharing between the U.S. and home country regulators have improved substantially. An international bank wishing to establish a branch in the United States must obtain approval from the Federal Reserve as well as from the licensing authority, and the Federal Reserve must find the bank to be subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor. These supervisory changes eliminate many of the concerns about establishing additional FDIC-insured branches that led to the statutory prohibition.

International banks operating in the United States benefit the U.S. economy through job creation, operating expenditures, capital investments, and taxes. The vast majority of international bank branches are licensed with the states, and are assets to the states' economies. The Committee should review and remove this prohibition, and allow international banks the option of offering insured accounts.

Challenges to Regulatory Burden Relief

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

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

We appreciate that the largest financial services providers want more coordinated regulation that helps them create a nationwide financial marketplace. We share these goals, but not at the expense of distorting our marketplace, denying our citizens the protection of state law and the opportunity to seek redress close to home, or eliminating the diversity that makes our financial system great. The Comptroller's regulations may reduce burden for our largest, federally-chartered institutions, but they do so at the cost of laying a disproportionate burden on state-chartered institutions and even on smaller national banks.

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

Conclusion

Mr. Chairman, members of the subcommittee, the regulatory environment for our nation's banks has improved significantly over the past ten years, in large part because of your vigilance.

As you consider additional ways to reduce burden on our financial institutions, we urge you to remember that the strength of our banking system is its diversity – the fact that we have enough financial institutions, of enough different sizes and specialties, to meet the needs of the world's most diverse economy and society. While some federal intervention may be necessary to reduce burden, relief measures should allow for further innovation and coordination at both the state and federal levels, and among community-based institutions as well as among the largest providers.

Diversity in our financial system is not inevitable. Community banking is not inevitable. This diversity is the product of a consciously developed state-federal system, and any initiative to relieve regulatory burden must recognize this system's value. A responsive and innovative state banking system that encourages community banking is essential to creating diverse local economic opportunities.

State bank examiners are often the first to identify and address economic problems, including cases of consumer abuse. We are the first responders to almost any problem in the financial system, from downturns in local industry or real estate markets to the emergence of scams that prey on senior citizens and

other consumers. We can and do respond to these problems much more quickly than the federal government, often bringing these issues to the attention of our federal counterparts and acting in concert with them.

State supervisors are sensitive to regulatory burden, and constantly look for ways to simplify and streamline compliance. Your own efforts in this area, Chairman Bachus, have greatly reduced unnecessary regulatory burden on financial institutions regardless of their charter.

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

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

We commend you, Mr. Chairman, and the members of this subcommittee for your efforts in this area and we urge you to move this bill through the House of Representative this session of Congress. We thank you for this opportunity to testify, and look forward to any questions that you and the members of the subcommittee might have.

STATEMENT OF

WILLIAM F. KROENER, III
GENERAL COUNSEL
FEDERAL DEPOSIT INSURANCE CORPORATION

on the

"Financial Services Regulatory Relief Act of 2005"

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

September 22, 2005
Room 2128, Rayburn House Office Building

Chairman Bachus, Representative Sanders, Representative Hensarling and Members of the Subcommittee, I appreciate the opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on H.R. 3505, proposed legislation to provide regulatory burden relief. The FDIC shares the Subcommittee's continuing commitment to eliminate unnecessary burden and to streamline and modernize laws and regulations as the financial industry evolves. This is an important endeavor and our nation's insured financial institutions are counting on us to succeed in our efforts to reduce unnecessary regulatory burden.

The Federal bank and thrift regulatory agencies have been working together over the last few years to identify regulatory requirements that are outdated, unnecessary or unduly burdensome, in accordance with the requirements of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). The agencies have identified numerous proposals to reduce regulatory burden and I am pleased to see that quite a few of them are included in H.R. 3505. We continue to work with the other agencies in an effort to achieve greater consensus and, as required by law, we will submit a final report to Congress with legislative recommendations, next year.

In my testimony today, I will identify twelve regulatory burden relief proposals that are supported by all of the Federal banking agencies. Next, I will address specific provisions in the proposed legislation that the FDIC requested to improve our performance. Finally, I will suggest additional provisions for inclusion in the proposed legislation. However, I would first like to take a moment to update the Subcommittee on recent activities by the FDIC and other Federal agencies addressing the need for regulatory flexibility in response to Hurricane Katrina.

RECENT ACTIONS BY FDIC AND OTHER AGENCIES IN RESPONSE TO HURRICANE KATRINA

As you know, all of the Federal banking agencies recognize the challenges faced by financial institutions in the aftermath of Hurricane Katrina. Without question, the federal banking agencies should exercise discretion and flexibility in the enforcement of regulatory requirements and execution of supervisory responsibility with regard to financial institutions and their communities and customers affected by Hurricane Katrina. We have provided timely information regarding the availability of banking services in the three affected states and posted information for consumers and bankers in the affected states on our website – www.fdic.gov. The FDIC has asked insured financial institutions to consider all reasonable and prudent steps to meet the financial needs of their customers and communities. In cooperation with the other Federal agencies, we have also provided banks with written guidance on two pressing issues.

Check Cashing. There is no Federal banking law that prohibits banks from cashing checks of non-customers. As defined in the Customer Identification Program Rule (CIP Rule), check cashing by itself is not the opening of an account and therefore, the CIP Rule does not apply if all the customer does is cash a check, one time or many times. It is left up to individual banks to establish their own policies and procedures on check cashing services for customers and non-customers. The banking regulators have encouraged banks--in writing--to meet the financial services needs of the Hurricane victims in a number of ways including waiving ATM fees, easing restrictions on check cashing, and being

reasonable in their approach to verifying the identity of displaced individuals. Examiners, like bankers, are fully aware that this is the right thing to do under the circumstances.

Opening New Accounts. If customers are opening new accounts, banks must follow Customer Identification Rule under the Bank Secrecy Act. The banking agencies, in conjunction with FinCEN, published a question-and-answer document on September 12 to clarify how banks can comply with the CIP Rule even if customers have little or no written identification. Essentially, the four pieces of information required by the CIP are: 1) name 2) date of birth 3) address [or prior or temporary address, in the case of evacuees] and 4) Tax ID number. Most people can provide these required elements on the spot. Verification can take place later, and can be done without written documents.

POTENTIAL LEGISLATIVE ACTION

In previous natural disasters, Congress temporarily relaxed Prompt Corrective Action (PCA) requirements for affected institutions. The Depository Institutions Disaster Relief Acts of 1992, 1993, and 1997 each had a section titled, "Deposit of Insurance Proceeds." That section provided the banking agencies authority to permit an insured depository institution to subtract from the institution's total assets, in calculating compliance with the leverage limit prescribed under section 38 of the Federal Deposit Insurance Act (FDI Act), an amount not exceeding the qualifying amount attributed to flood-related insurance proceeds and government assistance, if the agency determined the institution:

- had its principal place of business within disaster area;
- derived more than 60 percent of its total deposits from persons and businesses within the disaster area:
- was adequately capitalized before the major disaster; and
- had an acceptable plan for managing the increase in its total assets and total deposits.

The authority to subtract such assets from the leverage capital ratio calculation lasted for 18 months. Due to the widespread nature and the severity of the damage, as well as the dollar volume of relief funds that will be flowing to the area, we believe many banks would avail themselves of similar relief if it were offered by Congress in response to Katrina. Such relief would be very beneficial to banks in the area.

EGRPRA INTERAGENCY CONSENSUS ITEMS

Through the interagency EGRPRA effort led by former FDIC Vice Chairman John Reich, now Director of the Office of Thrift Supervision, consensus among all of the Federal banking agencies was reached on twelve regulatory burden relief proposals. Five of these proposals currently are included in H.R. 3505, as well as a variation on a sixth. The FDIC joins with the other Federal banking agencies in supporting inclusion of the remaining six of the proposals in the current regulatory relief legislation. Specifically, the twelve interagency consensus proposals for regulatory burden relief are:

Interagency Provisions Included in H.R. 3505

1. Repeal Certain Reporting Requirements Relating to Insider Lending

These amendments, included as Section 403 in H.R. 3505, repeal certain reporting requirements related to insider lending imposed on banks and savings associations, their executive officers, and their principal shareholders. The reports recommended for elimination are: (1) reports by executive officers to the board of directors whenever an executive officer obtains a loan from another bank in an amount more than he or she could obtain from his or her own bank; (2) quarterly reports from banks regarding any loans the bank has made to its executive officers; and (3) annual reports from bank executive officers and principal shareholders to the bank's board of directors regarding their outstanding loans from a correspondent bank.

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

2. Streamline Depository Institution Merger Application Requirements

This proposal, included as Section 610 in H.R. 3505, streamlines merger application requirements by eliminating the requirement that each Federal banking agency must request a competitive factors report from the other three Federal banking agencies, in addition to requesting a report from the Attorney General. Instead, the

agency reviewing the application would be required to request a report only from the Attorney General and give notice to the FDIC as insurer.

3. Improve Information Sharing with Foreign Supervisors

This proposal, included as Section 612 in H.R. 3505, amends Section 15 of the International Banking Act of 1978 to add a provision to ensure that the Federal Reserve, OCC, FDIC, and OTS cannot be compelled to disclose information obtained from a foreign supervisor in certain circumstances. Disclosure could not be compelled if public disclosure of the information would be a violation of the applicable foreign law and the U.S. banking agency obtained the information under an information sharing arrangement or other procedure established to administer and enforce the banking laws. This amendment would reassure foreign supervisors that may otherwise be reluctant to enter into information sharing agreements with U.S. banking agencies because of concerns that those agencies could not keep the information confidential and public disclosure could subject the foreign supervisor to a violation of its home country law. It also would facilitate information sharing necessary to supervise institutions operating internationally, lessening duplicative data collection by individual national regulators. The banking agency, however, cannot use this provision as a basis to withhold information from Congress or to refuse to comply with a valid court order in an action brought by the U.S. or the agency.

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

This amendment, included as Section 404 in H.R. 3505, increases the threshold for the small depository institution exception under the Depository Institution

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

5. Call Report Streamlining

This proposal, included as Section 606 in H.R. 3505, requires the Federal banking agencies to review information and schedules required to be filed in Reports of Condition (Call Reports) every five years to determine if some of the required information and schedules can be eliminated. Currently, banks must report substantial amounts of financial and statistical information with its Call Report schedules that appears to many bankers to be unnecessary to assessing the financial health of the institution and determining the amount of insured deposits it holds. This amendment would require the agencies to review their real need for information routinely so as to reduce that burden.

6. Enhance Examination Flexibility

The FDI Act requires the banking agencies to conduct a full-scale, on-site examination of the insured depository institutions under their jurisdiction at least once every twelve months. The FDI Act provides an exception for small institutions—that is institutions with total assets of less than $250 million—that are well-capitalized and well-managed, and meet other criteria. Examinations of these qualifying smaller institutions are required at least once every eighteen months. The interagency proposal raises the total assets ceiling for small institutions to qualify for an 18-month examination cycle

from $250 million to $500 million, thus potentially permitting more institutions to qualify for less frequent examinations. Section 607 of H.R. 3504 raises the asset ceiling to $1 billon; the FDIC supports this higher amount. The bill would reduce regulatory burden on low-risk, smaller institutions and permit the banking agencies to focus their resources where the great majority of the industry's assets and deposits are.

Interagency Consensus Items Not Currently Included in H.R. 3505

The remaining proposals supported by all of the Federal banking agencies are not included in H.R. 3505:

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

The proposed amendments to the Bank Holding Company Act and the FDI Act shorten the current 15-day minimum post-approval waiting period for certain bank acquisitions and mergers when the appropriate Federal banking agency and the Attorney General agree that the transaction would not have significant adverse effects on competition. Under those circumstances, the waiting period could be shortened to five days. However, these amendments would not shorten the time period for private parties to challenge the transaction under the Community Reinvestment Act.

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

This proposal amends the Bank Merger Act (12 U.S.C. 1828(c)) to exempt certain merger transactions from both the competitive factors review and post-approval waiting periods. It applies only to merger transactions between an insured depository institution

and one or more of its affiliates, as this type of merger is generally considered to have no affect on competition.

9. Increase Flexibility for Flood Insurance

The FDIC and the other federal bank regulators have developed amendments to the National Flood Insurance Program to improve program operations and reduce regulatory burden by revising the maximum dollar amount qualifying for the "small loan" flood insurance exception; eliminating coverage gaps when an institution must buy insurance on the borrower's behalf; and modifying the current system for assessing civil monetary penalties. We will continue to develop these proposals and seek additional ideas to improve the flood insurance program, especially in light of Gulf Coast hurricane damage.

The following three consensus proposals have been included in earlier regulatory relief and other legislation aimed at repealing the prohibition against the payment of interest on demand deposits, but are not included in this bill at this time.

10. Authorize the Federal Reserve to Pay Interest on Reserves

This amendment would give the Federal Reserve express authority to pay interest on balances that depository institutions are required to maintain at the Federal Reserve Banks. By law, depository institutions are required to hold funds against transaction accounts held by customers of those institutions. These funds must be held in cash or on reserve at Federal Reserve Banks. Over the years, institutions have tried to minimize their reserve requirements. Allowing the Federal Reserve Banks to pay interest on those reserves should put an end to economically wasteful efforts by banks to circumvent the

reserve requirements. Moreover, it could be helpful in ensuring that the Federal Reserve will be able to continue to implement monetary policy with its existing procedures.

11. Increase Flexibility for the Federal Reserve Board to Establish Reserve Requirements

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

12. Authorize Member Bank to Use Pass-Through Reserve Accounts

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

PROVISIONS TO INCREASE FDIC EFFICIENCY

The FDIC has worked closely with the Subcommittee in developing several of the provisions contained in the proposed legislation that will help the FDIC become more efficient and effective in its regulation of insured institutions. The FDIC enthusiastically

supports several statutory provisions of the Financial Services Regulatory Relief Act of 2005 as described below.

Judicial Review of Conservatorship and Receivership Appointments

The FDIC supports Section 402 of H.R. 3505 that specifies the time period during which the appointment, in certain circumstances, of the FDIC as conservator or receiver of a failed insured depository institution could be challenged. Moreover, this provision provides greater certainty to the receiver's activities and to those doing business with the receiver.

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

Enforcement of Agreements and Conditions

The FDIC applauds inclusion of Section 405 that enhances the safety and soundness of insured depository institutions and protects the deposit insurance funds from unnecessary losses. The proposed amendment provides that the Federal banking agencies may enforce (i) conditions imposed in writing, and (ii) written agreements in which an institution-affiliated party agreed to provide capital to the institution. The proposal similarly would clarify existing authority of the FDIC as receiver or conservator to enforce written conditions or agreements entered into between insured depository institutions and institution-affiliated parties and controlling shareholders.

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

Amendment Clarifying FDIC's Cross Guarantee Authority

The FDIC is pleased that H.R. 3505 contains a provision necessary to correct a gap in current law regarding cross guarantee liability. As part of the Federal Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Congress established a system that permits the FDIC to assess liability for FDIC losses caused by

the default of an insured depository institution. Cross guarantee liability, however, is currently limited to commonly controlled insured depository institutions as defined in the statute. Because the statutory definition does not include certain types of financial institutions such as credit card banks that are controlled by nonbank holding companies, liability may not attach to insured institutions that are owned by the same nonbank holding company.

Over the years, a growing number of companies have acquired, either directly or through an affiliate, one or more credit card banks, trust companies, industrial loan companies, or some combination of those types of institutions. Because these companies do not fall within the scope of depository institution holding companies for common control purposes, in the event of default, the FDIC may not be able to assess cross guarantee liability as envisioned in the statute. Section 407 of the proposed legislation corrects language to strengthen the FDIC's efforts to protect the deposit insurance funds when it is determining whether and to what extent to exercise its discretionary authority to assess cross guarantee liability. The assessment of liability would continue to be only against the insured depository institution under common control with the defaulting institution.

Amendment Clarifying the FDIC's Golden Parachute Authority

The FDIC also supports Section 408 of H.R. 3505 that amends Section 18(k) of the FDIC Act to clarify that the FDIC could prohibit or limit a nonbank holding company's golden parachute payment or indemnification payment. In 1990, Congress added this section to the FDI Act and authorized the FDIC to prohibit or limit prepayment of salaries or any liabilities or legal expenses of an institution-affiliated party

by an insured depository institution or depository institution holding company. Such payments are prohibited if they are made in contemplation of the insolvency of such institution or holding company or if they prevent the proper application of assets to creditors or create a preference for creditors of the institution. Due to the statutory definition of depository institution holding company, it is not clear that the FDIC is authorized to prohibit these types of payments made by nonbank holding companies. Some examples are companies that own only credit card banks, trust companies, or industrial loan companies.

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

Change in Bank Control Act Amendment

The FDIC supports Section 409 of the proposed legislation that amends the Change in Bank Control Act to address an issue that arises when a "stripped charter" institution is the subject of a change-in-control notice. A stripped charter is essentially a bank charter with insurance, but without any significant ongoing business operations. Such "stripped charters" can result after a purchase and assumption transaction where the assets and liabilities of an institution are transferred to an acquiring institution, but the charter remains and may have value attached to it.

The Change in Bank Control Act provides the appropriate Federal banking agency with authority to disapprove a change-in-control notice within a set period of time. The availability of stripped charters for purchase in the establishment of new banking operations is sometimes used as an alternative to de novo charter and deposit insurance applications. Change-in-control notices are subject to strict time periods for disapproval and extensions of time beyond the 45 days for review. These time frames place significant pressures on the agencies when they are required to analyze novel or significant issues or complex or controversial business proposals. For example, issues presented by change-in-control notices proposing control by non-resident foreign nationals, or issues presented where third parties are proposed to have significant participation in the bank's operations, generally require additional scrutiny to satisfy safety and soundness concerns. The FDIC supports the provisions of H.R. 3505 that clarify the bases for which such notices may be disapproved and expand the bases for extensions of time for consideration of certain notices raising novel or significant issues. The provision is a safety and soundness measure that would greatly increase the agencies' ability to adequately consider the risks inherent in a proposed business plan and to use that information in determining whether to disapprove a notice of change-in-control.

Recordkeeping Amendment

The FDIC supports Section 604 of the bill that modifies the requirement for retention of old records of a failed insured depository institution at the time a receiver is appointed. Currently, the statute requires the FDIC to preserve all records of a failed institution for six years from the date of its appointment as receiver, regardless of the age

of the records at the time of the failure. After the end of six years, the FDIC can destroy any records that it determines to be unnecessary, unless directed not to do so by a court or a government agency or prohibited by law. Consequently, the FDIC must preserve for six years very old records that have no value to the FDIC, the public interest, or to any pending litigation.

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

Preservation of Records by Optical Imaging and Other Means

The FDIC supports Section 605 of H.R. 3505 to permit the FDIC to rely on records preserved electronically, such as optically imaged or computer scanned images, as well as the "preservation of records by photography" currently provided by the statute.

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

manner of the preservation of records to ensure their reliability, regardless of the technology used.

Clarification of Section 8(g) Prohibition Authority

Section 8(g) of the FDI Act provides the appropriate Federal banking agency with the authority to suspend or prohibit individuals charged with certain crimes from participation in the affairs of the depository institution with which they are affiliated. The FDIC supports Section 609 of H.R. 3505 that clarifies that the agency may suspend or prohibit those individuals from participation in the affairs of any depository institution and not solely the insured depository institution with which the institution affiliated party is or was associated. The provision will make clear that a Federal banking agency may use the Section 8(g) remedy even where the institution that the individuals were associated with ceases to exist.

The FDIC also supports a number of provisions that were requested by our fellow regulators and included in the proposal, for example, we support provisions that streamline merger application requirements and authorize additional community development activities through investments by institutions that promote the public welfare. Moreover, the bill makes a number of changes to update or conform existing statutes that we believe are quite useful.

OTHER ISSUES FOR INCLUSION IN THE BILL

The FDIC respectfully recommends that the Subcommittee consider including the following additional regulatory relief items in the bill. The appendix to my testimony contains the relevant legislative language.

Authority to Enforce Conditions on the Approval of Deposit Insurance

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

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

Clarification of Section 8 Enforcement Authority that Change-in-Control Conditions are Enforceable

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

equally to conditions imposed in connection with notices and to applications, notices, or other requests by an institution-affiliated party.

Deposit Insurance Related to the Optional Conversion of Federal Savings Associations

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

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

Bank Merger Act and Bank Holding Company Act

The FDIC supports amendments to the Bank Merger Act and Bank Holding Company Act to require consideration of the potentially adverse effects on the insurance funds of any proposed bank merger transaction or holding company formation/ acquisition. As presently written, these laws do not require that any specific

consideration be given to a transaction's possible impact on the deposit insurance funds. The omission is noteworthy and potentially damaging to the financial viability of the funds.

Language specifying consideration of risks to the insurance funds already exists for consideration of other transactions. For example, regarding change in control of insured banks, the FDI Act provides authority to the appropriate Federal banking agency to disapprove any proposed acquisition if the agency determines that the proposed transaction would result in an adverse effect on the Bank Insurance Fund or the Savings Association Insurance Fund.

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

Given the potential insurance risks inherent in transactions involving large diversified financial services organizations, the addition of an "adverse effect on the deposit insurance funds" assessment factor as a requirement under the Bank Merger Act and Bank Holding Company Act would seem warranted. As with the other factors, each of the agencies would be required to make a separate "adverse effect on the deposit insurance funds" evaluation during its review of the proposed transaction. The intent would be to ensure that the financial integrity of the BIF and the SAIF are prime considerations in any proposed combination. As indicated, there is precedent in other

bank application reviews and we believe a compelling case can be made for its inclusion in both the Bank Merger Act and the Bank Holding Company Act.

The FDIC also suggests including language that will:

1) provide for the FDIC in its role as receiver of failing institutions to gain access to individual FICO scores to improve the FDIC's ability to evaluate assets and recommend transaction structures for failing banks;

2) clarify the provision of the FDI Act relating to the resolution of deposit insurance disputes in the case of failed insured depository institutions; and

3) exclude from the Federal Advisory Committee Act advisory committees to the banking agencies.

CONCLUSION

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

APPENDIX

LEGISLATIVE LANGUAGE FOR FDIC RECOMMENDATIONS

Authority to Enforce Conditions on the Approval of Deposit Insurance

Sec. ____. FEDERAL BANKING AGENCY AUTHORITY TO ENFORCE DEPOSIT INSURANCE CONDITIONS.

(a) Section 8 of the Federal Deposit Insurance Act (12 U.S.C. § 1818) is amended –

(1) in subsection (b)(1) in the first sentence, by striking "any condition imposed in writing by the agency" and inserting "any condition imposed in writing by a Federal banking agency";

(2) in subsection (e)(1)(A)(i)(III), by striking "any condition imposed in writing by the appropriate Federal banking agency" and inserting "any condition imposed in writing by a Federal banking agency"; and

(3) in subsection (i)(2)(A)(iii), by striking "any condition imposed in writing by the appropriate Federal banking agency" and inserting "any condition imposed in writing by a Federal banking agency".

Clarification of Section 8 Enforcement Authority that Change-in-Control Conditions are Enforceable

Sec.____. CLARIFICATION OF ENFORCEMENT AUTHORITY.

Section 8 of the Federal Deposit Insurance Act (12 U.S.C. 1818) is amended –

(a) in subsection (b)(1), in the first sentence, by striking "the granting of any application or other request by the depository institution" and inserting "any action on any application, notice, or other request by the depository institution or institution-affiliated party,";

(b) in subsection (e)(1)(A)(i)(III), striking "the grant of any application or other request by such depository institution" and inserting "any action on any application, notice, or request by such depository institution or institution-affiliated party"; and

(c) in subsection (i)(2)(A)(iii), by striking "the grant of any application or other request by such depository institution" and inserting "any action on any application, notice, or other request by the depository institution or institution-affiliated party".

Deposit Insurance Related to the Optional Conversion of Federal Savings Associations

Sec ____. CLARIFICATION OF APPLICATION REQUIREMENTS FOR OPTIONAL CONVERSION FOR FEDERAL SAVINGS ASSOCIATIONS.

(a) Paragraph 5 of the Home Owners' Loan Act (12 U.S.C. 1464(i)(5)) is amended to read as follows --

(5) CONVERSION TO NATIONAL OR STATE BANK. –

(A) IN GENERAL. – Any Federal savings association chartered and in operation before the date of the enactment of the Gramm-Leach-Bliley Act, with branches in operation before such date of enactment in 1 or more States, may convert, at its option, with the approval of the Comptroller of the Currency for each national bank, and with the approval of the appropriate State bank supervisor and the appropriate Federal banking agency for each State bank, into 1 or more national or State banks, each of which may encompass 1 or more of the branches of the Federal savings association in operation before such date of enactment in 1 or more States, but only if each resulting national or State bank (i) will meet all financial, management, and capital requirements applicable to the resulting national or State bank, and (ii) if more than 1 national or State bank results from a conversion under this subparagraph, has received approval from the Federal Deposit Insurance Corporation under section 5(a) of the Federal Deposit Insurance Act. No application under section 18(c) of the Federal Deposit Insurance Act shall be required for a conversion under this subparagraph.

(B) DEFINITIONS. – For purposes of this paragraph, the terms "State bank" and "State bank supervisor" have the meanings given those terms in section 3 of the Federal Deposit Insurance Act.".

(b) Section 4(c) of the Federal Deposit Insurance Act (12 U.S.C. § 1814(c)) is amended –

(1) after "Subject to section 5(d)", by inserting "of this Act and section 5(i)(5) of the Home Owners' Loan Act"; and

(2) in paragraph (2), after "insured State" by inserting "or Federal".

Bank Merger Act and Bank Holding Company Act

Bank Merger Act Amendment

Paragraph (5) of subsection (c) of section 18 of the FDI Act (12 U.S.C. § 1828(c)(5)) is amended -

> in the last sentence of paragraph (5), by inserting ", the potential risk of loss to the Bank Insurance Fund or Savings Association Insurance Fund" before ", and".

Bank Holding Company Act Amendment

Paragraph (2) of subsection (c) of section 3 of the Bank Holding Company Act (12 U.S.C. § 1842(c)(2)) is amended -

> by inserting ", the potential risk of loss to the Bank Insurance Fund or Savings Association Insurance Fund" before ", and".

Acquisition of FICO Scores

Sec.____. ACQUISITION OF FICO SCORES.

Section 604(a) of the Fair Credit Reporting Act (15 U.S.C. 1681b(a)) is amended by adding a new paragraph after paragraph (5) as follows:

"(6) To the Federal Deposit Insurance Corporation as part of its preparation for its appointment or as part of its exercise of powers as conservator or receiver for an insured depository institution under the Federal Deposit Insurance Act or other applicable Federal or State law or in connection with the resolution or liquidation of a failed or failing insured depository institution .".

Resolution of Deposit Insurance Disputes

Sec.____. RESOLUTION OF DEPOSIT INSURANCE DISPUTES.

Paragraphs (3), (4), and (5) of section 11(f) of the Federal Deposit Insurance Act (12 U.S.C. § 1821(f)(3)) are amended to read as follows:

> "(3) RESOLUTION OF DISPUTES. -- The Corporation's determination regarding any claim for insurance coverage shall be treated as a final

determination for purposes of this section. In its discretion, the Corporation may promulgate regulations prescribing procedures for resolving any disputed claim relating to any insured deposit or any determination of insurance coverage with respect to any deposit.

(4) REVIEW OF CORPORATION'S DETERMINATION. -- A final determination made by the Corporation shall be a final agency action reviewable in accordance with chapter 7 of title 5, United States Code, by the United States district court for the Federal judicial district where the principal place of business of the depository institution is located.

(5) STATUTE OF LIMITATIONS. – Any request for review of a final determination by the Corporation shall be filed with the appropriate United States district court not later than 60 days after such determination is issued.".

Amendment to Exclude Advisory Committees to the Banking Agencies from the Federal Advisory Committee Act

Sec.____. EXEMPTION FROM THE FEDERAL ADVISORY COMMITTEE ACT.

The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by adding at the end the following new section:

"Sec. _____ . ADVISORY COMMITTEES ESTABLISHED BY THE FEDERAL BANKING AGENCIES.—

(a) IN GENERAL.-- The Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision may each establish and use a committee composed of persons selected by the agency to provide advice and recommendations to the agency relating to safety and soundness, product and service developments and delivery, or consumer issues affecting the institutions supervised by such agencies, and, with respect to committees formed by the Federal Deposit Insurance Corporation, the protection, operation, and administration of the deposit insurance funds, including the resolution and liquidation of failed or failing insured depository institutions.

(b) EQUAL TREATMENT.--Notwithstanding any other law, a Federal banking agency that establishes and uses an advisory committee under subsection (a) shall be treated in the same manner as if it were the Federal Reserve System establishing and using the advisory committee.".

Testimony of George Latham
Deputy Commissioner of Financial Institutions
Virginia Bureau of Financial Institutions
On behalf of the
National Association of State Credit Union Supervisors
Before the Subcommittee
on Financial Institutions and Consumer Credit
United States House of Representatives
September 22, 2005

NASCUS History and Purpose

Good morning, Chairman Bachus, and distinguished members of the Subcommittee. I am George Latham, Deputy Commissioner of Financial Institutions for the Bureau of Financial Institutions for the Commonwealth of Virginia. I appear today on behalf of the National Association of State Credit Union Supervisors (NASCUS). NASCUS represents the 48 state and territorial credit union agencies and is advised by the NASCUS Credit Union Advisory Council, composed of more than 600 state-chartered credit unions dedicated to defending the dual chartering system for credit unions.

The mission of NASCUS is to enhance state credit union supervision and regulation and promote policies that ensure a safe and sound state credit union system. We achieve those goals by serving as an advocate for a dual chartering system that recognizes the traditional and essential role that state government plays as a part of the national system of depository financial institutions.

NASCUS applauds the introduction of H.R. 3505, the Financial Services Regulatory Relief Act of 2005. We appreciate that a section is dedicated to regulatory relief provisions for credit unions. This Subcommittee's continued commitment to providing ongoing regulatory relief ensures a safe and sound environment for credit unions and the consumers they serve. We are pleased to have this opportunity to share our legislative priorities for regulatory relief and to compare and contrast them with the provisions in H.R. 3505.

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NASCUS Priorities for Regulatory Relief

H.R. 3505 offers many regulatory relief provisions that further the safety and soundness of credit unions. NASCUS priorities for regulatory relief focus on reforms that will strengthen the state system of credit union supervision and enhance the capabilities of state-chartered credit unions. The ultimate goal is to meet the financial needs of consumer members while assuring that the state system is operating in a safe and sound manner.

In this testimony, I will address provisions included in H.R. 3505 that are vital to the future growth and safety and soundness of state-chartered credit unions. In addition, I will share more regulatory relief provisions that NASCUS believes would further strengthen the legislation. They are as follow:

- Regulatory modernization that provides parity for credit unions with other financial institutions.
- Allowing non-federally insured credit unions to join the FHLBs.
- Capital reform including amending the current Prompt Corrective Action (PCA) provision for credit unions, allowing risk-based capital reform and amending the definition of net worth to include the retained earnings of a merging credit union when calculating net worth.
- Member business lending, expanding the lending provision and amending the definition of a member business loan.
- Preservation of the dual chartering system and protection against the preemption of state laws.

Regulatory Relief Provided by H.R. 3505

State regulators appreciate the foresight that went into the provisions provided in this bill. H.R. 3505 offers several important regulatory relief provisions for state-chartered credit unions.

A most important provision is an amendment to the definition of net worth, which cures the unintended consequences for credit unions of the Financial Accounting Standards Board (FASB) business combination accounting rules. FASB's Financial Accounting Standard No. 141 requires the acquisition method for business combinations and effectively eliminates the pooling method for the combinations of mutual enterprises. Chairman Bachus and members of the Subcommittee, NASCUS applauds the inclusion

of this provision in H.R. 3505, as well as the House passage of H.R. 1042. Both amend the definition of net worth to include the net retained earnings of a merging credit union with that of the surviving credit union. Mergers are a safety and soundness tool regulators use to protect funds deposited by American consumers and to preserve the National Credit Union Share Insurance Fund. We recognize and appreciate that a similar provision was introduced in H.R. 2317, the Credit Union Regulatory Improvement Act, commonly called CURIA.

NASCUS is also pleased that H.R. 3505 includes language that provides an exemption from the pre-merger notification requirements of the Clayton Act. Federally insured credit unions would be provided the same exemption from pre-merger notification requirements and fees of the Federal Trade Commission currently enjoyed by other depository institutions.

H.R. 3505 also provides credit unions similar treatment as other depository institutions under securities laws established in the Securities and Exchange Act of 1934.

We believe that both of these parity provisions for credit unions with other financial institutions should be expanded to include all state-chartered credit unions, not just those that are federally insured.

Privately-Insured Credit Unions Should Be Eligible to Join Federal Home Loan Banks (FHLBs)

We applaud the inclusion of Section 301 in H.R. 3505, which enables privately-insured credit unions access to FHLBs. Currently, federally insured credit unions have access to the FHLBs, while privately-insured credit unions do not. NASCUS has long advocated that privately insured credit unions should have access to the FHLBs. We are pleased that H.R. 3505 would allow non-federally insured credit union to join the FHLBs.

Non-federally insured credit unions are regulated by the same state regulatory agencies as those credit unions with federal insurance. The mission of the examination process is to ensure that state credit unions, regardless of their insurance type, operate in a safe and sound manner. Federal and private share insurance systems have been established to protect credit union shareholders.

The regulatory and examination functions performed by a state examiner primarily determine the safety and soundness of state-chartered credit unions. State agencies perform examinations and issue rules that ensure safe and sound financial practices. The exam process includes safeguards to ensure that financial and operational deficiencies are corrected. When necessary, state agencies may take enforcement action to ensure that financial and operational remedies are implemented. All of these actions, working together, ensure a safe and sound state credit union system.

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To manage insurance risk, state and federal regulators must work together. In fact, often the National Credit Union Administration (NCUA) relies significantly on the examination reports produced by state examiners. Moreover, in a vast majority of cases, state agencies use the same computerized examination platform (AIRES) as used by the NCUA. NASCUS agencies cooperatively participate in the development and testing of NCUA's examination program and procedures.

In addition, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established a series of safety and soundness requirements both for entities that offer private deposit insurance to credit unions and for credit unions that opted for private deposit insurance.

Granting non-federally insured institutions access to the FHLBank system does not establish a new membership principle. Today, more than 50 insurance companies, chartered and regulated by state governments with no federal oversight or insurance, are members of these Banks.

NASCUS believes that allowing FHLB membership for privately-insured credit unions follows the same basic principle. Moreover, since state examination of privately insured credit unions is so strong and at least comparable to NCUA's examination program, it does not inflict any new or unusual exposure on the FHLB system.

Further, it introduces an additional layer of financial discipline. Each Federal Home Loan Bank has a sophisticated credit screening system to assure that any borrower, federally insured or not, is credit worthy. In addition, every advance is secured by marketable collateral.

Expanding State Agency Regulatory Authority

In addition to providing regulatory relief for non-federally insured credit unions, we are pleased H.R. 3505 provides additional authorities to state regulators. It provides amendments to FDICIA that allow the state supervisor of a state-chartered credit union, that receives deposits insured by a private deposit insurer, to examine and enforce compliance disclosure regulations.

While expanding state regulatory authority, this legislation repeals examination and enforcement authority of the Federal Trade Commission (FTC) for credit unions with private insurance. Section 315 of H.R. 3505 confirms that the FTC retains enforcement authority of the disclosure requirements and the manner and content of the disclosures necessary for a credit union with private insurance. NASCUS supports the language included in H.R. 3505 that recognizes state supervisory authority as the overseer of

examination and enforcement authority of compliance of disclosure requirements for credit unions with private insurance.

Expanding H.R. 3505

Two areas that would be beneficial in the regulatory oversight of state-chartered credit unions are additional capital reform and a change in the definition of a member business loan.

Capital Reform

Capital reform continues to be a critical concern for the nation's credit unions. NASCUS strongly believes regulatory relief for credit unions must include capital reform that amends the Prompt Corrective Action (PCA) provision of the Federal Credit Union Act (the Act). It is imperative that the Act include more than retained earnings when calculating a credit union's net worth ratio. There are many reasons other forms of capital should be permitted for credit unions.

At the beginning of this month, we witnessed the devastation of Hurricane Katrina. State credit union regulators in the affected states helped ensure branch operations continued in a safe and sound manner and that members had access to cash. These regulators' concerns will soon shift to concerns about capital requirements imposed statutorily by PCA.

Section 216 of the Act establishes mandatory net worth categories for credit unions and does not provide flexibility to temporarily waive PCA requirements. Further, it restricts the net worth of a credit union to just its retained earnings. The statutory language establishing mandatory net worth categories, coupled with the narrow definition of retained earnings, is problematic for credit unions.

Many of the credit unions affected by Hurricane Katrina will need retained earnings to rebuild their credit unions. In addition, it is predicted that many members will walk away from loan obligations because their car or home, which secured their loan, no longer exists. As retained earnings are reduced for relief efforts, regulators in these states may have to downgrade credit unions for not meeting PCA requirements.

As this happens, under the current PCA regulation, these credit unions will lose investment authorities and other privileges associated with being a well capitalized institution. Many of these authorities enable them to better serve members. This example demonstrates how viciously this cycle affects and potentially hurts American consumers.

A legislative change is needed to broaden the definition of net worth in the Act. The statutory requirements discussed above are not similar to statutory requirements of other financial institutions, and potentially have a negative effect on the survival of a credit union. NASCUS has long advocated for a broader definition of net worth. Therefore, NASCUS applauds Section 314 that amends the definition of net worth to include the retained earnings of any credit union that merges into another credit union. NASCUS further recommends the addition of language modifying the definition of the net worth ratio to exclude from the numerator and the denominator a credit union's deposit in the National Credit Union Share Insurance Fund. Such language is included in CURIA.

Risk-Based Capital

Beyond an amendment to the Act that provides a broader definition for net worth, NASCUS endorses and has a long-standing policy supporting risk-based capital for credit unions. Risk-weighted capital reform should be flexible. New statutes and regulations should be progressive and not designed to regulate to the lowest common denominator. We believe risk-based capital is a sound and logical approach to capital reform for credit unions. NASCUS recommends that the risk-based net worth language in Section 102 of CURIA be included in H.R. 3505. Risk-based net worth and alternative capital authority are also complimentary capital reforms.

Alternative Capital Authority for Credit Unions

NASCUS supports capital reform beyond the risk-weighted capital and FASB merger fix. We believe that an important part of capital reform is providing credit unions access to alternative capital. The combination of current PCA requirements and a review of many state credit union balance sheets by their CEOs have revealed a need for alternative capital.

As noted above, the Act defines credit union net worth as retained earnings only. The NCUA determined that it lacks the regulatory authority to broaden the net worth definition to include other forms of capital as a part of PCA calculations. Thus, credit unions require an amendment to the Act to rectify this statutory deficiency.

NASCUS's Credit Union Advisory Council members have shared that even with the lower leverage ratio and risk-based capital as proposed in H.R. 2317 (CURIA), some state-chartered credit unions may not be able to rely solely on retained earnings to meet the capital base required by PCA standards. Many NASCUS regulators have concurred with this conclusion, as well. As credit unions grow and serve more consumers in their fields of membership, their assets will grow. As assets grow, credit unions experience reduced net worth ratios as earnings retention lags growth in assets.

We firmly believe alternative capital is necessary for credit unions to continue meeting the financial needs of their members. This is especially true for credit unions providing services such as financing for home ownership, or financial education and credit counseling—each an important part in achieving the American dream.

In July, the NASCUS Alternative Capital Task Force released a white paper that presents both equity and debt models for alternative capital. The instruments and arrangements discussed in this paper are designed to preserve the not-for-profit, mutual, member-owned and cooperative structure of credit unions. Moreover, these instruments ensure that ownership interest remains with the members. The white paper has been shared with the credit union community for study and feedback. The Alternative Capital white paper is attached to this testimony for review. We look forward to working with members of Congress and congressional staff in the coming weeks on the models presented.

As regulators, we should take every financially feasible step to strengthen the capital base of this nation's credit union system. NASCUS recognizes that strong capital reform requires that state and federal regulators work together. In 1998, the Credit Union Membership Access Act, H.R. 1151, provided that NCUA consult and cooperate with state regulators in constructing PCA and member business lending (MBL) regulations as required by the Act. Legislation or not, NASCUS firmly believes that cooperation results in better regulation and a stronger and safer credit union system.

Member Business Lending

NASCUS is pleased Section 306 of H.R. 3505 includes a provision that provides member business lending exclusions to nonprofit religious organizations. The purpose of this provision is to enhance community development activities of these organizations. However, NASCUS believes that further regulatory relief for member business lending is necessary.

NASCUS supports amending the definition of a member business loan in the Act. Section 201 of H.R. 2317 raises the statutory limit on credit union member business loans to 20 percent of total assets. We recommend that a similar provision be added to H.R. 3505. This provision would provide an opportunity for economic growth for credit unions by facilitating business lending without jeopardizing safety and soundness.

Regulatory relief for member business lending is important for consumers. In today's fast-paced economy, it is vital that lending is available to consumers who want to start a new business. Entrepreneurship is part of fulfilling the American dream. NASCUS has a vision of providing well-thought-out regulations to best position credit unions to make members' dreams become reality.

We further support the language in Section 202 of H.R. 2317, and recommend it be included in H.R. 3505. This provision amends the current definition of a member business loan by granting NCUA the authority to exempt loans of $100,000 or less. The recommended inclusion of Section 202 of H.R. 2317 into H.R. 3505 would increase the definition of business loans from the current amount of $50,000 to $100,000.

The addition of both of these provisions would provide credit unions with regulatory relief as it concerns member business lending. NASCUS supports an amendment to H.R. 3505 that includes both provisions.

Bank Secrecy Act Provisions

NASCUS appreciates the importance of the Bank Secrecy Act (BSA), and the recognition in H.R. 3505 that a balance must be met between the burden of producing the required reports for BSA compliance and the benefit of filing such reports. Title VII, BSA Compliance Burden Reduction, of H.R. 3505 recognizes that financial institutions experience a compliance burden when meeting money-laundering laws necessary to prevent terrorist acts.

Currently, the Secretary of the Treasury (the Secretary) has regulatory authority to define exemptions that financial institutions may file concerning currency transaction reports (CTRs). H.R. 3505 provides further flexibility to the Secretary to grant CTR exemptions for certain parties.

NASCUS believes this review by the Secretary under Section 701, including consideration of exemptions, will better balance the burden of reporting with the analytical and investigative needs of the federal government. We recognize the proposed language in Section 701 (c)(2)(C), discussing the review, is consistent with current regulatory trends concerning the risk-based assessment of new customers.

NASCUS believes the language in Title VII of H.R. 3505 will yield positive results by attempting to reduce the inconsistencies in monetary transaction recording and reporting enforcement and examination requirements.

NASCUS further appreciates the proposed requirement that the Comptroller General conduct a study of CTRs that are filed with the Secretary to help financial institutions best use the exemption provisions and mitigate issues that limit their effective use. In addition, it requires a feasibility study be performed by the Treasury to develop electronic communications interfaces between financial institutions and FinCEN, potentially reducing regulatory burdens on state-chartered credit unions.

NASCUS believes that state credit union regulators have a safety and soundness responsibility to encourage state-chartered credit unions to comply with all applicable

laws and regulations. We recommend that Section 702(b), Enforcement Programs, of H.R. 3505 should reference state regulators as contributing members of FFIEC. Referencing state regulators reinforces the importance of the partnership between state and federal regulators in enforcing and monitoring BSA and anti-money laundering compliance.

NASCUS appreciates the provisions in H.R. 3505 that attempt to reduce the regulatory burden of financial institutions. We believe it is a step in the right direction to balance the reporting burden with the needed information of policy makers, financial regulators, law enforcement and intelligence agencies. We suggest that future reviews of BSA also address filing of Suspicious Activities Reports (SARs) and the monitoring activities required.

Conclusion

In conclusion, NASCUS strongly supports the following issues for regulatory relief:

- NASCUS supports Section 314 of H.R. 3505 that amends the definition of net worth to include the retained earnings of a merging credit union with that of the surviving credit union.
- NASCUS supports Section 301 of H.R. 3505 that allows non-federally insured credit unions to be eligible to join the FHLBs.
- NASCUS supports Section 315 of H.R. 3505 that recognizes state supervisory authority as the overseer of examination and enforcement authority of compliance of disclosure requirements for credit unions with private insurance.
- NASCUS supports Section 312 of H.R. 3505 that provides all federally insured credit unions the same exemptions as banks and thrift institutions from pre-merger notification requirements of the Clayton Act.
- NASCUS supports Section 313 of H.R. 3505 that provides credit unions similar treatment as other depository institutions under securities laws established in the Securities and Exchange Act of 1934.
- NASCUS supports expanding H.R. 3505 to include an amendment to the Prompt Corrective Action (PCA) provision of the Act to include all forms of capital when credit unions calculate their net worth ratio.
- NASCUS believes H.R. 3505 should include risk-based capital reform.

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- NASCUS believes H.R. 3505 should be expanded to allow credit unions to issue alternative capital.
- NASCUS believes H.R. 3505 should include an expanded definition of member business lending to 20 percent of total assets of a credit union, furthering the goal of providing loans for consumer members.
- NASCUS believes H.R. 3505 should amend the definition of a member business loan by granting NCUA the authority to exempt loans $100,000 or less.
- NASCUS believes the BSA provisions in H.R. 3505 are a step in the right direction of balancing the reporting burden with needed information of policy makers, financial regulators, law enforcement and intelligence agencies.
- NASCUS believes Section 702(b), enforcement programs, of H.R. 3505 should reference state regulators as contributing members of FFIEC.
- NASCUS believes future reviews of BSA should address filing of Suspicious Activities Reports (SARs) and the monitoring activities required.

NASCUS appreciates the opportunity to testify today on the provisions in H.R. 3505. We welcome further participation in the discussion and deliberation of this legislation and other legislation that provides regulatory relief for state-chartered credit unions. We urge this Subcommittee to protect and enhance the viability of the dual chartering system for credit unions by acting favorably on the provisions we have discussed in our testimony.

Thank you.

Attachment –"Alternative Capital for Credit Unions...Why Not?"

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NASCUS

Alternative Capital for Credit Unions ...

Why Not?

Summer 2005

Alternative Capital for Credit Unions—Why Not?

Alternative capital for credit unions has been a hotly debated topic in recent years. Arguments have been presented pro and con about the concept, each side presenting their argument with conviction and true passion.

We all share the long-term vision of a safe and sound state credit union system. NASCUS appreciates your time reviewing this document and we ask that while you review our presentation of this issue, you think about alternative capital for credit unions from a "Why not?" perspective. After all, out-of-the box thinking allowed credit unions to progress into the dynamic institutions we appreciate and know today.

Reasons It Makes Sound Sense

NASCUS presents the attached white paper to demonstrate that there are models of alternative capital instruments that the credit union community can and should consider as alternative means to raise capital. The instruments presented enhance credit union capital adequacy and safety and soundness.

Each of the alternative capital instruments and arrangements discussed in this paper are designed specifically to preserve the not-for-profit, mutual, member-owned and cooperative structure of credit unions. Moreover, these instruments ensure that ownership interest remains with the members. As such, these instruments preserve the federal income tax exemption that credit unions have historically enjoyed.

The equity model instruments described in the attached paper qualify as equity capital balances under GAAP and, as such, provide a degree of permanence such that a sudden outflow of capital will not occur. The debt model instrument described provides similar benefits such that other regulators have recognized these instruments as capital for regulatory purposes. While providing a feasible means for augmenting capital, these instruments ensure that the capital structure of credit unions is not fundamentally changed and that the safety and soundness of the credit union community as a whole is preserved.

NASCUS firmly believes that these alternative capital instruments allow a feasible means to augment capital and should be studied and tested further to demonstrate their market viability. We believe also that each model presents strong reasoning to examine and make appropriate changes to the definition of net worth in the Federal Credit Union Act to include other forms of capital.

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Models of Alternative Capital Instruments

Background

Since the passage of the Credit Union Membership Access Act of 1998, and the NCUA's promulgation of the prompt corrective action regulations (PCA Regulations), credit union leaders have loudly decried the "PCA trap." These leaders argue that successful member service inevitably leads to asset growth; rapid asset growth results in diminished capital ratios; the PCA minimums (which are higher than those for banks and thrifts) mean that growth and member service have to be curtailed.

In trying to escape this trap, some credit union boards and their management teams have suggested that the credit union turn to a state charter and private share insurance. Others have suggested conversion to a mutual savings bank, while some have recommended that credit unions be permitted to issue one or more forms of alternative capital instruments that would receive recognition for regulatory capital purposes. In fact, many credit unions that have sought to convert to a mutual savings bank charter in recent memory have cited lack of access to capital alternatives as a rationale for conversion.

Unlike other financial institutions, credit unions have been able to increase their capital only by retaining a portion of their net earnings. For the first eight decades of their existence, American credit unions generally were not subject to capital ratio requirements and their regulators instead required them to add to retained earnings each quarter. As a result of the capital adequacy ratios that were imposed in 1998, most federally insured credit unions must maintain a minimum of 7% "net worth" or fall below the well-capitalized category and face increased regulatory requirements.

Unlike definitions associated with generally accepted accounting principles, the statutory definition of a federally insured credit union's "net worth" includes only the credit union's retained earnings.[1] The statute presumably omits any reference to any form of capital instrument because credit unions do not increase their capital by issuing common stock or taking advantage of other capital enhancement techniques generally available to banks and thrifts. They do not currently issue capital instruments because such instruments would have no regulatory value and, for state-chartered credit unions, there is a fear that such instruments would jeopardize the credit union's federal income tax-exempt status under the Internal Revenue Code.

The credit union community has debated for several years whether or not credit unions can and should offer capital instruments. Most detractors cite their concern that such capital instruments, especially if issued to non-members, would nullify the tax-exempt status of credit unions. In 2004, the U.S. Government Accountability Office released a report finding no compelling need for alternative capital at that time. The GAO based its

[1] However, low-income credit unions are permitted also to include a form of uninsured subordinated debt (secondary capital) as part of their "net worth" when determining compliance with the requirements of the PCA Regulations.

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finding on three broad areas of concern. First, the GAO felt that, although non-credit union system purchasers of alternative capital instruments would provide market discipline, the involvement of such "outside investors" could threaten the member-owned, cooperative structure of credit unions. Second, the GAO felt that "inside investors" could raise systemic risk concerns if weaker credit unions could bring down stronger credit unions due to alternative capital investments – the so-called "daisy-chain effect." Third, the GAO felt there was no clear alternative capital model to study.

This paper seeks to address this last concern by presenting three alternative capital instrument models for credit unions to study. The first two models are equity capital instruments – one that raises funds from members only, the other from non-members. Both of the models are "debt" for federal income tax purposes, while being characterized as "equity" under generally accepted accounting principles. Banks and business corporations have successfully issued similar "hybrid" instruments for more than two decades.

Next, we present a subordinated debt model instrument, which, when properly structured, is treated by other FFIEC regulators as Tier 2 capital.

This paper argues that such model structures can and should be treated by the credit union community, Congress, and credit union regulators as regulatory capital. The models presented in this white paper are not meant to be exhaustive.

Competing Considerations – "Debt" for Tax Purposes, "Equity" for Accounting Purposes

Debt characterization – State-chartered credit unions are exempt from federal income taxes under Section 501(c)(14)(A) of the Internal Revenue Code. That section creates a three-pronged test for determining the tax exemption. Under one of those prongs, credit unions are barred from issuing "capital stock" if they wish to remain tax exempt.

Neither the Internal Revenue Code nor IRS regulations define "capital stock" for this purpose. The relatively few published court opinions on the subject suggest that a lack of certain features tends to make an instrument less like common stock or capital stock and more like debt. Some of the key features to avoid are (a) voting rights, (b) any holder's right to put the instrument back to the issuer, and (c) appreciation in the instrument's value in accordance with the issuer's profitability.

Meanwhile, some of the key features that make an instrument look more like debt are (d) repayment of the face amount at a time certain (maturity) and (e) a rate of return tied to an external benchmark (rather than the issuer's profitability). A preferred rate of return will also help bolster the debt argument. Taken together, these considerations are a key to assuring that the instrument would not to be characterized by the IRS as "capital stock."

Equity – The applicable accounting literature reveals several key features of instruments that are treated as equity. The most salient of those features are (1) distributions at the discretion of the issuer, (2) no obligation on the part of the issuer to repay any amount

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with respect to the holder's original contribution except, perhaps, upon liquidation; and (3) participation in the residual interests of the issuer (sharing in any profitability of the issuer upon liquidation). More explicit subordination of the claims of the instrument holders to the claims of creditors will also make an instrument more "equity-like."

Walking the line – The proposed hybrid instruments discussed below blend the above features, specifically:

- No voting rights;
- No put rights on the part of the holder;
- Redemption only at the discretion of the issuer, and then only at the face amount;
- Indefinite final maturity;
- Interest or dividends payable at a fixed rate rather than based on performance; and
- Subordination to claims of creditors and depositors.

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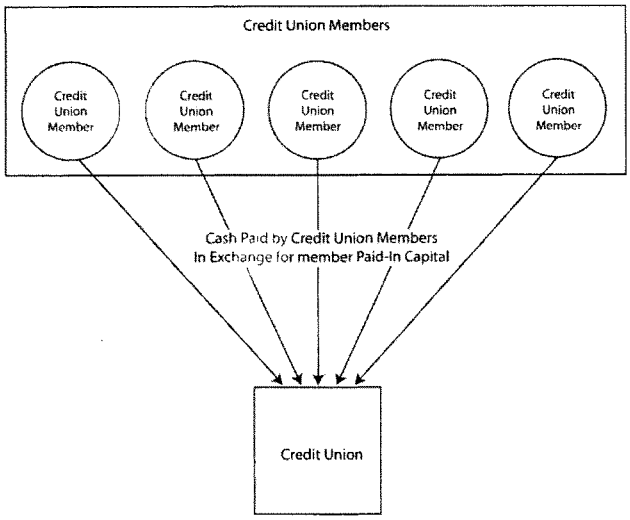
Model One – Member Paid-In Capital – Key Characteristics

Member Paid-In Capital



The first hybrid capital instrument model could be called "Member Paid-In Capital" because of its similarity to instruments by the same name currently issued by corporate credit unions. The Member PIC issued by corporate credit unions is recognized by the NCUA as regulatory capital.[2]

With Member PIC, dividends (which are structured to be equivalent to interest) would be payable at a specified rate, most likely based on an external standard (*e.g.*, LIBOR, Federal Home Loan Bank stock dividend rate). To satisfy GAAP equity accounting standards, dividends on PIC could be deferred at the credit union board's discretion (*e.g.*, the credit union could forgo a dividend payment if, immediately thereafter, the credit union would fail to meet one or more applicable capital ratios).

[2] Corporate credit unions are specifically exempt from the Federal Credit Union Act's prompt corrective action requirements. Thus, there is no statutory "net worth definition" impediment to the NCUA's recognition of alternative forms of instruments or accounts as capital for regulatory purposes.

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Like equity instruments, Member PIC could not be "put" by the member back to the credit union – meaning that the member has no right to immediate redemption. However, the credit union could redeem Member PIC in a variety of situations at the credit union's sole discretion. For example, the credit union could either call Member PIC or offer pro rata redemption. In addition, the credit union could choose, in its sole discretion, to honor a member's redemption request under limited circumstances. Those limited circumstances most likely would include both a lengthy waiting period (*e.g.*, five years) and a requirement that, immediately following such redemption, the credit union would remain in compliance with all applicable capital ratios.

To give Member PIC two additional features typically present in GAAP equity instruments, it would have no stated maturity date and would be subordinate to other obligations and share accounts. Member PIC has sufficient GAAP equity characteristics that it would undoubtedly qualify as Tier 1 capital in the eyes of the other FFIEC regulatory agencies.

On the other hand, bolstering the argument that Member PIC would not be "capital stock" for tax purposes, it would not grant holders any voting rights in the credit union nor would it be transferable to non-members without the consent of the credit union. Further, bolstering Member PIC's tax treatment as debt rather than "capital stock," it would entitle holders to receive interest payments only and the face amount on liquidation of or redemption by the credit union. Member PIC's priority also tends to support its debt characterization for tax purposes. In this regard, Member PIC would have priority over retained earnings, meaning that Member PIC would not suffer losses until all retained earnings had been exhausted to meet the credit union's liabilities.

In 1997, the IRS issued a private letter ruling to the effect that U.S. Central Credit Union Member PIC with characteristics substantially similar to those above did not constitute capital stock for purposes of determining whether or not U.S. Central was exempt from federal income taxation under Section 501(c)(14)(A). Meanwhile, U.S. Central's independent auditors have consistently treated such instruments as equity for GAAP purposes.

More recently, State Employees' Credit Union of North Carolina issued Equity Shares, similar to Member PIC in the corporate credit union system. In May of 2005, the IRS issued a private letter ruling concluding that the Equity Shares issued by State Employees' Credit Union, do not constitute "capital stock" within the meaning of section 501(c)(14)(A) of the Internal Revenue Code. This ruling indicated Equity Shares are merely a means of saving in that they grant neither a participating equity interest in the credit union nor any participation in the management of the credit union; accordingly, they do not impact the credit union's tax exempt status under section 501(c)(14)(A) of the Internal Revenue Code.

Although the IRS private letter rulings apply only to PIC obligations issued by U.S. Central and to Equity Shares issued by State Employees' Credit Union, respectively, and cannot be relied upon by any other party, it is reasonable to assume that the IRS would view similar private letter ruling requests in the same manner.

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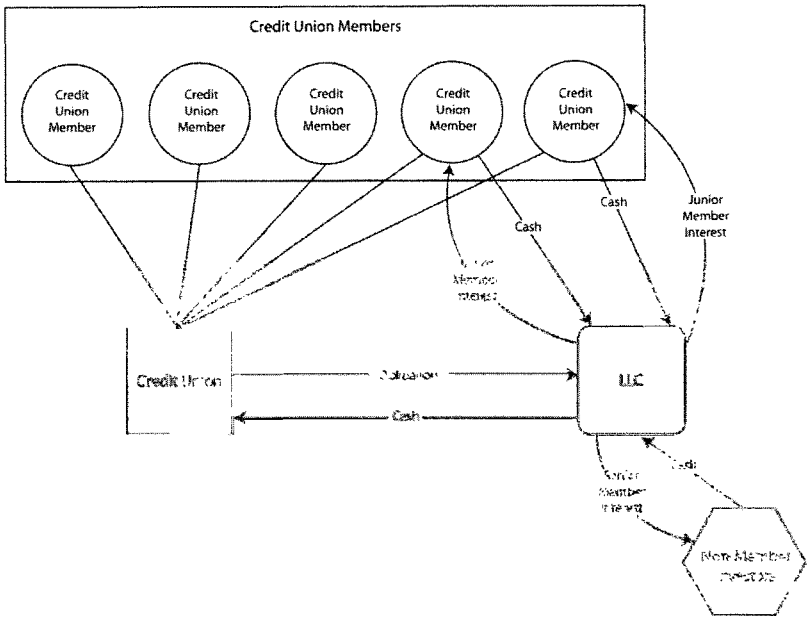
Model Two – Non-Member Paid-In Capital – Key Characteristics

Non-Member Paid-In Capital



The second hybrid capital instrument model is designed to obtain capital from outside the group of the credit union's members, and is thus called "Non-Member PIC." The non-members have only an indirect interest in the credit union and never become members.

Under the model, the credit union would first cause a limited liability company (or, LLC) to be formed. The initial contributors to the LLC's capital (and, thus, its initial owners) would be a limited number (*e.g.,* seven to ten) of current individual members of the credit union, most likely officers or directors of the credit union. These individuals would contribute at least 3 percent of the proposed total capital of the LLC (*i.e.,* the total capital to be contributed to the credit union), in exchange for 100 percent of the "voting junior interests" to be issued by the LLC. The LLC would obtain the remaining 97 percent of its capital by issuing 100 percent of its "non-voting senior interests" to persons not necessarily affiliated with the credit union. The LLC would be treated as a partnership for federal income tax purposes.

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The LLC would then become a member of the credit union and purchase a special share certificate with many of the features outlined above for Member PIC (the "Obligation"). Despite its financial interest in the credit union, the LLC would have but one vote on matters coming before the credit union members for a vote. Meanwhile, the voting control of the LLC would be vested solely in the holders of the voting junior interests. The only exception would be a limited voting right for the holders of the non-voting senior interests in the event that the credit union failed to pay interest to the LLC for an extended period (*e.g.*, three years).

The credit union would pay interest on the Obligation to the LLC at a specified preferred rate. The LLC, in turn, would pass on all or substantially all of its income from the Obligation to the holders of the LLC's non-voting senior interests. Further, interest would have to be paid in full to the holders of the non-voting senior interests before any interest could be paid to the holders of the voting junior interests. Interest on the Obligation could be deferred, but deferred interest would compound at a specified rate. To overcome the Obligation's subordination and the lack of voting rights associated with the non-voting senior interests, the rate of return on both instruments would have to be fairly attractive to non-members of the credit union.

While the Obligation would have no stated maturity date, it would be callable by the credit union at any time after five years following issuance.

This structure is an adaptation of trust preferred securities that bank holding companies have routinely issued since 1987, and which is recognized as Tier 1 capital by other FFIEC regulatory agencies.

In 1997, the IRS issued a private letter ruling to U.S. Central Credit Union to the effect that an instrument involving an arrangement substantially similar to that above, pursuant to which U.S. Central could raise capital from non-members, would not constitute capital stock for purposes of determining whether or not U.S. Central was exempt from federal income taxation under Section 501(c)(14)(A). For business reasons, U.S. Central has not, however, ever raised capital from non-members under this or any other arrangement.

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Model Three – Subordinated Debt

In addition to the two hybrid instruments described above, it must be acknowledged that other FFIEC regulatory agencies recognize subordinated debt instruments as valuable capital supplements for the banks and thrifts they supervise. Under such agencies' regulations, in order to qualify as Tier 2 capital, subordinated debt must:

1. Be unsecured, i.e., not supported by pledged assets;
2. Be "subordinated," or "junior" to the claims of holders of credit union share accounts;
3. Not be insured by the FDIC; no protection in the event of insolvency;
4. Not contain put options (i.e., provisions that permit holders to accelerate the payment of principal prior to maturity);
5. Not be credit-sensitive (i.e., not make increased interest payments in near-default situations); and
6. Have an original weighted average maturity of no less than 5 years. Issues with a remaining maturity of between 4 and 5 years are weighted to be counted as capital at 80% of face value; between 3-4 years at 60%; between 2-3 years at 40%; between 1-2 years at 20 percent. Issues with remaining maturity of less than one year receive a 0 % weight.

The amount of subordinated debt (plus intermediate-term preferred stock) that qualifies as Tier 2 capital cannot exceed 50% of Tier 1 capital.

The Federal Credit Union Act's definition of "net worth" includes a form of uninsured subordinated debt (secondary capital) for low-income credit unions, as defined in such Act. The authors of this paper believe the Federal Credit Union Act should be amended to include such instruments as regulatory capital.

Conclusion

Thank you for reviewing the alternative capital instruments presented in this white paper. As mentioned, we created this paper, in part, to address the GAO Report that stated there was no clear alternative capital model to study. In addition, this paper provides an opportunity to address concerns in the credit union community about alternative capital.

NASCUS firmly believes that credit unions should have access to alternative capital and that it can be done in a safe and sound manner. We present these models to the credit union community for study and we welcome feedback on the models presented.

The models in this paper are structured to preserve the not-for-profit, mutual, member-owned cooperative structure of credit unions; they maintain the federal income tax exemption that credit unions enjoy. Two private letter rulings from the IRS have indicated that instruments structured similar to the equity models presented in this white paper are exempt from federal income taxation under Section 501(c)(14)(A). While the IRS private letter rulings apply only to PIC obligations issued by U.S. Central and to Equity Shares issued by State Employees' Credit Union, respectively, and cannot be relied upon by

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any other party, it is reasonable to assume that the IRS would view similar private letter ruling requests in the same manner.

This paper does not address regulatory authority, nor does it discuss state and federal law as it concerns alternative capital. Not every credit union may have regulatory or statutory authority to offer these instruments.

Our research indicates that only ten states have laws allowing state-chartered credit unions access to alternative capital[3]. When state law provides for alternative capital, the state regulatory authority must allow for it in its rules and regulations. Additionally, before credit unions may consider alternative capital for PCA purposes, an amendment to Section 216(o)(2) of the Federal Credit Union Act (12 U.S.C. 1790d(o)(2)(A)) is required to include more than retained earnings in the definition of net worth.

These models, structured correctly, preserve the interest of members and the equity capital models presented do not change the capital structure of the credit union system. Additionally, they provide a feasible means for credit unions to grow capital, enhancing the safety and soundness of the credit union system. Further, they provide a degree of permanence so credit unions are not faced with a sudden outflow of capital.

The models presented are viable in the marketplace and with proper disclosures, they provide a safe means for members, or potentially non members, to increase returns—an important goal for consumers in today's marketplace. Further, the equity model instruments described in the paper qualify as equity capital balances under GAAP, while the debt model instrument is recognized by some FFIEC regulators as capital for regulatory purposes.

NASCUS firmly believes that credit unions should have access to alternative capital. We welcome your feedback.

[3] *NASCUS Profile*, 2003-2004 Edition

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Statement of

Mark W. Olson

Member

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

House of Representatives

September 22, 2005

Chairman Bachus, Representative Sanders, and members of the Subcommittee, thank you for the opportunity to testify on H.R. 3505, the Financial Services Regulatory Relief Act of 2005, and other issues related to regulatory relief. The Board is aware of the current and growing regulatory burden that is imposed on this nation's banking organizations. Often this burden falls particularly hard on small institutions, which have fewer resources than larger institutions. The Board strongly supports the efforts of Congress to review periodically the federal banking laws to determine whether they can be streamlined without compromising the safety and soundness of banking organizations, consumer protections, or other important objectives that Congress has established for the financial system. Developing regulatory relief legislation that appropriately balances burden reduction and sound public policy is no easy task, and I commend the Subcommittee for again addressing the issue of regulatory relief.

In 2003, at Chairman Oxley's request, the Board provided a number of legislative proposals that we believe would improve the banking laws and relieve unnecessary burden. Since then, the Board has continued to work with the other federal banking agencies and Committee staff on regulatory relief matters and has supported several additional regulatory relief proposals.

I am pleased to note that some of the Board's most important legislative recommendations--including those authorizing depository institutions to pay interest on demand deposits, permitting the Federal Reserve to pay interest on balances held by depository institutions at Reserve Banks, and providing the Board greater flexibility in setting reserve requirements--were passed by the full House earlier this year as part of H.R. 1224, the Business Checking Freedom Act of 2005. A number of the Board's other legislative suggestions are incorporated into H.R. 3505, and we look forward to working with Congress, our fellow banking

agencies and other interested parties in developing, analyzing and perfecting other potential regulatory relief proposals as the legislative process moves forward.

Federal Reserve Response to Hurricane Katrina

Before turning to the provisions of H.R. 3505, I'd like to spend a few moments reviewing the steps that the Federal Reserve has taken to maintain and restore vital financial services to the people of the Gulf Coast--including those who remain in the region and those who have been forced by Hurricane Katrina to relocate outside the region. At the outset, I want to express our heartfelt sympathy to all of the individuals and families who have suffered so much in the past few weeks, including the employees of the New Orleans Branch of the Federal Reserve Bank of Atlanta, and to acknowledge the very brave efforts of many individuals to save lives, help the sick and displaced, and restore public order.

The Federal Reserve System, and particularly the Atlanta Reserve Bank, took a number of important steps immediately following Hurricane Katrina to assist depository institutions and customers affected by the disaster. For example, the Atlanta Reserve Bank and other Federal Reserve offices quickly adjusted their operations to allow the cash services normally supplied by the New Orleans Branch to be provided by other offices in the region. These offices have remained open each weekend since the disaster to help ensure that all depository institutions get the cash services they need and can service the critical cash needs of individuals and businesses in the region. More recently, we have begun special deliveries of cash to designated distribution points in the most affected areas to reduce the transportation burdens and expenses on depository institutions in these areas.

As relief and recovery efforts began, the restoration of check clearing became increasingly important. We quickly shifted the processing of checks normally handled by our

New Orleans office to Atlanta and worked with numerous individual institutions to address the special processing issues facing these institutions. To help ease some of the burden in check clearing, during the week of September 5, we began giving credit for checks deposited by banks in the New Orleans territory as if these checks were still being processed normally in New Orleans. We also did not return checks when we were unable to present them to severely affected institutions. Instead, we held those checks and worked closely with the institutions' primary supervisors to determine how and when we could restart normal check relationships with these institutions. Currently, we can present checks to all of the institutions that had service from the Federal Reserve prior to Katrina, although often at alternative locations.

The Atlanta Reserve Bank also reminded the depository institutions it serves that, as usual, the discount window is available to assist in meeting their liquidity needs. We have been in contact with many depository institutions in the affected areas and are carefully monitoring the situation. At this time, we have not seen evidence of significant funding difficulties or problems in balance sheet management.

In Washington, we have worked closely with the other regulatory agencies in encouraging financial institutions to consider all reasonable and prudent steps to ease burdens on persons that have been so deeply affected by Katrina. These steps may include waiving ATM fees for customers and non-customers, increasing ATM daily cash withdrawal limits, allowing loan customers to defer or skip some payments, waiving late fees for credit card and other loan balances, and delaying delinquency notices to credit bureaus. The banking agencies, working in conjunction with the Financial Crimes Enforcement Network (FinCEN), also have encouraged depository institutions to use the flexibility already embedded in existing regulations to use

non-documentary methods to verify the identity of customers who may not have access to their normal identification documents due to the hurricane.

At this point, the banking industry on the whole has responded well to this challenging situation, showing resilience and flexibility. While the challenges have by no means passed, banks appear to be taking appropriate actions to get their customers access to cash and banking services.

For our part, the Board has sought to assure institutions in the affected area that we will exercise prudence, discretion, and flexibility where possible and appropriate in fulfilling our supervisory and regulatory responsibilities. In this regard, we recognize that efforts by banking organizations to work with affected borrowers may cause an institution's levels of delinquent and nonperforming loans to increase. However, these actions, when conducted prudently, also can help protect the long-term viability of the institution, contribute to the local community and promote recovery. We also have recognized that the disaster may well impact the ability of banking organizations to comply with a variety of regulatory filing and other requirements. For this reason, we have publicly announced that the Federal Reserve will consider the unusual circumstances that organizations in the affected area have faced with respect to safety and soundness and compliance issues in determining what, if any, supervisory response is appropriate. We also have reminded banking organizations that the Federal Reserve will favorably consider activities that revitalize or stabilize designated disaster areas, especially those activities that benefit low- and moderate-income individuals or areas, in reviewing an institution's performance under the Community Reinvestment Act.

On a broader level, we also are cognizant of the concerns expressed by banking organizations regarding the burdens of complying with certain Bank Secrecy Act (BSA)

requirements. We recognize that provisions of the BSA require considerable effort by the banking industry to obtain, document and provide relevant financial information to support criminal investigations by law enforcement. To further promote the uniform application of BSA/anti-money laundering requirements, the federal banking agencies, working with FinCEN, recently issued a joint BSA/AML Examination Manual. The Board will continue to work with our fellow banking agencies and FinCEN to address key issues related to BSA/anti-money laundering compliance. With respect to currency transaction reports (CTRs), we support the efforts of the Treasury Department and others to develop ways of reducing the burdens imposed on banks in ways that would not adversely affect the ability of banks to manage their risk or unintentionally impede the investigative tools available to law enforcement.

De Novo Interstate Branching

Turning back to H.R. 3505, the Board strongly supports those aspects of the bill that would remove outdated barriers to de novo interstate branching by banks. Since enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal Act), all fifty states have permitted banks to expand on an interstate basis through the acquisition of an existing bank in their state. Interstate banking is not only good for banks, it is good for consumers and the economy. While the number of banks has fallen in recent years, the number of branches has risen sharply to more than 71,000 in 2004 compared with approximately 50,000 in 1990. More than 2,000 branches were opened by banks in 2004 alone. The creation of new branches helps maintain the competitiveness and dynamism of the American banking industry and improve access to banking services in otherwise under-served markets. It results in better banking services for households and small businesses, lower interest rates on loans, and higher

interest rates on deposits. Interstate branching also increases convenience for customers who live, work, and operate across state borders.

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

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

H.R. 3505 would remove this last obstacle to full interstate branching for banks and level the playing field between banks and thrifts by allowing banks to establish interstate branches on a de novo basis. The bill also would remove the parallel provision that allows states to impose a minimum requirement on the age of banks that are acquired by an out-of-state banking organization. These changes would allow banks, including in particular small banks near state borders, to better serve their customers by establishing new interstate branches and acquiring newly chartered banks across state lines. It also would increase competition by providing banks a less costly method for offering their services at new locations. The establishment and operation of any new interstate branches would continue to be subject to the other regulatory provisions and conditions established by Congress for de novo interstate branches, including the financial, managerial, and community reinvestment requirements set forth in the Riegle-Neal Act.

While the Board supports expanding the de novo branching authority of banks, the Board continues to believe that Congress should *not* grant this new branching authority to industrial loan companies (ILCs) unless the corporate owners of these institutions are subject to the same type of consolidated supervision and activities restrictions as the corporate owners of other full-service insured banks. I will explain the reasons for the Board's position more fully later.

Small Bank Examination Flexibility

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

The $250 million asset cutoff for an eighteen-month examination cycle has not been raised since 1994. The Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Office of Thrift Supervision unanimously support raising this asset cap from $250 million to $500 million. Doing so would provide meaningful relief to small institutions without jeopardizing the safety and soundness of insured depository institutions. In this regard, raising the threshold to $500 million would potentially allow approximately an additional 1,100 insured depository institutions to qualify for an eighteen-month examination cycle.

The Board, however, does not support raising the asset threshold for an eighteen-month examination cycle to $1 billion, as section 607 of the bill would do. Institutions that have assets approaching $1 billion tend to have more complex risk profiles and are more likely to operate business lines on a regional or national basis than institutions with assets of less than $500 million. For these reasons, the Board believes that institutions with assets of more than $500 million should continue to be subject to a twelve-month safety and soundness exam cycle.

The Board also does not support a separate provision of the bill (section 601), which would allow a federal banking agency to extend the twelve- or eighteen-month examination cycle for an institution of *any* size, and for a potentially indefinite period of time, in order to allocate and conserve the agency's examination resources. Despite advances in off-site monitoring, the Board continues to believe that regular on-site examinations play a critical role in helping bank supervisors detect and correct asset, risk-management, or internal control problems at an institution before these problems result in claims on the deposit insurance funds. These lessons were learned during the thrift and banking crises of the 1980s and were the reason Congress established the mandatory exam cycles in 1991. These mandatory on-site examination cycles impose important discipline on the federal banking agencies, ensure that insured depository institutions do not go unexamined for extended periods, and have contributed significantly to the safety and soundness of insured depository institutions. If an agency is experiencing shortages in its examination resources, we believe it would be better to address these constraints through the supplementation of the agency's resources, rather than by extending the mandated frequency of safety and soundness examinations.

Permit the Board to Grant Exceptions to Attribution Rule

H.R. 3505 includes another amendment that the Board proposed and that we believe will help banking organizations maintain attractive benefits programs for their employees. The Bank Holding Company Act (BHC Act) generally prohibits a bank holding company from owning, in the aggregate, more than 5 percent of the voting shares of any company without the Board's approval. The BHC Act also provides that any shares held by a trust for the benefit of a bank holding company's shareholders or employees are deemed to be controlled by the bank holding company itself. This attribution rule was intended to prevent a bank holding company from using a trust established for the benefit of its management, shareholders, or employees to evade the BHC Act's restrictions on the acquisition of shares of banks and nonbanking companies.

While this attribution rule has proved to be a useful tool in preventing evasions of the BHC Act, it does not always provide an appropriate result. For example, it may not be appropriate to apply the attribution rule when the shares in question are acquired by a 401(k) plan that is widely held by, and operated for the benefit of, the employees of the bank holding company. In these situations, the bank holding company may not have the ability to influence the purchase or sale decisions of the employees or otherwise control the shares that are held by the plan in trust for its employees. The bill would allow the Board to address these situations by authorizing the Board to grant exceptions from the attribution rule where appropriate.

Reduce Cross-Marketing Restrictions

Another amendment proposed by the Board and included in the bill would modify the cross-marketing restrictions imposed by the Gramm-Leach-Bliley Act (GLB Act) on the merchant banking and insurance company investments of financial holding companies. The GLB Act generally prohibits a depository institution controlled by a financial holding company

from engaging in cross-marketing activities with a nonfinancial company that is owned by the same financial holding company under the GLB Act's merchant banking or insurance company investment authorities. However, the GLB Act currently permits a depository institution subsidiary of a financial holding company, with Board approval, to engage in limited cross-marketing activities through statement stuffers and Internet websites with nonfinancial companies that are held under the act's insurance company investment authority (but not the act's merchant banking authority).

The bill would allow depository institutions controlled by a financial holding company to engage in cross-marketing activities with companies held under the merchant banking authority to the same extent, and subject to the same restrictions, as companies held under the insurance company investment authority. We believe that this parity of treatment is appropriate, and see no reason to treat the merchant banking and insurance investments of financial holding companies differently for purposes of the cross-marketing restrictions of the GLB Act.

The bill also would liberalize the cross-marketing restrictions that apply to both merchant banking and insurance company investments. This aspect of the amendment would permit a depository institution subsidiary of a financial holding company to engage in cross-marketing activities with a nonfinancial company held under either the merchant banking or insurance company investment authority if the nonfinancial company is not controlled by the financial holding company. When a financial holding company does not control a portfolio company, cross-marketing activities are unlikely to materially undermine the separation between the nonfinancial portfolio company and the financial holding company's depository institution subsidiaries.

Small Bank Holding Company Policy Statement

Another section of the bill (section 616) would direct the Board to propose for comment certain changes to its Small Bank Holding Company Policy Statement, including an increase in the asset threshold below which a bank holding company (BHC) qualifies as a "small" BHC for purposes of the Policy Statement. I am pleased to report that the Board already has taken steps to raise this asset threshold.

As a general matter, the Board has discouraged BHCs from using debt to finance the acquisition of banks or nonbank companies because high levels of debt at a parent BHC can impair the parent's ability to serve as a source of strength to its subsidiary banks. The Board has recognized, however, that small community-based BHCs may have less access to the capital markets and equity financing than larger BHCs and that, therefore, the use of acquisition debt may be needed to permit or facilitate the transfer of ownership of small banks. For this reason, the Policy Statement permits small BHCs to have higher levels of acquisition debt (and lower capital-to-asset ratios) than would otherwise be permitted for larger BHCs. Currently, a BHC is considered "small" for purposes of the Policy Statement if it has less than $150 million in consolidated assets and meets certain other conditions. The Policy Statement also contains certain ongoing restrictions on BHCs that operate under the Statement, which are designed to help ensure that these BHCs do not present an undue risk to the safety and soundness of their subsidiary banks.

Earlier this month, the Board requested public comment on proposed changes to the Policy Statement. These proposed changes would, among other things, raise the asset threshold in the Policy Statement from $150 million to $500 million in consolidated assets. With this proposed change, approximately 85 percent of all top-tier BHCs--or approximately 4,400

companies--would qualify for the Policy Statement. Raising the threshold to $500 million, as the Board has proposed, also goes well beyond the level (approximately $340 million) that would be needed to adjust the current threshold for inflation since it was established. The Board also has announced plans to propose revisions to its regulatory reporting framework to accommodate the changes proposed to the Policy Statement, which should further lower reporting and compliance costs for small BHCs.

This proposal balances the goals of facilitating the transfer of ownership of small banks, on the one hand, and ensuring capital adequacy and access to necessary supervisory information on the other hand. Of course, the Board will carefully review the comments that we receive on this proposal.

Industrial Loan Companies

As I noted earlier, the Board strongly supports allowing banks to open de novo branches on an interstate basis. The Board, however, opposes provisions, like those contained in H.R. 3505, that would grant this new authority to ILCs that operate under a special exemption in federal law.

ILCs are state-chartered FDIC-insured banks that were first established early in the twentieth century to make small loans to industrial workers. As insured banks, ILCs are supervised by the FDIC as well as by the chartering state. However, under a special exemption in current law, any type of company, including a commercial or retail firm, may acquire an ILC in a handful of states--principally Utah, California, and Nevada--and avoid the activity restrictions and supervisory requirements imposed on bank holding companies under the federal BHC Act.

When the special exemption for ILCs was initially granted in 1987, ILCs were mostly small, local institutions that did not offer demand deposits or other types of checking accounts. In light of these facts, Congress conditioned the exemption on a requirement that any ILCs chartered after 1987 remain small (below $100 million in assets) *or* refrain from offering demand deposits that are withdrawable by check or similar means.

This special exemption has been aggressively exploited since 1987. Some grandfathered states have allowed their ILCs to exercise many of the same powers as commercial banks and have begun to charter new ILCs. Today, several ILCs are owned by large, internationally active financial or commercial firms and a large retail firm recently applied to establish an exempt ILC. In addition, a number of ILCs themselves have grown large, with one holding more than $50 billion in deposits and an additional six each holding more than $1 billion in deposits.

Affirmatively granting ILCs the ability to open de novo branches nationwide would significantly expand the attractiveness of this loophole and further blur any remaining distinction between ILCs and full-service insured banks. This result would be inconsistent with both the historical functions of ILCs and the terms of their special exemption in current law.

Because the parent companies of exempt ILCs are not subject to the BHC Act, authorizing ILCs to open de novo branches nationwide would create an unlevel competitive playing field among banking organizations and undermine the framework Congress has established for the corporate owners of full-service banks. It would allow firms that are not subject to the consolidated supervisory framework of the BHC Act--including consolidated capital, examination, and reporting requirements--to own and control an insured bank with nationwide offices. It also would allow a foreign bank to acquire control of an insured bank and operate the bank anywhere in the United States without meeting the requirement under the BHC

Act that the foreign bank be subject to comprehensive supervision on a consolidated basis in its home country. In addition, it would allow financial firms to operate a nationwide insured bank without complying with the capital, managerial, and Community Reinvestment Act requirements established by Congress in the GLB Act.

Congress has established consolidated supervision as a fundamental component of bank supervision in the United States because consolidated supervision provides important protection to the insured banks that are part of a larger organization and to the federal safety net that supports those banks. Financial trouble in one part of an organization can spread rapidly to other parts. To protect an insured bank that is part of a larger organization, a supervisor needs to have the authority and tools to understand the risks that exist within the parent organization and its affiliates and, if necessary, address any significant capital, managerial, or other deficiencies before they pose a danger to the bank. This is particularly true today, as holding companies increasingly manage their operations--and the risks that arise from these operations--in a centralized manner that cuts across legal entities. Risks that cross legal entities and that are managed on a consolidated basis simply cannot be monitored properly through supervision directed at one, or even several, of the legal entities within the overall organization. For these reasons, Congress since 1956 has required that the parent companies of full-service insured banks be subject to consolidated supervision under the BHC Act. In addition, following the collapse of Bank of Commerce and Credit International, Congress has required that foreign banks seeking to acquire control of a U.S. bank under the BHC Act be subject to comprehensive supervision on a consolidated basis in the foreign bank's home country.

Authorizing exempt ILCs to open de novo branches nationwide would undermine this framework. It also would take away from Congress the important decision--recently reaffirmed

in the GLB Act--regarding the appropriate limits on the affiliation of banks and commercial entities. This loophole allows any type of company, including a retail or commercial firm, to own an exempt ILC without regard to the activity restrictions in the BHC Act that are designed to maintain the separation of banking and commerce.

In an attempt to address the issues associated with the mixing of banking and commerce, H.R. 3505 places certain limits on the types of ILCs that may open de novo interstate branches. However, the limits contained in the bill do not adequately address these important issues. For example, the bill would allow *any* ILC that received FDIC insurance before October 1, 2003, or had an application for deposit insurance pending on that date, to open de novo branches nationwide so long as the institution does not experience a change in control. Thus, the bill would allow those commercial and retail firms that acquired an ILC before October 1, 2003, to transform the institution into a nationwide retail bank.

Even those ILCs that are established or acquired *after* October 1, 2003, would be permitted to open interstate de novo branches unless an appropriate state supervisor for the ILC affirmatively determined that a company controlling the ILC derived more than 15 percent of its annual gross revenues from activities that are not "financial in nature or incidental to a financial activity." Importantly, the bill does *not* define these terms by reference to the GLB Act or otherwise establish any standards for a state authority to use in determining what activities are "financial in nature or incidental to a financial activity." Instead, the bill leaves this important determination--which has the potential to undermine the nation's longstanding policy of maintaining the separation of banking and commerce--to the discretion of the ILC's state supervisors. Moreover, unlike the grandfather provisions of the GLB Act on which the ILC provisions of the bill purportedly are based (*see* 12 U.S.C. § 1843(n)), H.R. 3505 would not

require a company that acquires an ILC after October 1, 2003, to divest its non-financial, commercial activities within a specified period of time.

The limits contained in H.R. 3505 also do not address the other risks and issues presented by ILCs. For example, the bill fails to address the supervisory issues associated with allowing domestic firms or foreign banks that are not subject to consolidated supervision to operate an FDIC-insured bank on a nationwide basis. The bill also fails to address the equity issues raised by enhancing a loophole that is available to only one type of financial institution chartered in a handful of states.

Let me be clear. The Board does not oppose granting ILCs the ability to open de novo branches if the corporate owners of ILCs that exercise these expanded powers are covered by the same supervisory and regulatory framework that applies to the owners of other full-service insured banks. Stated simply, if ILCs want to benefit from expanded powers granted other insured banks, then they and their corporate parents should be subject to the same rules that apply to the owners of other insured banks.

The Board believes that important principles governing the structure of the nation's banking system--such as consolidated supervision, the separation of banking and commerce, and the maintenance of a level playing field for all competitors in the financial services marketplace--should not be abandoned without careful consideration by the Congress. These matters deserve hearings and careful deliberation because they have the potential to change the landscape of our financial system and should not be considered as non-controversial regulatory relief matters.

Conclusion

I appreciate the opportunity to discuss the Board's legislative suggestions and priorities concerning regulatory relief. Besides the items that I have highlighted in my testimony, the bill includes several other provisions suggested or supported by the Board, including useful clarifications of the ability of insured banks to acquire savings associations in interstate merger transactions and of the authority of the federal banking agencies to maintain the confidentiality of supervisory information obtained from foreign supervisory authorities. The Board would be pleased to work with the Subcommittee, the full Committee, and their staffs as you seek to develop and advance meaningful regulatory relief legislation that is consistent with the nation's public policy objectives.

For Release Upon Delivery
10:00 a.m., September 22, 2005

TESTIMONY OF

JULIE L. WILLIAMS

CHIEF COUNSEL AND FIRST SENIOR DEPUTY COMPTROLLER

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

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AND CONSUMER CREDIT

Of the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. INTRODUCTION

Chairman Bachus, Ranking Member Sanders, Representative Hensarling, Representative Moore, and members of the Subcommittee, I appreciate this opportunity to appear before you today to discuss H.R. 3505, the Financial Services Regulatory Relief Act of 2005. Representatives Hensarling and Moore introduced this bill on July 28, 2005, and I commend them for taking the lead in sponsoring this important legislation. The Office of the Comptroller of the Currency (OCC) welcomes the opportunity to discuss the challenge of reducing unnecessary regulatory burden on America's banks and to offer suggestions for reforms, including some suggestions particularly affecting national banks and the national banking system.

Over the years, this Subcommittee has consistently addressed the need to reduce unnecessary burden on our nation's banks. We appreciate your continued efforts to pursue responsible regulatory burden relief legislation. Freeing banks from unnecessary burdens enables them to better meet the financial needs of their customers and their communities.

The Subcommittee's action on this legislation is even more important today in light of the Hurricane Katrina disaster that has devastated widespread areas in several states. While the legislative burden relief proposals in the bill supported by the OCC will benefit all banks, several of these items and others suggested by the OCC may be particularly helpful tenable banks to serve customers and communities in the disaster areas.[1] My testimony also

[1] *See, e.g.*, Section 601 (giving the Federal banking agencies flexibility to adjust examination cycles), and Section 401 (facilitating interstate *de novo* branching).

discusses other legislative proposals suggested by the OCC that may be beneficial in helping with the disaster relief, *e.g.*, increasing national banks' community development investment authority. In addition, as part of my testimony, I will summarize key actions that the OCC is taking to enable national banks to better assist their customers and communities affected by Hurricane Katrina.

Unnecessary regulatory burdens are not simply an issue of bank costs. For example, complying with unnecessary burdens requires banks to use valuable employee resources that may be better used to serve their customers and communities. Over-regulation neither encourages greater competition nor improved allocation of resources; to the contrary, it can shackle competition and lead to inefficient use of resources. Bank customers also feel the impact not only in the form of higher prices but also, in some cases, in the form of diminished product choices and services. Unnecessary regulatory burden also can become an issue of competitive viability, particularly for our nation's community banks and most particularly for our community banks in the disaster areas whose resources may have been stretched thin even before Hurricane Katrina.

Unnecessary regulatory burdens imposed on our banks arise from several sources. One source is regulations promulgated by the Federal banking agencies. We, as regulators, have the responsibility to ensure that our regulations effectively protect safety and soundness, foster the integrity of bank operations, safeguard the interests of consumers, <u>and</u> do not impose regulatory burdens that exceed what is necessary to achieve those goals, and thereby act as a drag on our banks' efficiency and competitiveness. We also

need to be flexible to the extent allowable under law and consistent with safety and soundness to enable our banks to meet customer needs for services in extraordinary circumstances. At the OCC, we have undertaken a new, thorough "scrub" of the rules that we promulgate to identify any areas remaining where we can streamline processes or eliminate unnecessary requirements to further these goals.

However, not all the regulatory burdens imposed on banks today come from regulations promulgated by bank regulators. Thus, we welcome the interest of the Subcommittee in issues such as regulatory implementation of the Bank Secrecy Act (BSA) and anti-money laundering standards. In addition, actions by other regulators can affect regulatory burdens on banks. In this regard, the Securities and Exchange Commission's (SEC) recent decision to take some additional time to implement the broker "push-out" provisions of the Gramm-Leach-Bliley Act (GLBA) holds promise that those provisions can be implemented in a manner that is both faithful to GLBA's intent and not so burdensome as to drive established banking activities out of banks.

Another source of regulatory burden is mandates of Federal legislation. Thus, relief from some manifestations of unnecessary regulatory burden requires action by Congress. My testimony focuses on legislative recommendations that are supported by the OCC, many of which are included in H.R. 3505.

In summary, my testimony will—

- First, summarize the actions that the OCC is taking to assist national banks and their customers affected by Hurricane Katrina;
- Second, summarize how the Federal banking agencies are working together under the able leadership of the Office of Thrift Supervision (OTS) Director John Reich to complete the process required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) to identify unnecessary regulatory burdens;
- Third, summarize some important regulatory initiatives that the OCC is pursuing with the other Federal banking agencies to reduce burden;
- Fourth, summarize some of the proposals that the OCC considers to be priority legislative items in H.R. 3505;
- Fifth, in the area of consumer protection, explain how we can both reduce unnecessary regulatory burden and more effectively use disclosures to provide information to consumers in a more meaningful way; and
- Sixth, provide an overview of several legislative items that the OCC supports that were not included in H.R. 3505.

II. REGULATORY INITIATIVES TO REDUCE BURDEN

REGULATORY RELIEF FOR BANKS AND CUSTOMERS IN THE HURRICANE DISASTER AREAS

The bank regulatory community – at the Federal and state levels – has worked together with outstanding teamwork to address the extraordinary dimensions of the aftermath of Hurricane Katrina. The four Federal banking agencies working with the National Credit Union Administration and the Conference of State Bank Supervisors (CSBS) immediately issued joint guidance urging insured depository institutions to consider all reasonable and prudent steps to assist customers' cash and financial needs in areas affected by the hurricane. Among the actions the Federal and state regulators have encouraged are:

- Waiving ATM fees for customers and non-customers;
- Increasing ATM daily cash withdrawal limits;
- Easing restrictions on cashing out-of-state and non-customer checks;
- Waiving overdraft fees as a result of paycheck interruption;
- Waiving early withdrawal penalties on time deposits;
- Waiving availability restrictions on insurance checks;
- Allowing customers to defer or skip some loan payments;
- Waiving late fees for credit cards and other loans due to interruption of mail and/or billing statements, or the customer's inability to access funds;
- Easing credit card limits and credit terms on new loans;
- Delaying delinquency notices to credit bureaus; and

- Encouraging institutions to use non-documentary customer verification methods for customers that are not able to provide standard identification documents.

In addition, the OCC has issued guidance on establishment of temporary branches, and branch- and employee-sharing arrangements. We also have compiled and published answers to frequently asked questions on additional topics including the Community Reinvestment Act (CRA), BSA, and various operational issues, including regulatory reporting requirements. We add additional questions and answers to our website as new issues surface.

Bottom line, consistent with our longstanding practice, the OCC will take into account the extraordinary circumstances impacting banks in the affected areas with respect to safety and soundness and compliance issues. We are committed to working with the banking industry and the other Federal and state financial regulators to respond to issues that arise in the aftermath of Hurricane Katrina and to minimize disruption and burden for banks and their customers in affected areas.

To that end, Comptroller Dugan, as Chairman of the Federal Financial Institutions Examination Council (FFIEC), earlier this week moved to establish a special FFIEC Katrina Working Group to facilitate the coordination, communication, and response to bank supervision issues that will arise in the weeks and months ahead in the aftermath of Hurricane Katrina. We are pleased that John Allison, Commissioner of the Mississippi Department of Banking and Consumer Finance, has agreed to participate as the FFIEC's

State Liaison Committee representative. In establishing the Working Group, Comptroller Dugan stressed that formation of the Working Group will facilitate interagency coordination and underscore each agency's commitment to assure that recovery efforts and concomitant resource commitments are supported at the highest levels of all participating agencies.

Finally, it is important to note, as the Subcommittee considers legislative proposals prompted by Hurricane Katrina, that legislation previously adopted by Congress in response to other disasters, contains provisions that were helpful before, and could be helpful now. I'm thinking in particular of provisions in the Depository Institutions Disaster Relief Acts of 1992, 1993, and 1997. One provision in those laws that I would call to your attention allowed the Federal banking agencies for a period of time to permit certain adequately capitalized depository institutions located in and serving customers in the affected areas to exclude deposits of insurance proceeds from their assets in their leverage capital ratio calculations for purposes of prompt corrective action requirements. As a result, these institutions were not adversely affected from a capital adequacy standpoint by the influx of deposits that were directly related to the damage and losses caused by the disaster. Another provision in those laws that you may want to consider is the provision that gave the Board of Governors of the Federal Reserve System (Fed) broad temporary authority to make exceptions to the Truth in Lending Act (TILA) for transactions in designated disaster areas, and to make exceptions to the Expedited Funds Availability Act (EFAA) for depository institution offices located in designated disaster areas. Consistent with safety and soundness and appropriate consumer protections, this

authority would give the Fed the ability to waive TILA and EFAA requirements pursuant to authority that they may not otherwise have under other law to assist in the recovery efforts for banks, consumers, and communities in the disaster areas.

EGRPRA PROCESS

Turning to the broader effort to eliminate unnecessary regulatory burden, the OCC is an active participant in and supporter of the regulatory burden reduction initiative being led by OTS Director Reich. Under Director Reich's capable and dedicated leadership, the Federal banking agencies have been working together to conduct the regulatory review required under section 2222 of EGRPRA. Section 2222 requires the FFIEC and each Federal banking agency to identify outdated, unnecessary regulatory requirements and, in a report to Congress, to address whether such regulatory burdens can be changed through regulation or require legislative action. The current review period ends in September 2006.

The Federal banking agencies – the OCC, the Board of Governors of the Federal Reserve System (Fed), the Federal Deposit Insurance Corporation (FDIC), and OTS – have divided their regulations into thirteen categories for purposes of publishing those regulations for review as part of the EGRPRA process. Since the first joint notice was published in mid-2003, the agencies have issued a total of five joint notices for public comment. To date, we have received over 800 comments on our notices, excluding comments on the fifth joint notice for which the comment period is still open. Every comment received will be

considered in formulating the agencies' recommendations for specific regulatory changes, as well as legislative recommendations.

Moreover, in addition to soliciting written comments, the Federal banking agencies, in conjunction with the Conference of State Bank Supervisors and state regulatory agencies, have held a total of seventeen banker and consumer outreach meetings in different cities and regions throughout the country to hear first-hand concerns and suggestions to reduce burden. The last four meetings were held over the past two months. The EGRPRA meeting in late July was attended only by consumer organizations but the three meetings since then were attended by both bankers and consumer organizations and resulted in open-end useful interaction between these two groups on various regulatory burden relief proposals.

OTHER BURDEN REDUCTION REGULATORY INITIATIVES

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

regulatory burdens. One was recently completed; one has great promise as a roadmap for a new approach to consumer disclosure requirements.

Reducing CRA Burden on Small Banks. Recently, the OCC, the Fed, and the FDIC finalized amendments to our CRA regulations. Before we recently amended our rules, a "small bank" was defined as a bank with assets less than $250 million and subject to certain other requirements. Banks above that asset threshold were categorized as "large" banks for CRA purposes and subject to a three-part test that separately assessed their lending, services, and investments.

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

In addition, the new rule expressly provides that banks' activities that revitalize and stabilize distressed or underserved rural areas and designated disaster areas, which would obviously include designated areas affected by Hurricane Katrina, are eligible for CRA credit. This change benefits banks of all sizes.

Improving the Value and Reducing the Burden of Privacy Notices. The OCC, together with the other Federal banking agencies, the Federal Trade Commission, the SEC, and the Commodity Futures Trading Commission, have undertaken an unprecedented initiative to simplify the privacy notices required under GLBA. Over a year ago, the agencies asked for comments on whether to consider amending their respective privacy regulations to allow, or require, financial institutions to provide alternative types of privacy notices, such as a short-form privacy notice, that would be more understandable and useful for consumers and less burdensome for banks to provide. The agencies also asked commenters to provide sample privacy notices that they believe work well for consumers, and to provide the results of any consumer testing that has been conducted in this area.

The OCC and the other agencies then engaged experts in plain language disclosures and consumer testing to assist in conducting a series of focus groups and consumer interviews to find out what sort of information consumers find most meaningful, and the most effective way to disclose that information to them. We expect that this consumer testing will be completed by the end of the year and will form the basis for a proposal to revise the current privacy notice rules. This project has the potential to be a win-win for consumers and financial institutions – more effective and meaningful disclosures for consumers, and reduced burden on institutions that produce and distribute privacy notices.

III. OCC SUPPORT FOR REGULATORY BURDEN RELIEF PROPOSALS IN H.R. 3505

The OCC also has recommended a package of legislative amendments that we believe will help reduce unnecessary regulatory burden on national banks and other depository institutions. Some of these items are discussed below, particularly the proposals that may be especially beneficial to community banks. In past testimonies before this Subcommittee, including our testimony on June 9, 2005, the OCC provided detailed summaries of our recommended legislative changes. Most of these items are included in H.R. 3505.

In addition, the banking agencies jointly recommended certain legislative changes to reduce burdens that have been identified as part of the EGRPRA process. The consensus items supported by the four Federal banking agencies also are discussed below and many of those items are included in H.R. 3505. As the legislative process moves forward, the agencies may jointly support additional items.

NATIONAL BANK-RELATED PROVISIONS

Repealing State Opt-In Requirements for *De Novo* Branching. Section 401 of H.R. 3505 includes provisions that would repeal the state opt-in requirement that applies to banks that choose to expand interstate by establishing branches on a *de novo* basis and would repeal the state age requirement for interstate mergers. These provisions would

remove significant unnecessary burdens imposed on both national and state banks that seek to establish new interstate branch facilities to enhance service to customers. Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, interstate expansion through bank mergers generally is subject to a state "opt-out" that had to be in place by June 1, 1997. Interstate bank mergers are now permissible in all 50 states. *De novo* branching, however, is permissible only in those approximately 23 states that have affirmatively opted-in to allow the establishment of new branches in the state. Approximately 17 of these 23 states impose a reciprocity requirement.

In many cases, in order to serve customers in multi-state metropolitan areas or regional markets, banks must structure artificial and often expensive transactions in order to establish a new branch across a state border. Community banks may not possess the resources to pursue these alternatives, and thus may be disadvantaged. And the circumstances of Hurricane Katrina illustrate another dimension to this issue as well. Community banks that seek to provide banking facilities to customers forced to relocate to other states may not be able to promise those customers the availability of banking facilities long-term, beyond the immediate emergency period, as a result of interstate branching restrictions. Larger banks, by contrast, may have more structural options available to them that enable them to retain customers that relocate to other states.

Providing Relief for Subchapter S National Banks. Another priority item supported by the OCC is the amendment in Section 101 of H.R. 3505 that would allow directors of national banks that are organized as Subchapter S corporations to purchase subordinated

debt instead of capital stock to satisfy the directors' qualifying shares requirements in national banking law. As a result, the directors purchasing such debt would not be counted as shareholders for purposes of the 100-shareholder limit that applies to Subchapter S corporations thereby permitting such national banks to attract additional shareholder investors. This relief would make it possible for more community banks with national bank charters to organize in Subchapter S form while still requiring that such national bank directors retain their personal stake in the financial soundness of these banks.

Simplifying Dividend Calculations for National Banks. Under current law, the formula for calculating the amount that a national bank may pay in dividends is both complex and antiquated and unnecessary for purposes of safety and soundness. Section 103 of H.R. 3505 would make it easier for national banks to perform this calculation, while retaining safeguards in the current law that provide that national banks (and state member banks)[2] need the approval of the Comptroller (or the Fed in the case of state member banks) to pay a dividend that exceeds the current year's net income combined with any retained net income for the preceding two years. The amendment would ensure that the OCC (and the Fed for state member banks) would continue to have the opportunity to deny any dividend request that may deplete the net income of a bank that may be moving towards troubled condition. Other safeguards, such as Prompt Corrective Action, which prohibit any insured depository institution from paying any dividend if, after that payment, the institution would be undercapitalized (*see* 12 U.S.C. § 1831o(d)(1)) would remain in place.

[2] *See* 12 U.S.C. § 324 and 12 C.F.R. § 208.5 generally applying the national bank dividend approval requirements to state member banks.

Modernizing Corporate Governance. The OCC also supports Section 102 of H.R. 3505 that would eliminate a requirement that precludes a national bank from prescribing, in its articles of association, the method for election of directors that best suits its business goals and needs. Unlike most other companies and state banks, national banks cannot choose whether or not to permit cumulative voting in the election of their directors. Instead, current law requires a national bank to permit its shareholders to vote their shares cumulatively. Providing a national bank with the authority to decide for itself whether to permit cumulative voting in its articles of association would conform the National Bank Act to modern corporate codes and provide a national bank with the same corporate flexibility available to most corporations and state banks.

Modernizing Corporate Structure Options. The OCC supports Section 109 of H.R. 3505 clarifying the OCC's authority to adopt regulations to permit a national bank to be organized other than as a body corporate. This provision would further clarify the OCC's authority to permit a national bank to organize in any business form. An example of such an alternative form of organization is a limited liability national association, comparable to a limited liability company. The provision also would clarify that the OCC may provide the organizational characteristics of a national bank operating in an alternative form, consistent with safety and soundness. Except as provided by these organizational characteristics, all national banks, notwithstanding their form of organization, would have the same rights and privileges and be subject to the same restrictions, responsibilities, and enforcement authority.

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

FEDERAL BRANCHES AND AGENCIES OF FOREIGN BANKS

The OCC also licenses and supervises Federal branches and agencies of foreign banks. Federal branches and agencies generally are subject to the same rights and privileges, as well as the same duties, restrictions, penalties, liabilities, conditions and limitations and laws that apply to national banks. Branches and agencies of foreign banks, however, also are subject to other requirements under the International Banking Act of 1978 (IBA) that are unique to their organizational structure and operations in the U.S. as an office of a foreign bank. In this regard, the OCC is recommending amendments to reduce certain unnecessary burdens on Federal branches and agencies while preserving national treatment with national banks.

Implementing Risk-Based Requirements for Federal Branches and Agencies. Section 111 of H.R. 3505 would allow the OCC to set the capital equivalency deposit (CED) for Federal branches and agencies to reflect their risk profile. The provision that is in the bill would prevent the OCC from setting the CED any lower than the minimum CED set by the state banking authorities for state-licensed branches and agencies in the state in which the Federal branch or agency is located. While we appreciate that Section 111 provides more flexibility than is currently the case, rather than the state floor limitation in the current bill, we would prefer an amendment that would allow the OCC, after consultation with the FFIEC, to adopt regulations setting the CED on a risk-based institution-by-institution basis. This approach would more closely parallel the risk-based capital framework that applies to both national and state banks.

SAFETY AND SOUNDNESS

The OCC also supports a number of amendments that would promote and maintain the safety and soundness and facilitate the ability of regulators to address and resolve problem bank situations.

Providing Flexibility in Adjusting the Examination Schedule to Allocate Examiner Resources More Efficiently. The OCC supports Section 601 of H.R. 3505 that would allow the Federal banking agencies to adjust the examination cycle for an insured depository institution if necessary for safety and soundness and the effective examination and supervision of insured depository institutions. Current law requires that an insured

depository institution must be examined in a full-scope, on-site examination at least once every 12 months, unless it qualifies for an 18-month examination cycle. Small insured depository institutions with total assets of less than $250 million may be examined on an 18-month cycle. This amendment would give the agencies needed flexibility to adjust the examination cycle if necessary to better allocate examiner resources in a manner that is consistent with safety and soundness and the effective examination and supervision of insured depository institutions.

Enforcing Written Agreements and Commitments. The OCC supports Section 405 of H.R. 3505 that would expressly authorize the Federal banking agencies to enforce written agreements and conditions imposed in writing in connection with an application or when the agency imposes conditions as part of its decision not to disapprove a notice, *e.g.*, a Change in Bank Control Act (CBCA) notice.

This amendment would address the anomalous results of some Federal court decisions that conditioned the agencies' authority to enforce certain conditions or agreements with respect to a non-bank party to the agreement on a showing that the non-bank party was "unjustly enriched." We believe that this amendment would enhance the safety and soundness of depository institutions and protect the deposit insurance funds from unnecessary losses.

Barring Convicted Felons From Participating in the Affairs of Depository Institutions. The OCC also supports Section 603 of H.R. 3505 that would give the Federal

banking agencies the authority to prohibit a person convicted of a crime involving dishonesty, breach of trust, or money laundering from participating in the affairs of an *un*insured national or state bank or *un*insured branch or agency of a foreign bank without the consent of the agency. Under current law, the ability to keep these "bad actors" out of depository institutions applies only to *insured* depository institutions. Thus, for example, it would be harder to prevent an individual convicted of such crimes from serving as an official of an uninsured trust bank -- the operations of which are subject to the highest fiduciary standards -- than to keep that individual from holding an administrative position at an insured bank.

Strengthening the Supervision of "Stripped-Charter" Institutions. The OCC supports Section 409 of H.R. 3505 that would address issues that have arisen when a stripped-charter institution (*i.e.*, an insured bank that has no ongoing business operations because, for example, all of the business operations have been transferred to another institution) is the subject of a change-in-control notice. The agencies' primary concern with such CBCA notices is that the CBCA is sometimes used as a route to acquire a bank with deposit insurance without submitting an application for a *de novo* charter and an application for deposit insurance, even though the risks presented by the two transactions may be substantively identical. In general, the scope of review of a *de novo* charter application or deposit insurance application is more comprehensive than the current statutory grounds for denial of a notice under the CBCA. There also are significant differences between the application and notice procedures. In the case of an application, the banking agency must affirmatively approve the request before a transaction can be consummated. Under the

CBCA, if the Federal banking agency does not act to disapprove a notice within certain time frames, the acquiring person may consummate the transaction. To address these concerns, the OCC supports Section 409 to clarify that (1) a Federal banking agency may extend the time period to consider a CBCA notice so that the agency may consider business plan information, and (2) the agency may use that information in determining whether to disapprove the notice.

IV. REDUCING BURDENS AND ENHANCING EFFECTIVENESS OF CONSUMER COMPLIANCE DISCLOSURES

Many of the areas that are often identified as prospects for regulatory burden reduction involve requirements designed for the protection of consumers. Over the years, those requirements – mandated by Congress and initiated by regulators – have accreted, and in the disclosure area, in particular, consumers today receive disclosures so voluminous and so technical that many simply do not read them – or when they do, do not understand them.

No matter how well intentioned, the current disclosures being provided to consumers in many respects are not delivering the information that consumers need to make informed decisions about their rights and responsibilities, but they are imposing significant costs on the industry and consuming precious resources.

In recent years, bank regulators and Congress have mandated that more and more information be provided to consumers in the financial services area. New disclosures have been added on top of old ones. The result today is a mass of disclosure requirements that

generally do not effectively communicate to consumers, and impose excessive burden on the institutions required to provide those disclosures.

There are two arenas – legislative and regulatory – in which we can make changes to produce better, more effective, and less burdensome approaches to consumer disclosures.

With respect to legislation to improve disclosures, we can learn much from the experience of the Food and Drug Administration (FDA) in developing the "Nutrition Facts" label. This well-recognized – and easily understood disclosure is on virtually every food product we buy.

The effort that led to the FDA's nutrition labeling began with a clear statement from Congress that the FDA was directed to accomplish certain *objectives*. While Congress specified that certain nutrition facts were to be disclosed, it gave the FDA the flexibility to delete or add to these requirements in the interest of assisting consumers in "maintaining healthy dietary practices." The current disclosure is the result of several years of hard work and extensive input from consumers. The "Nutrition Facts" box disclosure was developed based on goals set out by Congress and then extensive research and consumer testing was used to determine what really worked to achieve those goals.

This experience teaches important lessons that we need to apply to information provided to consumers about financial services products—

- First, financial services legislation should articulate the goals to be achieved through a particular consumer protection disclosure regime, rather than directing the precise content or wording of the disclosure.
- Second, the legislation should provide adequate time for the bank regulators to include consumer testing as part of their rulemaking processes.
- Third, Congress should require that the regulators must consider both the burden associated with implementing any new standards, as well as the effectiveness of the disclosures.

With respect to the regulatory efforts to improve disclosures, as discussed above, we are today using consumer testing – through focus groups and consumer interviews – to identify the content and format of privacy notices that consumers find the most helpful and easy to comprehend. We are hopeful that this initiative will pave the way for better integration of consumer testing as a standard element of developing consumer disclosure regulations.

On another front, the OCC also took the unusual step several months ago of submitting a comment letter to the Federal Reserve Board on its Advance Notice of Proposed Rulemaking related to credit card disclosures, discussing both the development of the FDA's "Nutrition Facts" label and the efforts of the Financial Services Authority (FSA) in the United Kingdom to develop revised disclosures for a variety of financial products. Our comments highlighted some of the lessons learned from the FDA's and FSA's efforts and urged the Fed to take guidance from this experience:

- Focus on key information that is central to the consumer's decision making (provide supplementary information separately in a fair and clear manner);
- Ensure that key information is highlighted in such a way that consumers will notice it and understand its significance;
- Employ a standardized disclosure format that consumers can readily navigate; and
- Use simple language and an otherwise user-friendly manner of disclosure.

V. BANKING AGENCY CONSENSUS ITEMS

As a result of the dialogue between the Federal banking agencies – the OCC, the Fed, the FDIC, and the OTS as part of the EGRPRA process and other discussions over the last several years on regulatory burden relief legislation, it has become apparent that there are a number of items that we all support. Most of these items are included in H.R. 3505 or in other legislation.

In brief, the four Federal banking agencies all support amendments to Federal law that would—

- Authorize the Fed to pay interest on reserve accounts under the Federal Reserve Act (FRA);
- Provide that member banks may satisfy the reserve requirements under the FRA through pass-through deposits;

- Provide the Fed with more flexibility to set reserve requirements under the FRA;[3]
- Repeal certain reporting requirements relating to insider lending under the FRA (*see* Section 403 of H.R. 3505);
- Streamline depository institutions' requirements under the Bank Merger Act (BMA) to eliminate the requirement that the agency acting on the application must request competitive factor reports from all of the other Federal banking agencies (*see* Section 610 of H.R. 3505);
- Shorten the post-approval waiting period under the BMA in cases where there is no adverse effect on competition;
- Exempt mergers between depository institutions and affiliates from the competitive factors review and post-approval waiting periods under the BMA (*see* Section 610 of H.R. 3505);
- Improve information sharing with foreign supervisors under the IBA (*see* Section 612 of H.R. 3505);
- Provide an inflation adjustment for the small depository institution exception under the Depository Institution Management Interlocks Act (*see* Section 404 of H.R. 3505);
- Provide more flexibility in the application of the Flood Disaster Protection Act of 1973 for lenders to force-place new flood insurance, and for remedies available to Federal supervisors to address violations;
- Enhance examination flexibility under the Federal Deposit Insurance Act (FDIA) by increasing the small bank threshold from $250 million to $500 million so that more

[3] These first three amendments dealing with the reserve requirements were included in H.R. 1224, the

small banks may qualify to be examined on an 18-month rather than an annual cycle;[4] and

- Provide that the Federal banking agencies will review the requirements for banks' reports of condition under the FDIA every five years and reduce or eliminate any requirements that are no longer necessary or appropriate (*see* Section 606 of H.R. 3505).

VI. COMMENTS ON OTHER LEGISLATIVE PROPOSALS NOT IN H.R. 3505

Some other important proposals supported by the OCC are not part of H.R. 3505. We urge the Subcommittee to consider them as this legislation moves forward. We note that these items may be particularly beneficial to banks in providing assistance to communities and customers in the Hurricane Katrina affected areas.

Enhancing National Banks' Community Development Investments. The OCC supports an amendment to the National Bank Act that would increase the maximum amount of a national bank's investments that are designed primarily to promote the public welfare either directly or by purchasing interests in an entity primarily engaged in making these investments, such as a community development corporation. We recommend increasing the maximum permissible amount of such investments from 10% to 15% of the bank's capital and surplus. The maximum limit only applies if the bank is adequately capitalized

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Business Checking Freedom Act of 2005, as reported by the House Financial Services Committee and as passed by the House on May 24, 2005.

[4] As discussed in my testimony, the OCC also supports Section 601 of H.R. 3505 enhancing examination flexibility under the FDIA by giving the Federal banking agencies the discretion to adjust the examination

and only if the OCC determines that this higher limit will not pose a significant risk to the deposit insurance fund. Today, more than 90% of national banks investments under this authority are in low-income housing tax credit projects and losses associated with such projects are minimal. Allowing adequately capitalized national banks to modestly increase their community development investments subject to the requirements of the statute will enable them to expand investments that have been profitable, relatively low-risk, and beneficial to their communities.

Giving National Banks More Flexibility in Main Office Relocations. The OCC supports an amendment to national banking law that will reduce unnecessary burdens on a national bank seeking to relocate its main office within its home state. The amendment would provide that a national bank that is merging or consolidating with another bank *in the same state* pursuant to national banking law, rather than the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal) which applies only to interstate mergers and consolidations, has the same opportunity to retain certain offices that it would have if the merger or consolidation were an interstate merger subject to Riegle-Neal. The amendment would allow a national bank, with the Comptroller's approval, to retain and operate as its main office any main office or branch of any bank involved in the transaction in the same manner that it could do if this were a Riegle-Neal transaction. This would give a national bank more flexibility when making the business decision to relocate its main office to a branch location within the same state.

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cycle for an insured depository institution if necessary for safety and soundness and the effective examination and supervision of insured depository institutions.

Paying Interest on Demand Deposits. The OCC supports the amendments to the banking laws to repeal the statutory prohibition on banks paying interest on demand deposits, that were included in H.R. 1224, the Business Checking Freedom Act of 2005, as reported by the House Financial Services Committee and as passed by the House on May 24, 2005. The prohibition on paying interest on demand deposits was enacted approximately 70 years ago for the purpose of deterring large banks from attracting deposits away from community banks. The rationale for this provision is no longer applicable today and financial product innovations, such as sweep services, allow banks and their customers to avoid the statutory restrictions. Repealing this prohibition would reduce burden on consumers, including small businesses, and reduce costs associated with establishing such additional accounts to avoid the restrictions.

VII. CONCLUSION

Mr. Chairman, on behalf of the OCC, we welcome these hearings. The OCC strongly supports initiatives that will reduce unnecessary burden on the industry in a responsible, safe and sound manner, including appropriate initiatives to assist in the Hurricane Katrina recovery effort. We would be pleased to work with you and your staff to make that goal a reality.

I would be happy to answer any questions you may have.

NASAA

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WRITTEN STATEMENT OF THE
NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION
TO THE FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE
HOUSE COMMITTEE ON FINANCIAL SERVICES
REGARDING
H.R. 3505 – THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005
SEPTEMBER 22, 2005

This statement is submitted on behalf of the North American Securities Administrators Association (NASAA).[1] State securities regulation predates the creation of the Securities and Exchange Commission and the NASD by almost two decades and has protected Main Street investors from fraud for nearly 100 years. State securities regulators are responsible for licensing firms and investment professionals, registering certain securities offerings, examining broker-dealers and investment advisers, providing investor education, and most importantly, enforcing our states' securities laws.

The role of state securities regulators has become increasingly important as growing numbers of Americans rely on the securities markets to prepare for their financial futures, such as a secure and dignified retirement or sending their children to college. While securities markets are global, most Americans still rely on local investment representatives in their home states when investing their funds. State securities regulators currently oversee the representatives that operate in their states.

NASAA appreciates this opportunity to provide information to the Subcommittee on your latest regulatory relief initiative. We commend the Committee for striving to make our financial services sector even more efficient, and for being attentive to the concerns of those who wish to ensure that efficiency does not undermine the system of investor protection that has made the U.S. markets the fairest in the world.

H.R. 3505, The Financial Services Regulatory Relief Act of 2005, amends several statutes relative to financial institutions. The majority of the provisions in H.R. 3505 do not directly impact state securities regulation, and we expect that the functional regulators for those sections will offer direct comment.

However, there is one provision that affects the ability of state securities regulators to license certain individuals in our states who are selling non-traditional deposit products. At one time,

[1] The oldest international organization devoted to investor protection, the North American Securities Administrators Association, Inc., was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico , the U.S. Virgin Islands, and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

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most CDs were fully FDIC insured and paid a fixed interest rate until they reached maturity. But, like many other products in today's markets, CDs have become more complex. Investors may now choose among variable rate CDs, jumbo CDs, callable CDs and CDs with other special features. These CDs pose significantly greater risks to investors. Accordingly, NASAA suggests fine-tuning the Section 209 "Selling and Offering of Deposit Products" language that was passed by the House of Representatives during the 108th Congress. By adding the phrase "fixed rate fully FDIC insured," as shown below, Congress can preserve the licensing authority of state securities regulators over independent agents who sell unconventional and risky deposit products. This in turn will help protect investors who traditionally have come to expect that CDs are generally a fixed rate product that are all fully FDIC insured and who would not otherwise invest in a risky CD.

We recognize that the current language in Section 209 represents an effort to balance regulatory relief with investor protection, and we appreciate the past accommodations of the House Financial Services Committee in the drafting process. But, the market has continued to evolve and the language we are now seeking helps to address new issues that have emerged. Independent contractors, not employees of thrifts are selling jumbo deposit products and market-based CDs. These products can exceed the limits of FDIC insurance and are more complex and riskier than traditional products. Because of the potential risk to investors, we believe that states should retain the right to require these independent contractors or agents to become licensed with their state securities regulator in order to sell these unconventional products.

The preemptive language of Section 209 raises a number of concerns. In order to protect investors, current federal and state laws allow states to regulate individuals who offer or sell securities, even if those securities are deposit products. At the same time, Congress and the states generally recognize that licensing exemptions are appropriate under certain circumstances – where for example, deposit products are sold by a bank through its employees. Our concern lies with non-bank-employees, often referred to as "independent agents" of the bank.

These are individuals who do not have the employee affiliation with the thrift, do not necessarily have adequate training, and do not fall under the supervision of the thrift. The problem is exacerbated because many investors assume that a salesperson representing a financial institution is an employee, fully backed by the institution. Yet this is not the case, and these independent agents need oversight if they are going to offer the more complex and riskier deposit products. NASAA's proposed amendment to Section 209 would help make that oversight available, without disturbing the licensing exemption for *bank employees* selling deposit products.

Section 209, as written, would increase the potential of fraudulent sales of deposit products to investors. Any person, regardless of training, knowledge of investment products and risks, or disciplinary background, could sell deposit products such as jumbo or market-based CDs. NASAA recently listed unregistered individuals as one of the top ten scams in the country. And history shows that abuses can and do occur in the sale of CDs. The types of misconduct we see include the sale of bogus CDs; the use of CDs in bait and switch schemes; and misrepresentations and omissions regarding the rate of return on the CD, the duration of the investment, and its liquidity.

Licensing is an important aspect of investor protection, conferring many benefits. Licensing requirements enable states to insist upon a minimum level of education and expertise among

those who sell investment products. Those requirements also enable state securities regulators to verify that a salesperson does not have a disciplinary history of fraud or misconduct. And, a licensing framework provides for the supervision of agents, disclosure of commissions, suitability requirements, complaint reporting and other benefits. Any cost of licensing is certainly outweighed by the positive return to investors. In short, Section 209 undermines the need to monitor individuals who are taking people's investment funds to the public.

Our proposed change in Section 209 is in keeping with well-established legal principles governing the regulation of CDs. The overarching principle that has emerged from the federal and state courts is this: regulating CDs as securities is necessary and appropriate if those CDs pose risks to investors and if those risks are not adequately addressed by other regulatory regimes. Thus, in *Marine Bank v. Weaver,* 455 U.S. 551 (1982), the Supreme Court held that it was unnecessary to subject fixed-rate, insured CDs to regulation as securities because investors were abundantly protected under federal banking laws and, through FDIC insurance, were "virtually guaranteed payment in full." *Id.* at 558-59. By the same token, however, where CDs pose risks that other laws do not address, the courts will invoke securities regulation to ensure that investors are adequately protected. Our proposed change in Section 209 simply codifies this principle: unless CDs are fixed-rate and fully-insured, states will retain their authority to impose licensing requirements on those who sell them, for the benefit of the investing public.

NASAA's suggested language to Section 209 is underlined below:

SEC. 209. SELLING AND OFFERING OF DEPOSIT PRODUCTS.
Section 15(h) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(h)) is amended by adding at the end the following new paragraph:

`(4) SELLING AND OFFERING OF DEPOSIT PRODUCTS- No law, rule, regulation, or order, or other administrative action of any State or political subdivision thereof shall directly or indirectly require any individual who is an agent of 1 Federal savings association (as such term is defined in section 2(5) of the Home Owners' Loan Act (12 U.S.C. 1462(5)) in selling or offering <u>fixed rate fully FDIC insured</u> deposit (as such term is defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813(l)) products issued by such association to qualify or register as a broker, dealer, associated person of a broker, or associated person of a dealer, or to qualify or register in any other similar status or capacity, if the individual does not—

`(A) accept deposits or make withdrawals on behalf of any customer of the association;
`(B) offer or sell a deposit product as an agent for another entity that is not subject to supervision and examination by a Federal banking agency (as defined in section 3(z) of the Federal Deposit Insurance Act (12 U.S.C. 1813(z)), the National Credit Union Administration, or any officer, agency, or other entity of any State which has primary regulatory authority over State banks, State savings associations, or State credit unions;
`(C) offer or sell a deposit product that is not a <u>fixed rate fully FDIC</u> insured deposit (as defined in section 3(m) of the Federal Deposit Insurance Act (12 U.S.C. 1813(m)));
`(D) offer or sell a deposit product which contains a feature that makes it callable at the option of such Federal savings association; or
`(E) create a secondary market with respect to a deposit product or otherwise add enhancements or features to such product independent of those offered by the association.'.

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