

Testimony of

Bradley E. Rock

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Banking, Housing and Urban Affairs

United States Senate

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Mr. Chairman and members of the Committee, my name is Bradley Rock. I am Chairman, President, and CEO of Bank of Smithtown, an \$900 million community bank located in Smithtown, New York, founded in 1910. I am also the Vice Chairman of the American Bankers Association (ABA). ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

I am glad to be here today to present the views of the ABA on the need to eliminate unnecessary, redundant, or inefficient regulatory burdens that increase costs for banks and reduce the amount of credit available to our communities. By now, it should not come as news that banks are struggling under the weight of increasing levels of regulatory burdens, many of which do not serve the objective of making the nation's banks operate more soundly or to provide meaningful

protections to consumers. These regulatory burdens raise the cost to banks and, consequently, place an unnecessary strain upon banks' abilities to efficiently serve their customers.

The USA PATRIOT Act, the Sarbanes-Oxley Act, and the Gramm-Leach-Bliley Act are all valuable pieces of legislation that strive to serve the public interest. However, overly complex or redundant compliance requirements render these laws far less effective than they would be otherwise. Banks, particularly community banks, are strained to the breaking point under the weight of thousands of pages of regulation, guidance, and other mandates. When the cumbersome layering of additional requirements, issued by the Securities and Exchange Commission (SEC), the Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), the American Institute of Certified Public Accountants (AICPA), and the Internal Revenue Service (IRS) are also taken into account, it is abundantly clear that bank resources are being stretched too thin.

The ABA would like to take this opportunity to thank the many members of the Senate Banking Committee that signed a joint letter to then-SEC Chairman Donaldson, expressing serious concerns with the SEC's proposed regulations implementing the "push-out" provisions of Title II of the Gramm-Leach-Bliley Act and urging the SEC not to finalize those regulations. As the Committee is aware, the proposal would create costly and unnecessary regulatory burdens on banks that offer traditional banking products and services. To date, the SEC has not issued final regulations and we, in the banking industry, are hopeful that the SEC will follow the guidance outlined by members of this Committee to work with the bank regulators to propose a new regulation for public comment that is consistent with Congressional intent and that does not "impose burdensome and wholly unjustifiable compliance costs on the entire banking industry."

In addition, ABA has submitted comments to regulators on a wide range of regulatory relief priorities, which would make a real difference in the vitality of our nation's banks. We are pleased the regulators have acted on some of our recommendations and that our message is apparently being heard. For example, I am particularly pleased with regulators' support for changes that involve the Bank Secrecy Act (BSA), including discontinuing cash transaction report (CTR) requirements for seasoned customers – changes that would not only provide relief to banks and our regular customers, but also increase the security of our banking system by identifying criminal activity with greater precision. More can, and needs to be done, however.

In my testimony, I would like to make three key points:

- Excessive regulatory burden has a significant impact on bank customers and local economies.
- The regulatory burden is significant for banks of all sizes, but pound for pound, small banks carry the heaviest regulatory load. The community bank is in great danger of being regulated right out of business.
- There are many important regulatory issues that Congress should address this year, but several are especially pressing to maintain the competitive vitality of my industry. These include eliminating unnecessary CTRs, increasing the 500-shareholder threshold which triggers periodic reporting requirements that impose considerable financial and opportunity costs on smaller public companies; and preventing credit union capital erosion and widening credit union authority in higher-risk lending.

Excessive Bank Regulation Harms Consumers, Communities' Economies

Outdated laws and regulations divert scarce resources of banks that could otherwise be used to provide financial services demanded by our customers. New laws, however well intentioned, have added yet more layers of responsibilities on businesses like mine. While no single regulation by itself is overwhelming, the cumulative weight of all the requirements is overwhelming.

The burden of regulation has a significant impact on bank customers and local economies. Every new law, regulation or rule added means two things: more expensive bank credit and less of it. This is true for large and small businesses – likely hurting small businesses the most, as they need low-cost financing but cannot go directly to the capital markets. The result is slower economic growth.

During the past 25 years, the compliance burden has grown so large and is so pervasive throughout all levels of bank management that it is extremely difficult to measure. Research done by the ABA and the Federal Reserve¹ indicates that the total cost of compliance *today* for banks – *excluding* compliance costs due to legislation enacted in the last five years, such as the USA PATRIOT Act and Sarbanes-Oxley – would range from \$36 billion to \$44 billion per year. Compliance costs are expected to grow at an even faster pace in the coming years.

Certainly, some of the regulatory cost is appropriate for safety and soundness reasons. But consider the direct impact on bank lending and economic growth if this burden could be reduced by 20 percent and redirected to bank capital; it would support additional bank lending of \$72 billion to \$88 billion. This would clearly have a big impact on our economies. In fact, it represents nearly 10 percent of all consumer loans or 11 percent of all small business loans.

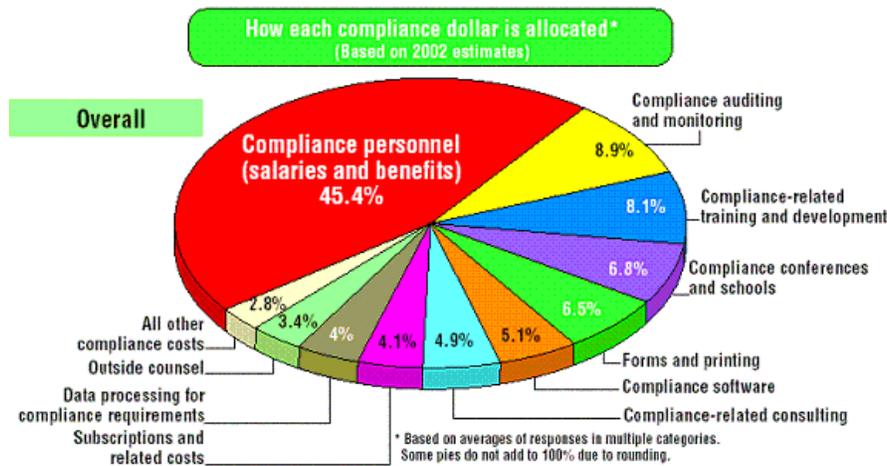
¹ “Survey of Regulatory Burden,” ABA, June 1992; Ellichehausen, “The Cost of Banking Regulation: A Review of the Evidence,” Staff Study, Board of Governors of the Federal Reserve System, April 1998.

Community Banks Hit Especially Hard

Regulatory costs are significant for banks of all sizes, but small banks carry the heaviest regulatory load. For the typical small bank, about one out of every four dollars of operating expense goes to pay the costs of government regulation. For large banks as a group, total compliance costs run into the billions of dollars annually.

The cumulative effect of new rules and regulations is already leading many community banks to look for merger partners to help spread the costs; some will go out of business altogether or consolidate with larger banks, as some have already done. Our members routinely mention regulatory burden as the first or second critical factor threatening the viability of their community banks. I can tell you, Mr. Chairman, the pressures to comply with all the regulations and still meet the demands of our customers are enormous. We feel that we must grow the bank rapidly to generate more revenues simply to pay for the ever-increasing regulatory cost. The sad part is that too much time and effort is now devoted to compliance and not to serving our customers.

Bankers at all levels, from bank directors and CEOs to compliance managers and tellers, spend endless hours on compliance paperwork. Because of the complexities involved, my bank pays more than \$100,000 each year to outside firms to help us with the big compliance issues. On top of this, one person on my staff has a full-time job just to coordinate all the activities throughout the bank related to regulatory compliance. I personally spend about one-and-a-half days per week just on compliance issues. Some CEOs tell me that they are now spending nearly half of their time on regulatory issues. In addition, banks spend billions annually on compliance training, outside compliance support (including accounting firms, consultants and attorneys), compliance related hardware and software, printing, postage, and telephone connections.



Source: Compliance Watch, 2003. Nationwide Bank Compliance Officer Survey. ABA Banking Journal, June 2003.

Banks that can least afford increasing compliance costs are hit the hardest. There are more than **2,491 banks and thrifts with fewer than 20 employees; nearly 900 banks and thrifts have fewer than 10 employees.** In order to fulfill their compliance obligations, banks of this size often are forced to hire an additional full-time employee just to complete government-mandated reports. According to the Small Business Administration’s Office of Advocacy, the total cost of regulation is 45 percent higher per employee for firms with fewer than 20 employees compared to firms with more than 500 employees due to the fixed costs associated with regulations.² The cost versus benefit analysis fails to make the case for many of the rules and regulations banks must follow and the reports that we generate.

The bottom line is that too much time and too many resources are consumed by compliance paperwork, leaving too little time and resources for providing actual banking services. I’m sure I speak for all bankers when I say that I would much rather spend my time talking with our customers

about their financial needs and how my bank might fulfill them than poring over piles of government regulations. The losers in this scenario are bank customers and the communities that banks serve.

CTRs, Shareholder Thresholds for Reporting Requirements, and Credit Union Expansions

In the appendix to this testimony is a list of recommended actions, every one of which would provide meaningful and much needed regulatory relief to banks. There are three issues in particular that I would like to emphasize.

Eliminate CTR Filings for Seasoned Customers [Matrix 176]

ABA and its members strongly believe that the current cash transaction reporting program has been rendered virtually obsolete by several developments: enhanced customer identification programs, more robust suspicious activity reporting, and the use of the more focused and intensive 314(a) inquiry/response process. We believe that the current CTR screen at the current level generates too many reports that capture extensive immaterial activity wasting law enforcement time and resources that could be spent more effectively on detection and investigation of criminal and terrorist activity.

In fact, as published in the U.S. Money Laundering Threat Assessment released earlier this year, the number of CTRs filed on an annual basis now tops 13.1 million with no signs of abating. Even at FinCEN's conservative estimate of around 25 minutes per report for filing and record-keeping, it means that the banking industry as a whole devoted around 5½ million staff hours of

² Crain, "Impact of Regulatory Costs for Small Firms," Small Business Administration, 2005

work to handling CTRs in 2005. Based on our recent survey, the industry paid around \$187 million in wages for this staff time.

Based on that same survey, three-quarters of the filings were for business customers who had been with the bank for over a year. That means that the industry spent around four million staff hours and over \$140 million last year filing notices on well-established customers!

A typical bank with \$2 billion of assets filed 1,400 CTRs in 2005. The filings took 583 staff-hours. And 438 of the staff-hours were simply to report on long-standing customers.

This trend is only likely to accelerate and demand more and more staff to report on more and more transactions further burying the real needles of money laundering under an exponentially growing mound of the hay of legitimate business transactions mindlessly recorded at great expense and increasing opportunity cost.

CTRs have been superseded by SARs and 314(a) inquiries

When establishing the BSA regulatory regime, Congress sought to require reports or records when they have “a high degree of usefulness” for the prosecution and investigation of criminal activity, money laundering, counter-intelligence and international terrorism. ABA and its members strongly believe that the current CTR reporting standards have long departed from this standard of achieving a high degree of usefulness.

To continue to require CTR filings for business customers whose identity has been verified under a bank’s Customer Identification Program (CIP) and tested under a period of experience with the bank and that remain subject to risk-based suspicious activity reporting is an inefficient use of resources by bankers and law enforcement. It also diverts scarce examiner resources by focusing on

compliance with *technical* reporting standards, rather than evaluating bank internal controls for detecting transactions that possess a likelihood of involving money laundering and terrorist financing.

Exempt Seasoned Customers from CTRs

Accordingly, **we believe that the best way to improve the utility of cash transaction reporting is to eliminate the routine reports being filed on legitimate American businessmen and businesswomen.** This can be achieved by establishing a seasoned customer exemption for business entities, including sole proprietorships, as endorsed by FinCEN last year in testimony before Congress.

It is important to remember that cash transaction data will not be lost, but rather will continue to reside in the normal bank account data for each seasoned customer. It will, therefore, be available to law enforcement whenever sought in connection with an inquiry from government enforcement entities. In particular, by using the USA PATRIOT Act 314(a) inquiry process, law enforcement will be able to obtain information in far greater detail on the accounts of suspects. Of course, all seasoned business customers would continue to be subject to suspicious activity monitoring and reporting, thereby alerting law enforcement to the kind of conduct that has been investigated and affirmatively considered as having a heightened potential for being illegal.

Eliminating CTR filings for seasoned customers would have the following benefits:

- The vast majority of the over 13 million CTRs filed annually would stop, saving many hours a year in filling out forms and law enforcement resources devoted to processing them.

- There would be an improvement in the quality of SARs, eliminating those that are filed on routine, legitimate cash transactions that approach but do not reach current CTR levels. Banks would be able to focus their energies on detecting genuinely suspicious handling of currency regardless of artificial thresholds.
- We would make an enormous stride forward in focusing our anti-money laundering efforts – by both law enforcement and the banking industry – on the real crooks and terrorists with far greater likelihood of detecting and stopping their activities.

The redundancy of CTR filings for seasoned customers with transaction accounts and the need to eliminate this inefficient use of resources by bankers and law enforcement was echoed by the Financial Crimes Enforcement Network (FinCEN) and all the bank regulators in Congressional testimony over the last year.

Simplifying the CTR Exemption Process Falls Short

ABA has worked cooperatively with FinCEN and the federal banking regulators to encourage institutions to make better use of statutory exemptions when they were changed in the late 1990's. Our Association did extensive outreach to our members, and while many institutions adjusted their CTR filing policies and utilized the two-tier exemption process, the general response was lukewarm at best.

Unfortunately, the compliance technicalities for, and examiner second-guessing of, banker use of the exemption and the renewal processes have discouraged many institutions from utilizing the tier-two exemptions. ABA has even received reports from members that examiners have threatened penalties and other formal criticisms for simple late filing of biennial renewal forms, a

regulatory climate that demands overhaul. We do not believe that improvements to this process will make a significant dent in the overwhelming number of CTRs filed each year that do little more than record the legal transactions of law-abiding citizens, thereby drawing attention and resources away from the effort to catch and stop criminal activity. Consequently, in adopting a seasoned customer exemption, we must ensure that the regulatory process and requirements that follow do not frustrate the goal of reducing unnecessary CTR filing.

Increase Shareholder Threshold for Registration

Currently, Section 12(g) of the Securities Exchange Act of 1934 requires a company with \$10 million in assets and 500 shareholders to register its securities with the SEC. Once registered with the SEC, a company comes under a significant weight of federal securities regulation, including requirements to file with the SEC annual and quarterly reports, and insider and beneficial owner reports, and to comply with the SEC's proxy and information statement rules. The 500 shareholder threshold has never been updated since it was initially set in 1964; in contrast the asset requirement has been updated incrementally from \$1 million to \$10 million since 1964.

These periodic reporting requirements impose considerable financial and opportunity costs on smaller public companies—costs that are ultimately borne by the company's shareholders and the nation as a whole as the job and economic creativity of small businesses are unnecessarily burdened. For example:

- Average auditing fees for smaller public companies, defined as companies with less than \$1 billion in revenue, rose from \$532,000 in 2003 to \$1,044,000 in 2004, a 96 percent increase. Large public companies also face very large increases in auditing fees – 58 percent from \$3,631,000 to \$5,734,000.

- Three-fourths of community banks surveyed by Grant Thornton last year indicated that director and officer liability insurance had increased significantly in 2003.
- The legal costs of public companies have increased dramatically, disproportionately impacting smaller public companies that do not have the requisite legal staff to draft committee charters, corporate governance principles, codes of ethics, director independence surveys and board of director and committee assessments.
- Significant opportunity costs have dampened the growth of business as capital that is currently used to fund unnecessary compliance programs is not available to fund expansion, including the opening of bank branches. In addition, lost productivity as a result of complying with these reporting requirements is estimated at \$1 million per year for companies with revenues of less than \$1 billion.

To reduce these costs and burdens, the 500-shareholder threshold should be increased to more accurately reflect the current size and conditions of the investment market. As noted above, updating the benchmarks for SEC registration is not without precedent as the asset size parameter has been increased to \$10 million from \$1 million initially set in 1964. Good public policy suggests that the shareholder threshold should be correspondingly increased. According to SNL Financial data, raising the threshold to 3,000 would exempt about six percent of the banking industry in terms of assets, or six hundred and eighteen bank holding companies. Even updating the threshold to 1,500 shareholders would exempt about five percent of the banking industry in terms of assets, or about five hundred bank holding companies.

The SEC regulations also provide that a company cannot seek to de-register until the number of shareholders of record is below 300. Sections 12(g)(4) and 15(d) of the Securities

Exchange Act of 1934 should be similarly updated to place the threshold for de-registration within the range of 900 to 1,800 shareholders of record.

Reject Efforts to Expand Credit Union Business Lending Authority

ABA strongly opposes the use of regulatory relief legislation to expand the commercial lending authority and/or prudent regulation of capital levels of credit unions. Such changes would reduce the safe and sound supervision of credit unions while fueling even more rapid extension of the government subsidies for an ever-increasing segment of the credit union industry, especially when the industry has failed to demonstrate that it is using its subsidies to benefit the underserved.

A fundamental change has occurred within the credit union industry that has divided the industry into two distinct groups – diversified conglomerate credit unions that act like and advertise themselves as commercial banks, and traditional credit unions that are more likely to embody credit unions’ mission to serve people of modest means. Today, more than 100 credit unions surpass \$1 billion in assets. These credit unions are much larger than the typical community bank in their local market, which has a median asset size of \$106 million as of September 2005. The current government subsidies for these diversified credit unions and lack of equivalent regulation have created huge competitive inequities in the local marketplace and represents an ever-increasing abuse of the credit union tax subsidy. Moreover, large-scale business lending is inconsistent with Congress’s original charge that credit unions serve “people of small means” and should not be encouraged further.

Conclusion

In conclusion, the cost of unnecessary paperwork and red tape is a serious long-term problem that will continue to erode the ability of banks to serve our customers and support the economic growth of our communities. We thank you for continuing to look for ways to reduce the regulatory burden on banks and thrifts, and to restore balance to the regulatory process. Mr. Chairman, the ABA is committed to working with you and the members of this Committee to achieve this goal.

Appendix

Additional Recommended Changes in Regulation

Not only are the demands on banks enormous, but they seem to change daily, which is its own form of burden. In addition to the specific reform delineated in the main body of this testimony, there are many other areas that should be addressed. Below is a summary of some recommended areas for reform. ABA is pleased to offer more detailed information to the Committee upon request on any of these points:

Sarbanes-Oxley Implementation

Continued oversight of how the Sarbanes-Oxley Act is being implemented is very important in order to ensure that the benefits of the new requirements outweigh the costs. The ABA provided detailed recommendations to the SEC and PCAOB to streamline the Section 404 process, and we are most appreciative of their focus and the subsequent PCAOB guidance issued in May of last year. In addition, the SEC and the PCAOB have announced they will sponsor a roundtable on May 10, 2006 to discuss second-year experiences with reporting and auditing requirements under Section 404. These regulatory oversight actions are extremely important to ensuring that costs associated with complying with the Act are appropriately reduced as registrants and auditors alike gain familiarity with the Act's requirements.

In addition to the need to streamline costs relating to Section 404, an area that continues to need further refinement is the separate audit opinion on internal controls. Section 404 and the related SEC regulations were modeled after the FDIC Improvement Act, which required

management reporting on internal controls and auditor attestations. However, the rules issued by the PCAOB went beyond these requirements by mandating an additional audit opinion on internal controls. This results in unnecessary duplication of effort and cost with little corresponding benefit.

Prohibit Mixing of Banking and Commerce

ABA has long taken the position that commercial firms should not own banks or savings institutions because of the potential for conflicts of interest (particularly in the credit granting process) and because of the potential for an unhealthy concentration of economic power. The so-called unitary thrift holding company charter, which allowed commercial firms to own a savings association, was closed prospectively in the Gramm-Leach-Bliley Act, precluding the possibility that commercial firms could use this channel to obtain a banking charter. The Gramm-Leach-Bliley Act provision represented a consistent extension of congressional policy going back 50 years.

However, the ILC charter remains an open avenue for commercial firms – even those large firms that are not primarily financial in nature – to provide retail and corporate banking services. ABA strongly supports closing this loophole for new commercial firms. We look forward to working with this Committee on this important issue going forward.

Eliminate Cross-Marketing Restrictions [Matrix 171]

ABA supports elimination of the prohibition in the Gramm-Leach-Bliley Act on cross-marketing between banks and non-financial portfolio companies where the Financial Holding Company (FHC) that owns the bank also has an investment position in a non-financial portfolio

company made through its securities affiliate. No such prohibition exists when the investment position in a portfolio company is made through an FHC's insurance affiliate.

Problems in the Consumer Protections on Bank Sales of Insurance Law

Section 47 of the Federal Deposit Insurance Act establishes certain protections for consumers who purchase insurance products from depository institutions. These protections include a disclosure that insurance products are not backed by the Federal Deposit Insurance Corporation, that such products may involve an investment risk, and that the purchase of an insurance product cannot be conditioned upon the approval of a loan. This disclosure is intended to distinguish insurance products from other banking products, especially insured deposit products.

Section 47, however, does not define the term "insurance product." As a result, the statute has been interpreted to apply to all types of insurance products, even insurance products for which the disclosure either is not necessary or is potentially confusing to the consumer. To address this problem, we recommend modifying the scope of the disclosure requirement to only apply to products wherein there is an investment risk, e.g., not fixed rate annuities or credit insurance.

Control of Shares by Trusts [Matrix 173]

ABA proposes a safe harbor from the attribution rules of Section 2(g)(2) of the Bank Holding Company Act: (1) for shares held in trust through a regulated employee benefit plan; or (2) for mutual fund shares held in trust provided any investment adviser or affiliate with the power to vote 25 percent of the shares of the investment company transfers the vote to the beneficial owners or an independent entity; or (3) for shares held in a common or collective fund.

The purpose of this safe harbor is to exempt certain bank and bank holding company employee investment holdings from being improperly attributed to the bank holding company when those holdings are held through an employee benefit plan or a common or collective fund, or the employee assets are invested in mutual fund shares held in trust. Without this exemption, bank holding companies, by virtue of their employees' activities, could be deemed to control the mutual fund or other company in which the plan or trust has invested.

Provide Parity for Savings Associations [Matrix 52]

ABA recommends eliminating disparate treatment of thrifts under the federal securities laws by eliminating the investment adviser and broker-dealer registration requirements that apply to thrifts, but not banks, under the Investment Advisers Act and the Securities Exchange Act of 1934.

Thrifts and banks provide investment adviser, trust and custody, third party brokerage, and other related services in the same manner, but have been subject to disparate requirements under the securities laws. There is no logical basis to structure the regulation of thrifts and banks differently. Removing the disparity will reduce regulatory burden by providing cost savings to affected thrift institutions and enhance competition that will benefit consumers.

Flood Insurance Compliance Problems

The Flood Disaster Protection Act of 1973 should be amended to streamline and simplify flood insurance requirements; resolve compliance problems when the official flood map is more than 10 years old; increase the "small loan" exception (currently \$5,000) and allow adjustments for

inflation on a regular basis; and to allow exceptions to flood insurance requirements for agricultural real estate where the value of most of the collateral is represented by land, not permanent structures.

In addition, the forced-placement rules should be changed to allow lenders to force-place flood insurance within 30 days (instead of the current 45 days) of notifying the borrower and regulators should be given more flexibility to tailor their actions to individual cases by eliminating mandatory civil monetary penalties for certain pattern and practice violations of the National Flood Insurance Program.

Clarify Citizenship for Federal Savings Associations [Matrix 58]

The National Bank Act generally provides that national banks are “citizens” of the states in which they are “located.” In its January 17, 2006 ruling (in *Wachovia v. Schmidt*), the Supreme Court clarified the meaning of “located” and ruled that a national bank is a citizen of the state in which its main office is located. This ruling clarified disagreement among federal courts that existed for more than a dozen years which had resulted in national banks having multiple state citizenships.

Unfortunately, uncertainty still exists for federal savings associations. Thus, to avoid inconsistent treatment of federally chartered financial institutions under the diversity statute (which governs when an interstate savings association can remove a case to federal court), the ABA recommends a change in the Home Owners’ Loan Act to provide that a federal savings and loan is a citizen in the state where its home office is located for federal court jurisdiction. In addition to providing parity for federal savings associations with national banks and other corporations, this amendment would provide clarity to all parties regarding when a civil suit involving a federal savings association may be heard in federal court.

Establish Protections for Information Provided to Banking Agencies [Matrix 100]

ABA proposes amending the Federal Deposit Insurance Act to provide that when a depository institution submits information to a bank regulator as part of the supervisory process, the depository institution has not waived any privilege it may claim with respect to that information. Recent court decisions have created ambiguity about the privileged status of information provided to supervisors when outside of the narrow confines of the actual examination. However, the purpose of providing confidentiality for examiner information is to encourage open communication between the regulator and the regulated financial institution. The process of preserving safety and soundness applies just as clearly to additional information supplied to regulators in any part of the supervisory process. The bank agencies have supported the change and we urge Congress to adopt these important protections.

Clarifying the Definition of “Deposit Broker”

In 1991, Congress enacted provisions restricting the use of brokered deposits. The idea was to prevent volatile flows of deposits to troubled institutions that were paying interest rates considerably higher than local market rates. Only well-capitalized banks are permitted to accept brokered deposits (without an FDIC waiver) and must report the extent to which the bank relies on such deposits. These are certainly important restrictions. However, current FDIC interpretations of a deposit broker captures deposits that are neither out-of-market nor marketed at high interest rates. For example, many banks use affiliates to originate deposits. If an entity originates funds solely for its affiliate insured depository institution, the deposits lack the indicia of “hot money” that often characterize typical brokered deposits.

Another instance of deposits being inappropriately considered to be brokered is when banks use a network to swap customer deposits to obtain FDIC insurance on the amounts swapped. In this case, a person deposits funds in a bank in an amount that would exceed FDIC insurance coverage. To obtain insurance on the full amount, the bank takes the uninsured portion and, through a network of banks created to facilitate placing deposits in insured accounts, swaps it with other network members on a dollar-for-dollar basis. The rate of interest the person receives on the entire amount of the deposit is set by his or her bank. As a result, the customer does not “chase” interest rates through the network. Since the use of the network does not create the volatility or distort local market interest rates, it should not be considered a brokered deposit within the meaning of the law. In fact, the network swapping is *designed to attract and retain local customers* – not “hot money” from around the country.

Many banks will avoid these stable and typically inexpensive deposits to avoid the brokered deposit label. Thus, an exclusion should be added to the list of exclusions to the term deposit broker for those persons that place customer funds either solely with an affiliate or through a network and receive matching funds in return and where the rate of interest is set by each bank.

Additional Regulatory Relief Provisions for Community Banks

There are several changes that would provide significant relief for community banks:

- Expanding eligibility for the 18-month examination cycle for banks up to \$1 billion in assets. [Matrix 169]
- Allowing short form Call Reports for certain community banks (generally well managed and well capitalized institutions with total assets of less than \$250 million).

- Directing the regulators to periodically review Call Report information schedules that must be filed and reduce or eliminate unnecessary information requirements.
[Matrix 109]
- Making it easier for smaller institutions to buy other banks and merge by raising the size limit from \$150 million to \$1 billion in assets for institutions that use acquisition debt to transfer ownership under Regulation Y's "Policy Statement on Assessment of Financial and Managerial Factors". [Matrix 116]

Additional Regulatory Relief Provisions for Savings Associations

- **Investment in Corporate Debt Not of Investment Grade.** The Federal Deposit Insurance Act should be amended to permit savings associations to invest in below-investment-grade or unrated "corporate debt securities." National banks are not subject to this prohibition, and ABA supports an amendment to permit savings associations to invest in these securities to the extent to which national banks are permitted.
- **Final Judgment Clarification.** ABA supports amending the Home Owners' Loan Act to clarify that "final judgment" occurs when a judgment is no longer subject to examination or appeal.
- **Eliminate Certain Notice Requirements for Subsidiaries.** The Federal Deposit Insurance Act should be amended to decrease duplicative and burdensome notifications that savings associations are required to provide to the FDIC and the Office of Thrift Supervision. The Act requires savings associations to give notice if the savings association elects to conduct a new activity through a subsidiary. ABA supports clarifying that such

notice to the FDIC is not required for a subsidiary to begin engaging in an activity if the activity is permissible for national banks.

Privacy Notices

- Financial institutions that have not changed their privacy policies and do not share consumer information that would trigger an opt-out notice under either the Gramm-Leach-Bliley Act or the Fair Credit Reporting Act would not have to provide an annual privacy notice. [Matrix 63]
- Provide business organization flexibility for national banks (e.g., Subchapter S and LLC forms). [Matrix 30]

Exemption for Small Depository Institutions from Some Auditing Requirements [Matrix 175]

ABA urged the FDIC to raise the asset size threshold to \$1 billion for exemption from the management reporting requirement for internal controls (and the related attestation) and independent membership of the audit committee of the board of directors. The FDIC evaluated these proposals and did ultimately adopt important changes that significantly reduce the regulatory burden on small banks, although the rule fell short of realizing the full regulatory relief potential. In particular, the rule raised the threshold for exemption and requires that there be for FDIC-insured institutions with assets greater than \$1 billion:

- internal control assessments by management and external auditors and
- the complete independence of members of the audit committee. FDIC-insured institutions between \$500 million and \$1 billion must have a majority (but no longer all) members of the audit committee be independent. In hardship cases, where an institution between \$500

million and \$1 billion has had difficulty in staffing the audit committee with a majority of independent members, then it may be granted a waiver by its supervisory agency.

The previous threshold, established by the FDIC in 1993, of \$500 million was not appropriate today given the state of the industry. At the time that threshold was set, banks under \$500 million represented 25 percent of total industry assets. The makeup of the industry has changed considerably since then. While more than 1,876 new banks have been chartered since then, institutions under-\$500 million today represent only 9.7 percent today of total industry assets. Moreover, in light of the structural changes which have taken place, the widely-held definition of a community bank today is one with assets of \$1 billion or less. We appreciate the action of the FDIC on this rulemaking.

Advisory Group for the Office of Foreign Assets Control

The Bank Secrecy Act Advisory Group has proven itself to be very useful in providing a forum of industry input in the development of informed Bank Secrecy Act/Anti-Money Laundering (BSA/AML) policy. Given that success, ABA recommends creating similar statutory authority for establishing an Advisory Group covering the area of economic sanctions administered by the Office of Foreign Assets Control (OFAC).