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TESTIMONY OF

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COMMISSIONER OF BANKING & CONSUMER FINANCE

For the

STATE OF MISSISSIPPI

On Behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

Before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

of the

UNITED STATES SENATE

June 22, 2004

Mr. Chairman and Members of the Committee, I appreciate this opportunity to appear on behalf of the Conference of State Bank Supervisors to present the views of CSBS on the important issue of regulatory burden as it impacts the nation's banking system.

CSBS is the professional association of state officials who charter, regulate and supervise over 6,300 state-chartered commercial and savings banks, and more than 400 state-licensed foreign banking offices nationwide.

As current chairman of CSBS, I am pleased to represent my colleagues in all 50 states and the U.S. territories.

CSBS gives state bank supervisors a national forum to coordinate, communicate, advocate and educate on behalf of the state banking system. As supervisors of over 74 percent of the nation's banks, state banking regulators have the closest vantage point when it comes to supervisory issues, as well as issues relating to our state and local economies. We have a unique perspective of how legislation and accompanying regulations impact the banking industry.

While most state-chartered banks fall into the category of community bank, I would like to point out that, as of year-end 2003, 47 of the top 100 banks in the nation were state-chartered, and about 225 state banks operated on an interstate basis. This is testimony to the work that CSBS and the states have done to provide seamless supervision through

coordination, innovation and the dynamic use of technology. We are proud of the role we play in maintaining safety and soundness in all the financial institutions we supervise.

First let me mention that CSBS is very concerned over regulatory actions occurring absent federal legislation that could result in a grave imbalance in the dual banking system.

As of year-end 2003, national banks had approximately 56 percent of the total assets in the banking system. Already since February, when the Office of the Comptroller of the Currency finalized its rule preempting national banks and their operating subsidiaries from state licensing requirements and state consumer protection laws, two large state-chartered banks have announced plans to convert their charters to national banks.

We also understand that several of the largest state-chartered banks are evaluating the potential competitive advantages of the preemption that the OCC has offered. With the announced and predicted conversions, the state system will likely shrink from 44 percent of the banking system's assets to under 33 percent in less then a year. Should many more of the banks with interstate operations switch charters, the state system will suffer.

In a worst-case scenario, should all 47 of the largest state-chartered banks convert to a national charter, total assets in state banks would plummet from 44 percent to 17 percent, severely impacting the viability of the state chartering and supervisory system.

To be clear, without the state chartering system, there would not be community based banks. In recent testimony before the Senate Banking Committee, Federal Reserve Chairman Greenspan referred to the American dual banking system and its support of community banks as a "jewel" of our economy. State bank supervisors see the value of this jewel every day. The preservation of a state bank chartering and regulatory system sets the United States' financial system apart from every other developed nation and is a primary contributor to our nation's diverse, vibrant, resilient and responsive economy.

Why am I raising the Comptroller's actions during a regulatory burden hearing? CSBS believes that without a viable dual banking system, one monolithic, unaccountable, federal regulator sitting in Washington, DC has the potential to dramatically increase regulatory burden for our nation's banking system.

Without a doubt, banks, especially community banks, bear a heavy share of regulatory burden. From our discussions with community banks, that burden is almost exclusively federal law and regulations. As FDIC Vice Chairman Reich points out, since the passage of FIRREA in 1989, federal bank and thrift regulatory agencies have issued 801 new rules. That is an average of one new regulation per week.

As the largest banks are pushing for a purely national set of rules for their evolving multi-state and increasingly retail operations, keep in mind that this regulatory scheme will also impose new requirements on state-chartered banks operating in the majority of states that do not already have similar rules in place. If we are to preserve a system of community

banking, Congress and bank regulators should rethink how these highly complex laws and reams of compliance regulations will apply, or even if they should apply, to smaller community banks.

The most important contribution toward reducing regulatory burden may be empowering the state banking system. The vast majority of innovations in banking products, services and business structures are the product of state banks and the flexibility of the state chartering system. CSBS greatly appreciates the commitment of the Congress to preserve and enhance the ability of the states to respond to customer and business needs. Support of dual federal and state chartering will allow our financial markets to continue to be the world's most vigorous.

Choice in the regulatory environment can have many of the same benefits that it has in the business environment. Knowing that banks have a choice, regulators work smarter and more effectively. The safety and soundness of the financial institutions we regulate is our goal, and it is essential that we have the necessary resources to ensure a healthy banking system. Without the existence of a parallel regulatory system, however, an expensive, inefficient and monolithic regulatory regime could easily develop that would burden and restrict financial institutions, disadvantage them in the marketplace, and create a less healthy banking system. As our founding fathers recognized, we need federalism, not just federal, in our banking system.

With this in mind, there are five provisions that we believe should be considered for any regulatory burden relief legislation that will be introduced in the Senate. Two of the provisions are in the House version of the regulatory relief bill, and three of our recommendations have not been addressed in the House bill.

Coordination of State Examination Authority

CSBS and the state banking departments have developed comprehensive protocols that govern coordinated supervision of state chartered banks that operate branches in more then one state. Through the CSBS Nationwide State Federal Cooperative Agreements, states that charter and regulate state banks work closely with either the FDIC or Federal Reserve and bank commissioners in host states where their bank operates branches to provide quality, risk-focused supervision. To further support these efforts we strongly support including language in a Senate regulatory relief bill that reinforces these principles and protocols that have been in place since 1996.

CSBS supports a provision in H.R. 1375 intended to improve the state system for multi-state state-chartered banks by codifying how state-chartered institutions with branches in more than one state are examined. While giving primacy of supervision to the chartering or home state, this provision, as slightly modified, requires both the home and host state bank supervisor to abide by any written cooperative agreement relating to coordination of exams and joint participation in exams.

In addition, the House bill provides that, unless otherwise permitted by a cooperative agreement, only the home state supervisor may charge state supervisory fees on multi-

state banks. Under this provision, however, the host state supervisor may, with written notice to the home state supervisor, examine the branch for compliance with host state consumer protection laws.

If permitted by a cooperative agreement, or if the out-of-state bank is in a troubled condition, the host state supervisor could participate in the examination of the bank by the home state supervisor to ascertain that branch activities are not conducted in an unsafe or unsound manner. If the host state supervisor determines that a branch is violating host state consumer protection laws, the supervisor may, with written notice to the home state supervisor, undertake enforcement actions. This provision would not limit in any way the authority of federal banking regulators and does not affect state taxation authority.

De Novo Interstate Branching

CSBS supports the provision in the House regulatory relief bill (H.R. 1375) allowing de novo interstate branching for banks and trust companies.

Current Federal law takes an inconsistent approach toward how banks may branch across state lines. While Riegle-Neal gave the appearance that states could control how banks could enter and branch within their borders, this has not always been the reality. In fact, state chartered banks are disproportionally affected by Riegle-Neal provisions that restrict state banks ability to establish de novo branches.

Perhaps because many believed that the federal thrift charter would be eliminated at the

time Riegle-Neal was adopted, the law has never applied to federally-chartered thrifts. The result is that a federal thrift can branch without regard to state law and rules of entry.

And through creative interpretations of the National Bank Act, the Office of the Comptroller of the Currency has circumvented the application of Riegle-Neal to national bank "branch-like" operations.

These interpretations have placed state-chartered institutions, particularly community banks in multistate markets, at a competitive disadvantage to those larger, federally-chartered institutions that can branch without restriction.

We encourage you to revisit the Riegle-Neal Act, and we urge Congress to eliminate the disadvantage has been created for state banks because of inconsistent application of federal law. CSBS appreciates the House action to rationalize the application of interstate branching laws between state and federal charters. We strongly encourage you to address this issue in any regulatory relief measure put forward by the committee.

Regulatory Flexibility for the Federal Reserve

Additionally, we would favor a provision that would give the Federal Reserve more flexibility with regard to state member banks.

In particular, CSBS encourages you to grant the Federal Reserve more flexibility to allow state member banks to engage in expanded activities authorized by their chartering state and approved by the FDIC as posing no significant risk to the deposit insurance fund.

This amendment would remove a provision in the Federal Reserve Act that places unnecessary limitations on the powers of a state member bank, limiting state member banks to the activities allowed for national banks. As state-chartered nonmember banks have always been allowed to exercise expanded powers – within the confines of safety and soundness – it is an appropriate regulatory relief effort to eliminate this prejudicial and unnecessary distinction between state-chartered member banks and state nonmember banks. This provision does away with this arcane restriction, which has no basis in promoting safety and soundness.

As you know, Congress has consistently reaffirmed the states' ability to craft banking charters to fit their economic needs and experiment with new products and services. Congress once again reaffirmed this authority in 1991, when the Federal Deposit Insurance Corporation Improvement Act (FDICIA) allowed states to continue to authorize powers beyond those of national banks.

An empowered state banking system is essential to the evolution of our banking system and elemental to state economic development. This change would help to advance those goals.

Limited Liability Corporations

The states and CSBS have a long history of advocating and facilitating innovations

within the banking industry, including organizational structures available to state-chartered banks.

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

Through a proposal released for public comment last summer and recently finalized, 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 small number of states now allow state-chartered banks to organize as LLCs, including Maine, Nevada, Texas and Vermont. Discussions with state banking agencies, however, indicate that additional states may consider this option in the future.

State banking departments and bankers alike are interested in the LLC operational structure because LLCs offer the same tax advantage (pass-through tax treatment) as Subchapter S corporations, with greater flexibility. LLCs, for example, are not subject to the limits on the number and type of shareholders that apply to a Subchapter S corporation. It remains an open question, however, whether pass-through taxation status for federal income tax purposes will be available to 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 rethink its interpretation of the tax treatment of state-chartered LLCs.

Federal Financial Institutions Examination Council

CSBS would like to see a state banking regulator have a vote on the Federal Financial Institutions Examination Council. I am currently Chairman of the State Liaison Committee, which consists of state bank, credit union and savings bank regulators, and as such am able to provide input at the FFIEC council meetings. However, neither I, nor any other state regulator, has any final say in federal policy or examination procedures impacting the institutions that we charter and supervise.

Improved coordination and communication between regulators clearly benefit bankers and reduce regulatory burdens. In that spirit, we suggest that Congress could improve the Federal Financial Institutions Examination Council (FFIEC) by changing the state position from one of observer to that of full voting member.

As we have stated previously, State bank supervisors are the chartering authorities for over seventy four percent of the banking industry, and are thus vitally concerned with changes in regulatory policy and procedures.

EGRPRA Recommendations

In addition, CSBS has participated in, and has been very supportive of, the FFIEC's EGRPRA initiative since its kickoff last June. Working with our Bankers Advisory Board, we have identified several issues that deserve Congress's attention. We have attached our comment letter to this testimony to be included in the record.

Conclusion

As you can see, much can be done to reduce regulatory burden for our nation's banks. Yet CSBS recognizes that America has the finest banking system in the world. As regulators, we want the banks we supervise to be successful. After all, they fuel our economy and keep the wheels of commerce turning.

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. Centralizing authority or financial power in one agency, or in a small group of narrowly-regulated institutions, would threaten the dynamic nature of our financial system.

The quest to streamline the regulatory process while preserving the safety and soundness of our nation's financial system is critical to our economic well-being and to the health of our nation's financial institutions. Like you, and like our federal agency counterparts, we at the state level are constantly balancing the public benefits of regulatory actions against their direct and indirect costs. Our most important guide is the fundamental principle of safety and soundness.

We commend this Committee for its efforts in this area. State bank supervisors appreciate the Committee's interest in eliminating barriers in federal law to allow more innovation from the state charter. We thank you for this opportunity to testify on this very important subject, and look forward to any questions you and the members of the Committee might have.

September 15, 2003

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn: Comments/OES

Re: Economic Growth and Regulatory Paperwork Reduction Act of 1996
Request for Comment (Docket No. 2003-20)

Dear Mr. Feldman:

The Conference of State Bank Supervisors ("CSBS") [1] welcomes the opportunity to respond to the Federal Financial Institution Examination Council's ("FFIEC's") request for comment [2] ("request") on its review of the financial institution regulations to reduce burden imposed on insured depository institutions, as required by section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). We believe it is important to support the goals of materially reducing regulatory burden currently imposed on the financial institution industry. In this regard, we applaud the FFIEC's efforts to reduce and simplify regulations that industry comments indicate are outdated, ineffective, or simply no longer meet the requirements initially enacted by Congress.

The FDIC's Vice Chairman John Reich and his Office have taken the leadership role in this regulatory endeavor. In this role, the Project Manager for the Vice Chairman and the EGRPRA comment and review process, Claude Rollin, has coordinated with CSBS to provide a personal request for comment to several state bank commissioners as well as our Bankers Advisory Board (BAB)[3]. In that request, Mr. Rollin made it clear that the Vice Chairman's Office is very interested in the industry's comments on reducing regulatory burden. Accordingly, CSBS held a conference call with its BAB to obtain the bulk of the comments contained in this letter. In the future, CSBS may share additional comments with the FFIEC from state bank commissioners, including those who serve

[1] CSBS is the professional organization of state officials responsible for chartering, regulating and supervising
the nation's 6,395 state-chartered commercial and savings banks and 419 state-licensed branches and agencies
of foreign banks.
[2] 68 Fed. Reg. 35589, (June 16, 2003).
[3] The CSBS Bankers Advisory Board is the organization's bank membership leadership group, which provides advice and support to the Board of Directors, and serves as a resource to CSBS members and staff throughout the year.

on the FFIEC "State Liaison Committee." We ask that the FFIEC consider all comments to reflect CSBS' view on this extremely important issue.

Background

EGRPRA, passed by Congress in 1996, requires the FFIEC and each appropriate Federal banking agency represented on the FFIEC to conduct a review of all regulations prescribed by the FFIEC or by any such appropriate Federal banking agency to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions. This review must take place at least once every ten years. In conducting the review the FFIEC is required to categorize the regulations and at regular intervals, provide notice and solicit public comment on a particular category or categories of regulations, requesting commentators to identify areas of the regulations that are outdated, unnecessary, or unduly burdensome. The FFIEC will publish the categories for which they are seeking comments twice a year. For this first publication, comments are requested for the following three categories of regulations: Applications and Reporting, Powers and Activities, and International Operations. Accordingly, the FFIEC must complete this review, eliminate unnecessary regulations to the extent that such action is appropriate, and provide an update to Congress no later than 2006.

To encourage full participation in the EGRPRA review, the Vice Chairman's Office has conducted several banker outreach sessions in Orlando, Florida, St. Louis, Missouri, and Denver, Colorado. A state bank commissioner, a CSBS representative, and representatives from all of the other Federal regulatory agencies have participated in all of the outreach sessions.

Industry comments from these outreach sessions have continued to develop a consistent list of regulations that should be reviewed and altered to reduce regulatory burden. The issues most frequently identified by financial institutions as burdensome or outdated include the USA PATRIOT Act, Bank Secrecy Act, Regulation D and the limitations on withdrawals from money market deposit accounts, Home Mortgage Disclosure Act, Expedited Funds Availability Act, Community Reinvestment Act, Truth in Lending Act (with special emphasis on the right of rescission), Privacy notices, and limitations on extending credit to insiders.

CSBS' Bankers Advisory Board Comments

During our conference call with the CSBS Bankers Advisory Board, a member highlighted the importance of the EGRPRA regulatory burden reduction process. This BAB member is the president of a $150-million community bank that employs four to five full time equivalent employees that focus exclusively on compliance. He also noted that non-banking entities do not have such compliance requirements and remarked that

this places his small bank at a competitive disadvantage. CSBS looks forward to working with the Federal banking agencies to reduce regulatory burden where possible.

The BAB conference call coordinated through CSBS uncovered items similar to those identified by industry representatives at the EGRPRA outreach meetings. BAB members provided details that might be of assistance when the FFIEC reviews the amount of burden imposed by these regulations. A summary of their comments and suggestions follows:

Currency Transaction Reports (CTR) and Suspicious Activity Reports (SAR)

- Although it was noted that industry representatives have estimated the cost of each CTR to be $25, that price is likely higher for smaller banks.
- One member of the BAB computed the cost of filing CTRs for his bank, assuming the average $25 per CTR is accurate. His bank generates 240 CTRs a day (approximately 65,000 a year). An average cost of $25 per CTR equates to an annual cost of $1.6 million. Separately, the same bank files about 50 SARs per year. The members of the BAB expressed widespread frustration because it appears that law-enforcement authorities do nothing with CTRs and SARs. One member reported that the FBI has failed to follow up on a SAR submitted two years ago involving a $2.4-million check kiting scheme. Another member of the BAB stated that the FBI has yet to act on a $140,000 note forgery. Law enforcement officials have indicated to both bankers that homeland security matters hinder and prevent investigations such as these. Our members question, if the CTRs are not going to be investigated, why the banks should shoulder such high costs to file them.
- CSBS noted to the BAB members that FinCEN is investigating electronic submissions of CTRs. The bankers, however, noted that their biggest cost involves the research and file-checking that are required to generate CTRs and SARs.
- Furthermore, one of the BAB members noted that banks are required to report on CTRs and SARs, at least in summary form, to their Boards of Directors – another cost item.

USA PATRIOT Act and "Know Your Customer"

- Members of the BAB, especially those in smaller communities, felt the "Know Your Customer" requirements add little value in investigating terrorism.
- When asked about documenting (possibly photocopying) customer identification information to be kept with signature cards, the members felt it would merely be "just another gotcha item" on examiners' checklists. BAB members also expressed concern that maintaining pictures of customers could result in claims of racial bias or profiling.

Limitation of Withdrawals from Money Manager Deposit Accounts
• The members of the BAB felt this limitation is completely outdated. It is anticompetitive to smaller banks that do not have sweep accounts or have to compete with non-bank entities that do not have similar restrictions.

Home Mortgage Disclosure Act (HMDA)
• BAB members believe the small bank threshold for reporting under the Home Mortgage Disclosure Act is no longer realistic. The members suggested increasing the asset threshold to at least $500,000, but $1 or $2 million is more realistic.
• Bankers noted that some holding companies keep a number of charters to stay under the HMDA and CRA asset size.

Community Reinvestment Act (CRA)
• BAB members noted that smaller banks are hardest hit by CRA requirements. It's difficult, if not impossible, for many of the smaller banks to meet the investment criteria.
• One member credited the FDIC as setting a precedent by allowing CRA credit for participation in the Money Smart financial education program. The precedent should be extended to give CRA credit for other good works, such as sponsoring Little League teams and the like.

Expedited Funds Availability
• BAB members agreed that this regulation needs to reviewed. The requirement that funds from cashiers' checks be granted on a next-day basis is generating significant fraud losses due to new technologies that allow scanning and/or color-copies.

Real Estate Settlement Regulations
• BAB members suggest that huge improvements could be made to lessen the regulatory burden in documents required for real estate loan settlement. It was suggested that lessening the amount of disclosure required may assist consumers by allowing them to focus on fewer papers. We have enclosed examples of the settlement documents that one of the BAB members suggested could be eliminated.
• BAB members also suggested that the Truth in Lending Act's right of rescission should be eliminated. Bank customers have complained when they do not receive refinance monies immediately upon loan closing. No bank on the BAB has ever had a right of rescission exercised.

Limitations on Insider Dealings
• For smaller banks, these regulations have the effect of driving their potentially best customers to other institutions. Banks can give preferred loan rates to employees, but not to officers and directors.
• BAB members expressed an interest in having regulators separate insider abuses from
EGRPRA Regulatory Burden Reduction Review

justified preferential treatment for insiders who merit it, as banks can do for employees.

Flood insurance

- FEMA flood maps are often years out of date.
- Generally, flood maps are not changed for 10-12 years, even though action has been taken to change the flood plane. Research, however, to change the 100 year flood plane is costly for banks to consider.
- In those cases where banks attempt to update the flood maps, there are paperwork delays. Examiners criticize banks for making a determination on the flood insurance question until some kind of official paperwork is in the loan file, even though "you know the house is on top of a hill and not going to be flooded," said one BAB member.

Conclusion

CSBS commends the FFIEC's and the FDIC's efforts to review all banking regulations in order to reduce regulatory burden. In conclusion, we would like to highlight that new proposed regulations on identity theft were released following the conference call with our BAB. Such regulations certainly may be necessary to protect consumers against malfeasants taking advantage of changing and updated technologies to commit fraud. As regulations continue to proliferate, however, it is critically important that regulators continually evaluate which regulations may no longer be necessary.

We also note that as the difference between banks, savings associations, credit unions, and investment/ brokerage firms continues to blur, it is important to ensure that financial institutions are not placed at a competitive disadvantage. CSBS further recommends regulators use sunset provisions in regulations. Such provisions would require regulations to be reviewed on a regular basis to ensure the need for the regulation still exists.

CSBS welcomes the opportunity to work with the FFIEC to assist in alleviating outdated an unduly burdensome regulations. Thank you for your consideration, and we invite you to contact CSBS for any additional information or assistance.

Best personal regards,

Neil Milner
President and CEO