Testimony of

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On behalf of

The Financial Services Roundtable

To The

Committee on Banking, Housing and Urban Affairs

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I. Introduction

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, my name is Steve Bartlett and I am President & CEO of The Financial Services Roundtable.

The Roundtable represents 100 of the nation's largest integrated financial services companies. Our members provide banking, insurance and investment products and services to millions of American consumers. Roundtable member companies account for $17.1 trillion in managed assets, $888 billion in revenue, and 2 million jobs.

The Roundtable appreciates the opportunity to share its views on the topic of regulatory relief for financial services firms. We strongly support efforts to reduce the regulatory burden confronting the financial services industry. Outdated laws and regulations impose significant, and unnecessary, burdens on financial services firms, and these burdens not only make our firms less efficient, but also increase the cost of financial products and services to consumers.

I recognize that in some respects I am "preaching to the choir" when I cite the burdens of regulation on financial services firms. This Committee, and Senator Crapo in particular, have been in the forefront of efforts to eliminate unnecessary and overly burdensome laws and regulations applicable to financial services firms. The Roundtable appreciates these efforts, and hopes that they will be fully realized with the enactment of a regulatory burden relief bill in this Congress.

Recently, the Roundtable has undertaken its own initiative aimed at regulatory burden relief. Based upon input from our members, we have identified four major regulatory problems in need of reform. We have undertaken a dialogue with the appropriate federal financial regulatory agencies about these problems, and, in some instances, have recommended specific remedies. I will begin by addressing these four key issues. I also have highlighted a number of other regulatory reforms sought by the Roundtable, many of which were incorporated in H.R. 1375, the Financial Services Regulatory Relief Act, which was approved by the House of Representatives in the last Congress. Please find attached to my testimony an addendum of regulatory relief proposals offered for consideration by The Financial Services Roundtable.

II. The Roundtable's Regulatory Oversight Coalition

Recently, The Roundtable initiated its own effort to reduce excessive regulation. This effort is focused on four regulatory problem areas:

- Suspicious Activity Report (SAR) filing requirements;
- SEC enforcement policies and practices;
- The confidentiality of information that is shared with federal financial regulators; and
- Compliance with Section 404 of the Sarbanes-Oxley Act.

SARs

Roundtable member companies strongly support the government's efforts to combat money laundering and terrorist financing. However, we believe that the current system of reporting suspicious activities is not working properly. The best evidence of this is the dramatic increase in SAR filings in recent years. For example, since 1996, national SAR reporting has increased 453 percent. Similarly, FinCEN reported 81,197 filings in 1997 versus 288,343 filings in 2003. As of October 28, 2004, depository institutions had filed a total of 297,753 SARs, and the total number of SAR filings is projected to double this year.

There are several reasons for this dramatic increase in SAR filings. First, the failure to file SARs has become a criminal issue. The U.S. Justice Department has aggressively pursued actions against financial institutions for failing to file SARs. This criminalization of the filing process has created a huge reputational risk for financial institutions, and has caused institutions to file an increasing number of SARs in order to avoid any potential for prosecution. Second, there are no clear standards for when SARs should be filed. Although guidelines are in place, examiners neither clearly nor consistently apply them. In addition, financial institutions do not receive feedback from law enforcement on the type of information that should be included in the SAR. Third, Roundtable member companies have encountered a "zero tolerance" policy among the federal financial regulatory agencies. Under this policy, institutions are held accountable for every single transaction.

Finally, there is a lack of coordination among the various agencies and examiners responsible for SAR filings. This lack of coordination often results in duplicate requests and multiple filings.

To address these problems, The Roundtable has urged the federal financial regulatory agencies to take the following actions:

- Develop clear, simple guidelines on SARs, which include safe harbor protections for institutions and individuals who file the SAR;
- Draft regulations and/or guidelines that focus on an institution's anti-money laundering program and policies, not individual transactions;
- Coordinate with each other on all examination procedures, and provide consistent interpretations of the Bank Secrecy Act;
- Consider raising the Currency Transaction Report (CTR) threshold above the current $10,000.00 level; and
- Provide additional guidance on Customer Identification Programs, including tailoring the regulations to individual businesses versus a one size fits all approach.

Additionally, the Roundtable recommends that any decision to pursue a criminal charge against a financial institution for failure to file a SAR, or other report required by the Bank Secrecy Act, should be made by the main Justice Department, not a field office, and that such decisions be made in consultation with the appropriate federal financial regulator for the institution.

SEC Enforcement

Roundtable member companies are increasingly concerned about the enforcement policies and practices of the Securities and Exchange Commission (SEC). Just as the Roundtable supports compliance with federal anti-money laundering laws and regulations, the Roundtable supports compliance with our nation's securities laws.

Nonetheless, we believe that compliance is being hindered by certain SEC enforcement policies and practices.

Specifically, the Roundtable believes that there should be a "firewall" between the SEC's examination staff and the Division of Enforcement. A firewall would give institutions a chance to more freely discuss compliance issues and other practices outside of a potential enforcement context. This is the model that has been successfully followed by the federal banking agencies, and we believe that it would enhance, not reduce, compliance with securities laws.

Second, we believe that the SEC should provide a notice to institutions when an investigation is complete. Currently, no such notices are provided, and this practice can have an unnecessary chilling effect on business operations.

Third, as discussed further below, we believe the SEC should drop its policy of "forcing" companies to waive attorney-client privilege in the course of an investigation. This policy is impairing the attorney-client privilege, and this threatens to undermine internal discussion and investigations.

Finally, we believe the SEC should give financial institutions adequate time to respond to broad document requests.

The SEC has said that it will not tolerate unreasonable delays in response to inquiries. The Roundtable does not endorse unreasonable delays, but has found that the SEC's definition of what constitutes an unreasonable delay is often very limited. This has created problems for institutions that are trying to determine what information is relevant and what is protected by the attorney-client privilege.

Confidentiality of Information Shared with Regulators

Financial institutions are required to share an increasing amount of information with federal financial regulators. Reporting and filing requirements imposed by federal law and regulators are a major source of this burden. For example, since the enactment of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, federal banking and thrift regulators have promulgated over 801 final rules, most of which impose various types of reporting and filing requirements. Additionally, financial institutions are asked to provide a wide-range of documents and information to regulators in the course of examinations and investigations.

Unfortunately, this information sharing is threatened by two developments. First, there is the potential for confidential information that is shared with a federal financial regulator to become accessible by third parties. Needless to say, this potential can have significant chilling effects on the nature and type of information an institution is willing to share with its regulator.

Second, the Justice Department, the SEC, and the other federal financial regulators have adopted policies that effectively undermine the attorney-client privilege. Under these policies, the wavier of the attorney-client privilege is a condition for being deemed "cooperative" with the agency, and the failure to waive the privilege can adversely affect the nature of the charges that may be brought in an enforcement case or the size of any civil money penalty that may be assessed against an institution. Such policies can have significant unintended consequences:

- They have a chilling effect on the communications between management, boards of directors and their attorneys because of the uncertainty over what conversations and work-product is protected:
- They discourage internal investigations. The current regulatory environment, including reforms brought about by the Sarbanes-Oxley Act, encourages companies to conduct thorough internal investigations and, to the extent necessary, communicate the results of those investigations to the appropriate federal regulators. Yet, the likelihood that such communications will result in a waiver of the attorney-client privilege creates a disincentive to conducting investigations. Thus, the current waiver policy is directly counter to the goals of Sarbanes-Oxley and similar regulatory reforms. Furthermore, the policies place employees in a difficult position during the course of investigations. If employees cooperate in an investigation, their statements may have to be provided to the investigation agency. If an employee decided not to cooperate and withholds information, the employee risks termination or other action against them.

To protect the confidentiality of information given to a federal financial regulator, the Roundtable urges the enactment of legislation similar to The Financial Services Antifraud Network Act of 2001 (also known as the Bank Examination Report Privilege Act or BERPA), which was proposed in the 107th Congress[1], and the Securities Fraud

[1] H.R. 1408, Financial Services Antifraud Network Act of 2001, U.S. House of Representatives, 107th Congress (November 7, 2001).

Deterrence and Investor Restitution Act, which was proposed in the 108th Congress.[2] These proposals would protect the integrity and effectiveness of the information shared with federal financial regulators. For example, BERPA would clarify that information voluntarily disclosed to an examining agency continues to be protected by the institution's own privileges. BERPA also would codify and strengthen the bank supervisory privilege by defining confidential supervisory information, affirming that such information is the property of the agency that created or requested it, and protecting this information from unwarranted disclosure to third parties. Furthermore, BERPA would reaffirm the agencies' powers to establish procedures governing the production of confidential supervisory information to third parties.

The Roundtable also recommends that such legislation be expanded to cover information shared with an institution's auditors. The Sarbanes-Oxley Act protects privileged documents provided to the Public Company Accounting Oversight Board (PCAOB) in connection with the inspections and investigations of registered audit firms.

This protection, however, does not extend to information obtained by the auditors themselves. Ensuring that information shared with auditors can remain subject to confidentiality will help to ensure the flow of information between an institution and its auditors.

With respect to the governmental policies that have the effect of undermining the attorney-client privilege, The Roundtable recommends that Congress make it clear to the

[2] H.R. 2179, Securities Fraud Deterrence and Investor Restitution Act, U.S. House of Representatives, 108th Congress (May 21, 2003).

Justice Department and the federal financial regulators that the waiver of the privilege should not be a matter of policy in all investigations.

Section 404 of the Sarbanes-Oxley Act

Section 404 of the Sarbanes-Oxley Act requires SEC-reporting firms to conduct annual assessments of the effectiveness of their internal controls, and to have their auditors independently attest to and report on this assessment. The Roundtable supports the goals of this section. Strong corporate governance and transparency of management structure and internal controls are important. Nonetheless, the Roundtable has identified a certain substantial concern with the implementation of Section 404.

Most notably, Section 404 has changed the role of auditors. It has made auditors hesitant to provide advice to clients, caused auditors to impose excessive testing and documentation requirements on clients, and significantly increased the cost of outside audits.

Additionally, Section 404 has imposed significant initial and on-going costs on companies. A recent survey by Financial Executives International found that the total cost of compliance per company is approximately $4.36 million. These costs include large increases in external costs for consulting, software and other vendors, additional personnel, and, as noted above, additional fees by external auditors.

Furthermore, Roundtable members have encountered confusion over the standards in Section 404. For example, we find a need for clarity on the meaning of terms such as "material weakness" and "significant controls."

III. Other Needed Regulatory Reforms

There are a number of other needed regulatory reforms that the Roundtable urges the Committee to consider as it crafts regulatory relief legislation. I will start by highlighting provisions from H.R. 1375, and then list some other recommended changes to federal law.

Interstate Banking

It was exactly ten years ago that Congress enacted the landmark Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. Since then, the public benefits anticipated by that Act have been realized.

The creation of new bank branches has helped to maintain the competitiveness of our financial services industry, and has improved access to financial products in otherwise underserved markets. Branch entry into new markets has enhanced competition in many markets, and this, in turn, has resulted not only in a better array of financial products and services for households and small businesses, but also in competitive prices for such products and services. There is, however, one remaining legal barrier to interstate branching, which should be eliminated.

Under the Riegle-Neal Act, a bank cannot establish a new or so-called "de novo" interstate branch without the affirmative approval of a host state. Since 1994, only 17 states have given that approval; 33 states have not. The time has come to remove this barrier to interstate branching. The Roundtable urges the Committee to do so by incorporating Section 401 from H.R. 1375 in its version of regulatory relief legislation.

Section 401 eliminates the provision in the Riegle-Neal Act that requires state approval for de novo branching. In other words, the enactment of Section 401 would allow a bank to establish new branches in any state, without limitations.

Section 401 is supported by the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Conference of State Bank Supervisors. These federal and state regulators recognize the public benefits associated with expanding access to banking offices. They also realize that current law has created some competitive disparities between different types of institutions.

Section 401 also makes other useful modifications to interstate operations. It removes a minimum requirement on the age of a bank that is acquired by an out-of-state bank. It allows state bank supervisors to permit state banks to engage in interstate trust activities similar to the trust activities permissible for national banks. It facilitates mergers and consolidations between insured banks and uninsured banks with different home states. All of these changes facilitate the provision of banking products and services to consumers.

Coordination of State Exams

A second provision related to interstate banking that we would urge the Committee to incorporate in its version of regulatory relief legislation is Section 616 of H.R. 1375. Section 616 of H.R. 1375 clarifies the authority of state banking supervisors over interstate branches of state chartered banks. It provides that the banking supervisor of the state in which a bank is chartered (a "home" state supervisor) is responsible for the examination and supervision of branches located in other states, and that only a home state supervisor may impose supervisory fees on interstate branches. Section 616 also encourages state banking supervisors to enter into cooperative supervisory agreements related to the examination and supervision of state banks with interstate operations. Such an agreement could provide for joint examinations, and even the assessment of joint supervisory fees. Furthermore, Section 616 acknowledges the authority of a "host" state banking supervisor to examine the interstate branches of state banks for compliance with host state law.

The addition of this provision will help to avoid needless confusion, and potential conflict, over the examination and supervision of the interstate branches of state banks.

Regulation of Thrift Institutions

While The Roundtable supports all of the thrift provisions in H.R. 1375, I would highlight three of those provisions, which are particularly important to our members.

Parity for Thrifts Under the Federal Securities Laws

Section 201 of H.R. 1375 would establish regulatory parity between the securities activities of banks and thrifts. For years, the brokerage and investment activities of commercial banks have enjoyed exemptions under federal securities laws.[3] As a result, the securities activities of banks have been subject to regulation by banking regulators,

[3] The scope of this exemption was narrowed in the Gramm-Leach-Bliley Act.

not the Securities and Exchange Commission. Thrift institutions, on the other hand, have not enjoyed similar exemptions under the Exchange Act or the Investment Advisors Act, even though Congress has, over time, permitted thrifts to engage in the same brokerage and investment activities as commercial banks.[4] As a result, the securities activities of thrifts have been subject to regulation by both the Securities and Exchange Commission (SEC) and the Office of Thrift Supervision (OTS).

Using its rulemaking powers, the SEC has attempted to address this regulatory disparity, first by granting thrifts a regulatory exemption under the Exchange Act, and, most recently, by proposing a limited exemption for thrifts under the Investment Advisors Act. Unfortunately, those actions by the SEC do not fully resolve the disparity between the regulation of banks and thrifts. Therefore, we urge the Committee to include Section 201 in its version of regulatory relief legislation.

Section 201 would establish an explicit exemption for thrifts in the Exchange Act that is comparable to the exemption for commercial banks. This statutory change would remove any doubt about the permanence of the existing regulatory exemption adopted by the SEC.

Section 201 also would make the exemption for thrifts under the Investment Advisors Act parallel to the current exemption for banks. The regulation recently proposed by the SEC grants thrifts an exemption from SEC regulation only when they are engaged in investment advisory activities in connection with trust activities. It would not apply to other investment advisory services, such as retail planning services. Section 201

[4] In 1999, Congress did amend the Investment Company Act to treat thrifts the same as banks.

draws no such distinction. It would give thrifts the same exemption as commercial banks.

The OTS examines the securities-related activities of thrifts, just as the OCC and other banking agencies examine the securities-related activities of commercial banks. Thus, the exemptions proposed in Section 201 do not leave a regulatory void. They simply place thrifts on regulatory par with commercial banks, by eliminating the costs associated with registration with the SEC.

Auto Loans

The Roundtable urges the Committee to incorporate Section 208 of H.R. 1375 in its version of regulatory relief legislation. Current law limits the amount of automobile loans by a thrift to no more than 35 percent of the institution's assets. Section 208 would remove this ceiling. Congress has previously determined that credit card loans and education loans by thrifts should not be subject to any asset limitation. Automobile loans should be placed in this same category. Doing so will allow thrifts to further diversify their portfolios and enhance their balance sheets. Also, this provision would increase competition in the auto loan business, to the benefit of consumers.

Dividends

The Roundtable supports Section 204 of H.R. 1375. Section 204 would replace a mandatory dividend notice requirement for thrifts owned by savings and loan holding companies with an optional requirement under the control of the Director of OTS. The existing mandatory requirement is no longer necessary. Other existing federal statutes and regulations give the OTS the authority to ensure that thrifts held by holding companies pay dividends only in appropriate circumstances. Moreover, the current mandatory requirement applies only to thrifts owned by savings and loan holding companies, not to those owned by other companies or banks. Thus, Section 204 removes a disparity in regulation that need not exist.

Cross Marketing

Presently, an insurance affiliate of a financial holding company may engage in cross-marketing with a company in which the insurance affiliate has made an investment if (1) the cross-marketing takes place only through statement inserts and Internet websites; (2) the cross-marketing activity is conducted in accordance with the anti-tying restrictions of the Bank Holding Company Act (BHCA); and (3) the Board determines that the proposed arrangement is in the public interest, does not undermine the separation of banking and commerce, and is consistent with the safety and soundness of depository institutions. Under current law, however, a merchant banking affiliate of a financial holding company may not engage in such limited cross-marketing activities with the companies in which it makes investments. The Roundtable urges the Committee to amend the BHCA and establish parity of treatment between financial holding companies that own insurance affiliates and those that own merchant banking affiliates.

We also urge that the Committee permit a depository institution subsidiary of a financial holding company to engage in cross-marketing activities with a nonfinancial company held by a merchant banking affiliate if the nonfinancial company is not controlled by the financial holding company. When a financial holding company does not control a portfolio company, cross-marketing activities are unlikely to materially undermine the separation between banking and commerce.

In these non-control situations, the separation of banking and commerce is maintained by the other restrictions contained in the BHCA that limit the holding period of the investment and restrictions that limit the financial holding company's ability to manage and operate the portfolio company.

These proposed modifications to the BHCA were incorporated in Section 501 of H.R. 1375.

SEC Regulation of Broker-Dealers

Sections 201 and 202 of the Gramm-Leach-Bliley Act were intended to provide for SEC regulation of certain new securities activities, but permit banks to continue to engage directly in traditional trust and accommodation activities, that have long been regulated by the banking agencies. The Gramm-Leach-Bliley Act never envisioned that banks would be forced to "push out" traditional trust activities into SEC regulated companies. Despite this clear Congressional intent, the SEC has issued proposed regulations that would do exactly that – it would force banks to divest historic business lines and push them out to registered broker-dealers. The Federal Reserve and the OCC have objected to these proposed regulations, and their comment letter to the SEC emphasizes the importance of issuing a regulation that conforms to Congressional intent.

Nevertheless, the SEC appears adamant in going forward with a far-reaching regulation that would effectively require banks to cease engaging in many traditional banking activities. The Committee should amend the Gramm-Leach-Bliley Act to strike sections 201 and 202 to ensure that banks may continue to engage in traditional banking funtions without the threat of having to push these activities out into a nonbanking company.

Diversity Jurisdiction

Under the law, citizens of two different states may avail themselves of the federal courts if certain jurisdictional thresholds are met. Every corporation is deemed to be a citizen of two states: (1) the state of incorporation; and (2) the state in which it has its principal place of business, if different. Thus a company with offices in every state will still be able to use the federal courts, as long as the other party is not a citizen of the company's "home" state.

National banks and federal savings associations are treated differently. The statute provides that a national bank is a citizen in the state in which it is located, and at least one court has held that this means every state in which the bank has a branch. For federal savings associations, there is no provision governing their citizenship, and this issue has to be litigated over and over.

We urge the Committee to amend the law to clarify that both a national bank and a federal savings association are citizens of the state in which the institution's main or home office is located and the state in which they maintain their principal place of business, if different. This would put national banks and federal thrift associations under the same rules that apply to every other corporation in America.

Anti-Tying

We urge the Committee to repeal the price variance feature of the existing anti-tying rule so that a banking institution can give a price break to commercial customers if that commercial customer decides to purchase other products and services from the institution. Banks should have the ability to offer a commercial customer a price break on a product or service if the commercial customer decides to buy another product or service. This change would not encourage anti-trust activities. Unlike the classic tying case, the customer could not be forced into buying a product. If the customer thinks the price break is good enough, he or she can buy the product. If the customer does not think the price break is good enough, he or she is under no obligation to buy the product. Furthermore, our proposed change would apply only to commercial customers, not individuals or small businesses.

Simplified Privacy Notice

Like many consumers, the Roundtable member companies have found that the privacy notice required by the GLBA is overly confusing, and largely ignored by many consumers.

Accordingly, we recommend that the Committee use this opportunity to simplify the form of the notice required by GLBA.

There is extensive research in support of simple notices. That research indicates that consumers have difficulty processing notices that contain more than seven elements, and require the reader to translate vocabulary used in the notice into concepts they understand. Consumer surveys also indicate that over 60 percent of consumers would prefer a shorter notice than the lengthy privacy policy mandated by GLBA.

Recognizing the problem created by the existing GLBA privacy notice, the federal banking agencies, the FTC, NCUA, CFTC and SEC recently requested comment on alternative notices that would be more readable and useful to consumers. These federal agencies, however, lack the authority to make a simplified notice truly consumer-friendly because they cannot address conflicting and overlapping state privacy laws. Section 507 of GLBA permits individual states to adopt privacy protections that are "greater" than those established by GLBA. This provision allows states to adopt their own privacy notices, and this simply adds to consumer confusion and frustration.

We strongly recommend that the Committee include a provision in its version of regulatory relief legislation that directs the relevant federal agencies to finalize a simplified privacy notice for purposes of GLBA, and provides that such a notice supersede state privacy notices. As the research has indicated, consumers will be better served if they are given a simple, uniform explanation of an institution's privacy policy and their privacy rights.

Real Estate Brokerage

The Financial Services Roundtable strongly supports the authorization of financial services holding companies to engage in real estate brokerage activities. We believe that the Gramm-Leach-Bliley Act of 1999 clearly contemplated this would be a permissible "financial activity" for financial services holding companies, and thus can be authorized by a joint rulemaking of the Treasury Department and the Federal Reserve Board. We also strongly support legislation, such as H.R. 2660 sponsored by Chairman Oxley and Ranking Member Frank in the House, that would define this activity as "financial" without the need for a rulemaking proceeding.

IV. Conclusion

In conclusion, the Roundtable appreciates the efforts of the Committee to eliminate laws and regulations that impose significant, and unnecessary, burdens on financial services firms. The costs savings that will result from this regulatory relief legislation will benefit the consumers of financial products and services. We look forward to working with the Committee on this important legislation.

Addendum

Clarification of Cross Marketing Provision

Provide that the cross-marketing prohibition applicable to financial holding companies and their merchant banking investments would apply only to entities *controlled* by a financial holding company. The current cross-marketing provision was enacted by GLBA to provide a safeguard against the mixing of banking and commerce. As a practical matter, this proposal would allow cross-marketing arrangements between depository institutions and non-financial companies when the shares of those companies are owned or controlled by a securities firm or its affiliate, because those are not merchant banking activities or between depository institutions and non-financial entities where the financial holding company does not *control* the entity in which it has a interest under merchant banking authority.

Clarification of Brokered Deposits

Provide a new definition for brokered deposits so that the safety & soundness purpose of the brokered-deposit law and regulation can be served. That purpose is to identify & control deposits that are likely to be more volatile than most, and to report that situation on the call reports. That purpose is not served if the definition sweeps too broadly. By doing so, it will flag a larger quantity of brokered deposits on the call report as hot money than really is. This defeats the purpose of the report, and also may create (rather than reduce) safety & soundness issues by increasing reputation risk for the affected institutions

Increase Competition in Real Estate Activities

Provide authorization of financial services holding companies to engage in real estate brokerage activities. Support H.R. 2660 that would define this activity as "financial" without the need for a rulemaking proceeding.

Provide new exemption under Bank Merger Act

Add a *de minimis* exception for small deposit transactions among affiliated depository institutions. Since those institutions are already under common control, those transactions do not pose any competitive issues of the sort that the Bank Merger Act is primarily directed at.

Technical amendment clarifying the operating subsidiaries of a BHC

Amend Section 4(c)(1)(C) of the Bank Holding Act of 1956 to read: "(C) furnishing services to or performing services for such bank holding company or its subsidiaries;

The only change made by this amendment is to strike the word “banking”. The amendment clarifies that a Section 4 (c)(1)(C) subsidiary of a bank holding company may provide services not only to the bank holding company and its banking subsidiaries, but also to its non-banking subsidiaries and thereby confirms the Federal Reserve’s interpretation, while eliminating the regulatory requirements that the subsidiary be wholly owned.