

**Testimony of
America's Community Bankers
on
Consideration of Regulatory Reform Proposals
before the
Committee on Banking, Housing and Urban Affairs
of the
United States Senate
on
June 22, 2004**

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

and

**Member, Board of Directors
Chairman, Committee on Mutual Institutions
Member, Government Affairs Steering Committee
America's Community Bankers
Washington, DC**

Chairman Shelby, Senator Sarbanes and Members of the Committee, I am Mark Macomber, President and CEO of Litchfield Bancorp in Litchfield, Connecticut. Litchfield Bancorp is a \$162 million state chartered community bank, part of a two bank mutual holding company.

I am here this morning representing America's Community Bankers. I serve on ACB's Board of Directors and Executive Committee and am Chairman of the Mutual Institutions Committee. I want to thank Chairman Shelby and Senator Crapo for their leadership in initiating the discussion today of the impact of outdated and unnecessary regulations on community banks and the communities they serve.

ACB is pleased to have this opportunity to discuss with the committee recommendations to reduce the regulatory burden and red tape on community banks. When unnecessary and costly regulation is removed, community banks will be able to better serve consumers and small businesses in their local markets. ACB has a long-standing position in support of reduction of regulatory burden. Community banks operate under a regulatory scheme that becomes more and more burdensome every year.

Community banks today are subject to a host of laws, some over a half-century old, which were originally enacted to address concerns that no longer exist. These laws stifle innovation in the banking industry and put up needless roadblocks to competition without contributing to the safety and soundness of the banking system. The burden of these laws results in lost business opportunities for community banks. But, consumers

and businesses also suffer because their choices among financial institutions and financial products are more limited as a result of these laws, and, in the end, less competition means consumers and businesses pay more for these services.

In addition to the regulations imposed on community banks to ensure safe and sound operation of the bank and to protect the deposit insurance fund, we must comply with an array of consumer compliance regulations, anti-money laundering regulations and new corporate governance standards enacted in the Sarbanes-Oxley Act. As a community banker, I understand the importance of reasonable consumer protection regulations, and I understand the importance of tracking and eliminating terrorist financing mechanisms and also of having a strong corporate governance system in place. As a community banker, I see how much it costs, both financially and in numbers of staff hours for my small mutual community bank to comply with these laws. As a community banker, I see projects that will not get funded, products not offered and consumers not served because I have had to make a large resource commitment to comply with the same regulations with which banks thousands of times larger must comply.

This hearing and this topic are important and timely. Ten years ago there were 12,000 banks in the US. Today, there are only 9,000 of us left. ACB is concerned that community banks are unable to compete with financial services conglomerates and unregulated companies because of the cost of regulation. Community banks are at the heart of cities and towns everywhere and to lose that segment of the industry because of over regulation would be a shame.

Now let me turn to the subject of today's hearing. ACB has a number of recommendations to reduce regulations on community banks that will help make doing business easier and less costly, further enabling community banks to help their communities prosper and create jobs. ACB's specific legislative proposals are attached in an appendix. The House of Representatives adopted many of ACB's recommendations in the Financial Services Regulatory Relief Act of 2003 (H.R. 1375), by an overwhelming bipartisan vote of 392 to 25.

Priority Issues

Expanded Business Lending

A high priority for ACB is a modest increase in the business-lending limit for savings associations. In 1996, Congress liberalized the commercial lending authority for federally chartered savings associations by adding a 10 percent "bucket" for small business loans to the 10 percent limit on commercial loans. Today, savings associations are increasingly important providers of small business credit in communities throughout the country. As a result, even the "10 plus 10" limit poses a constraint for an ever-increasing number of institutions. Expanded authority would enable savings associations to make more loans to small- and medium-sized businesses, thereby enhancing their role as community-based lenders. An increase in commercial lending authority would help increase small business access to credit, particularly in smaller communities where the

number of financial institutions is limited. To accommodate this need, ACB supports eliminating the lending limit restriction on small business loans while increasing the aggregate lending limit on other commercial loans to 20 percent. Under ACB's proposal, these changes would be made without altering the requirement that 65 percent of an association's assets be maintained in assets required by the qualified thrift lender test.

Parity Under the Securities Exchange Act and Investment Advisers Act

ACB vigorously supports providing parity for savings associations with banks under the Securities Exchange Act and Investment Advisers Act. Statutory parity will ensure that savings associations and banks are under the same basic regulatory requirements when they are engaged in identical trust, brokerage and other activities that are permitted by law. As more savings associations engage in trust activities, there is no substantive reason to subject them to different requirements. They should be subject to the same regulatory conditions as banks engaged in the same services. The Securities and Exchange Commission has issued a proposal that would not grant parity for savings associations. We do not believe that the regulatory proposal is adequate and believe that a legislative change is necessary.

The Securities and Exchange Commission has already recognized that it is appropriate to treat banks and savings associations the same under these acts by proposing regulations that provide parity for certain of the exemptions from broker dealer registration under the Securities Exchange Act. ACB supports a legislative change. Such

a change will ensure that savings associations will have the same flexibility as banks to develop future products and offer services that meet customers' needs.

Easing Restrictions on Interstate Banking and Branching

ACB strongly supports removing unnecessary restrictions on the ability of national and state banks to engage in interstate branching. Currently, national and state banks may only engage in de novo interstate branching if state law expressly permits. ACB recommends eliminating this restriction. The law also should clearly provide that state-chartered Federal Reserve member banks may establish de novo interstate branches under the same terms and conditions applicable to national banks. ACB recommends that Congress eliminate states' authority to prohibit an out-of-state bank or bank holding company from acquiring an in-state bank that has not existed for at least five years. The new branching rights should not be available to newly acquired or chartered industrial loan companies with commercial parents (those that derive more than 15 percent of revenues from non-financial activities).

Other Important Issues

Streamlined CRA Examinations

ACB strongly supports amending the Community Reinvestment Act to allow community banks with less than \$1 billion dollars in assets to participate in the CRA's small institution examination program. According to a report by the Congressional Research Service, a community bank participating in the streamlined CRA exam can save 40 percent in compliance costs. Expanding the small institution exam program will free up capital and other resources for almost 1,700 community banks across our nation that are in the \$250 million to \$1 billion asset-size range, allowing them to invest even more into their local communities.

Interest on Business Checking

Prohibiting banks from paying interest on business checking accounts is long outdated, unnecessary and anti-competitive. Restrictions on these accounts make community banks less competitive in their ability to serve the financial needs of many business customers. Permitting banks and savings institutions to pay interest directly on demand accounts would be simpler. Institutions would benefit by not having to spend time and resources trying to get around the existing prohibition. This would benefit many community depository institutions that cannot currently afford to set up complex sweep operations for their – mostly small – business customers.

In this Congress, ACB supported two pieces of legislation, adopted by the House of Representatives, that would repeal the Depression-era ban: H.R. 758, the Business Checking Freedom Act of 2003, and Title VII of H.R. 1375, the Business Checking Freedom Act of 2004. ACB urges the Senate to adopt this legislation either as part of a broader regulatory relief package or as a stand-alone bill.

Eliminating Unnecessary Branch Applications

A logical counterpart to proposals to streamline branching and merger procedures would be to eliminate unnecessary paperwork for well-capitalized banks seeking to open new branches. National banks, state-chartered banks, and savings associations are each required to apply and await regulatory approval before opening new branches. This process unnecessarily delays institutions' plans to increase competitive options and increase services to consumers, while serving no important public policy goal. In fact, these requirements are an outdated holdover from the times when regulatory agencies spent unnecessary time and effort to determine whether a new branch would serve the "convenience and needs" of the community.

Coordination of State Examination Authority

ACB supports the adoption of legislation clarifying the examination authority over state-chartered banks operating on an interstate basis. ACB recommends that Congress

clarify home- and host-state authority for state-chartered banks operating on an interstate basis. This would reduce the regulatory burden on those banks by making clear that a chartering state bank supervisor is the principal state point of contact for safety and soundness supervision and how supervisory fees may be assessed. These reforms will reduce regulatory costs for smaller institutions.

Limits on Commercial Real Estate Loans

ACB recommends increasing the limit on commercial real estate loans, which applies to savings associations, from 400 to 500 percent of capital, and giving the OTS flexibility to increase that limit. Institutions with expertise in non-residential real property lending and which have the ability to operate in a safe and sound manner should be granted increased flexibility. Congress could direct the OTS to establish practical guidelines for non-residential real property lending that exceeds 500 percent of capital.

Loans to One Borrower

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

The per-unit limit is an excessive regulatory detail that creates an artificial market restriction in high-cost areas.

Home Office Citizenship

ACB recommends that Congress amend the Home Owners' Loan Act to provide that for purposes of jurisdiction in federal courts, a federal savings association is deemed to be a citizen of the State in which it has its home office. Federal law already provides that all national banks are deemed citizens of the states in which they are located for jurisdictional purposes. (28 U.S.C. 1348) No similar provision exists for federal savings associations. For purposes of obtaining diversity jurisdiction in federal court, the courts have found that a federal savings association is considered a citizen of the state in which it is located only if the association's business is localized in one State. If a Federal savings association has interstate operations, a court may find that the federally chartered corporation is not a citizen of any state, and therefore no diversity of citizenship can exist. The amendment would provide certainty in designating the state of their citizenship.

Interstate Acquisitions

ACB supports the adoption of legislation to permit multiple savings and loan holding companies to acquire associations in other states under the same rules that apply to bank holding companies under the Riegle-Neal Interstate Banking and Branching

Efficiency Act of 1994. This would eliminate restrictions in current law that prohibit (with certain exceptions) a savings and loan holding company from acquiring a savings association if that would cause the holding company to become a multiple savings and loan holding company controlling savings associations in more than one state.

Application of QTL to Multi-State Operations

ACB supports legislation to eliminate state-by-state application of the QTL test. This better reflects the business operations of savings associations operating in more than one state.

Applying International Lending Supervision Act to OTS

ACB recommends that the ILSA be amended to clarify that the ILSA covers savings associations. Such a provision would benefit OTS-regulated savings associations operating in foreign countries by assisting the OTS in becoming recognized as a consolidated supervisor, and it would promote consistency among the federal banking regulators in supervising the foreign activities of insured depository institutions.

OTS Representation on Basel Committee on Banking Supervision

ACB recommends another amendment to the ILSA that would add OTS to the multi-agency committee that represents the United States before the Basel Committee on Banking Supervision. Savings associations and other housing lenders would benefit by having the perspective of the OTS represented during the Basel Committee's deliberation.

Parity for Savings Associations Acting as Agents for Affiliated Depository Institutions

ACB recommends that the Federal Deposit Insurance Act be amended to give savings associations parity with banks to act as agents for affiliated depository institutions. This change will allow more consumers to access banking services when they are away from home.

Inflation Adjustment under the Depository Institution Management Interlocks Act

ACB supports increasing the exemption for small depository institutions under the DIMA from \$20 million to \$100 million. This will make it easier for smaller institutions to recruit high quality directors. The original \$20 million level was set a number of years ago and is overdue for an adjustment.

Reducing Debt Collection Burden

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

Mortgage Servicing Clarification

The FDCPA requires a debt collector to issue a “mini-Miranda” warning when it begins to attempt to collect a debt. This alerts the borrower that his debt has been turned over to a debt collector. However, the requirement also applies in cases where a mortgage servicer purchases a pool of mortgages that include delinquent loans. While the mini-Miranda warnings are clearly appropriate for true third party debt collection activities, they are not appropriate for mortgage servicers who will have an ongoing relationship with the borrower.

ACB urges the adoption of legislation to exempt mortgage servicers from the mini-Miranda requirements. The proposed exemption (based on H.R. 314, the Mortgage Servicing Clarification Act) is narrowly drawn and would apply only to first lien mortgages acquired by a mortgage servicer for whom the collection of delinquent debts is

incidental to its primary function of servicing current mortgages. The exemption is narrower than one recommended by the FTC for mortgage servicers. The amendment would not exempt mortgage servicers from any other requirement of the FDCA.

Repealing Overlapping Rules for Purchased Mortgage Servicing Rights

ACB supports eliminating the 90-percent-of-fair-value cap on valuation of purchased mortgage servicing rights. ACB's proposal would permit savings associations to value purchased mortgage servicing rights, for purposes of certain capital and leverage requirements, at more than 90 percent of fair market value – up to 100 percent – if the federal banking agencies jointly find that doing so would not have an adverse effect on the insurance funds or the safety and soundness of insured institutions.

Loans to Executive Officers

ACB recommends legislation that eliminates the special regulatory \$100,000 lending limit on loans to executive officers. The limit applies only to executive officers for “other purpose” loans, i.e., those other than housing, education, and certain secured loans. This would conform the law to the current requirement for all other officers, i.e., directors and principal shareholders, who are simply subject to the loans-to-one-borrower limit. ACB believes that this limit is sufficient to maintain safety and soundness.

Decriminalizing RESPA

ACB recommends striking the imprisonment sanction for violations of RESPA. It is highly unusual for consumer protection statutes of this type to carry the possibility of imprisonment. Under the ACB's proposal, the possibility of a \$10,000 fine would remain in the law, which would provide adequate deterrence.

Bank Service Company Investments

Present federal law stands as a barrier to a savings association customer of a Bank Service Company from becoming an investor in that BSC. A savings association cannot participate in the BSC on an equal footing with banks who are both customers and owners of the BSC. Likewise, present law blocks a bank customer of a thrift service corporation from investing in the savings association service corporation.

ACB proposes legislation that would provide parallel investment ability for banks and thrifts to participate in both BSCs and savings association service corporations. ACB's proposal preserves existing activity limits and maximum investment rules and makes no change in the roles of the federal regulatory agencies with respect to subsidiary activities of the institutions under their primary jurisdiction. Federal savings associations thus would need to apply only to OTS to invest.

Eliminating Savings Association Service Company Geographic Restrictions

Currently, savings associations may only invest in savings association service companies in their home state. ACB supports legislation that would permit savings associations to invest in those companies without regard to the current geographic restrictions.

Streamlining Subsidiary Notifications

ACB recommends that Congress eliminate the unnecessary requirement that a state savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary. Under ACB's proposal, a savings association would still be required to notify the OTS, providing sufficient regulatory oversight.

Authorizing Additional Community Development Activities

Federal savings associations cannot now invest directly in community development corporations, and must do so through a service corporation. National banks and state member banks are permitted to make these investments directly. Because many savings associations do not have a service corporation and choose for other business reasons not to establish one, they are not able to invest in CDCs.

ACB supports legislation to extend CDC investment authority to federal savings associations under the same terms as currently apply to national banks.

Eliminating Dividend Notice Requirement

Current law requires a savings association subsidiary of a savings and loan holding company to give the OTS 30 days' advance notice of the declaration of any dividend. ACB supports the elimination of the requirement for well-capitalized associations that would remain well capitalized after they pay the dividend. Under this approach, these institutions could conduct routine business without regularly conferring with the OTS. Those institutions that are not well capitalized would be required to pre-notify the OTS of dividend payments.

Reimbursement for the Production of Records

ACB's members have long supported the ability of law enforcement officials to obtain bank records for legitimate law enforcement purposes. In the Right to Financial Privacy Act of 1978, Congress recognized that it is appropriate for the government to reimburse financial institutions for the cost of producing those records. However, that act provided for reimbursement only for producing records of individuals and partnerships of five or fewer individuals. Given the increased demand for corporate records, such as records of organizations that are allegedly fronts for terrorist financing, ACB

recommends that Congress broaden the RFPA reimbursement language to cover corporate and other organization records.

ACB also recommends that Congress clarify that the RFPA reimbursement system applies to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (title III of the USA PATRIOT Act). Because financial institutions will be providing additional records under the authority of this new act, it is important to clarify this issue.

Extending Divestiture Period

ACB recommends that unitary savings and loan holding companies that become multiple savings and loan holding companies be provided 10 years to divest non-conforming activities, rather than the current two-year period. This would be consistent with the time granted to new financial services holding companies for similar divestiture under the Gramm-Leach-Bliley Act. The longer time gives these companies time to conform to the law without forcing a fire-sale divestiture.

Restrictions on Auto Loan Investments

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

limitation will expand consumer choice by allowing savings associations to allocate additional capacity to this important segment of the lending market.

Credit Card Savings Associations

Under current law, a savings and loan holding company cannot own a credit card savings association and still be exempt from the activity restrictions imposed on companies that control multiple savings associations. However, a savings and loan holding company could charter a credit card institution as a national or state bank and still be exempt from the activity restrictions imposed on multiple savings and loan holding companies. ACB proposes that the Home Owners' Loan Act be amended to permit a savings and loan holding company to charter a credit card savings association and still maintain its exempt status. Under this proposal, a company could take advantage of the efficiencies of having its regulator be the same as the credit card institution's regulator.

Protection of Information Provided to Banking Agencies

Recent court decisions have created ambiguity about the privileged status of information provided by depository institutions to bank supervisors. ACB recommends the adoption of legislation that makes clear that when a depository institution submits information to a bank regulator as part of the supervisory process, the depository institution has not waived any privilege it may claim with respect to that information. Such legislation would facilitate the free flow of information between banking regulators

and depository institutions that is needed to maintain the safety and soundness of our banking system.

Conclusion

I wish to again express ACB's appreciation for your invitation to testify on the importance of reducing regulatory burdens and costs for community banks. We strongly support the Committee's efforts in providing regulatory relief, and look forward to working with you and your staff in crafting legislation to accomplish this goal.