H.R. 3951—THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2002

HEARINGS

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

MARCH 14; APRIL 25, 2002

Printed for the use of the Committee on Financial Services

Serial No. 107–62

U.S. GOVERNMENT PRINTING OFFICE

78–401 PS WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
MARGE ROUKEMA, New Jersey, *Vice Chair*
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Ohio
BOB BARR, Georgia
SUE W. KELLY, New York
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
CHRISTOPHER COX, California
DAVE WELDON, Florida
JIM RYUN, Kansas
BOB RILEY, Alabama
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, North Carolina
DOUG OSE, California
JUDY BIGGERT, Illinois
MARK GREEN, Wisconsin
PATRICK J. TOOMEY, Pennsylvania
CHRISTOPHER SHAYS, Connecticut
JOHN B. SHADEGG, Arizona
VITO FOSSELLA, New York
GARY G. MILLER, California
ERIC CANTOR, Virginia
FELIX J. GRUCCI, JR., New York
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
PATRICK J. TIBERI, Ohio

JOHN J. LAFALCE, New York
BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
KEN BENTSEN, Texas
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
MAX SANDLIN, Texas
GREGORY W. MEEKS, New York
BARBARA LEE, California
FRANK MASCARA, Pennsylvania
JAY INSLEE, Washington
JANICE D. SCHAKOWSKY, Illinois
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
STEPHANIE TUBBS JONES, Ohio
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
WILLIAM LACY CLAY, Missouri
STEVE ISRAEL, New York
MIKE ROSS, Arizona

BERNARD SANDERS, Vermont

Terry Haines, Chief Counsel and Staff Director

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

SPENCER BACHUS, Alabama, *Chairman*

DAVE WELDON, Florida, *Vice Chairman*
MARGE ROUKEMA, New Jersey
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
MICHAEL N. CASTLE, Delaware
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
BOB BARR, Georgia
SUE W. KELLY, New York
PAUL E. GILLMOR, Ohio
JIM RYUN, Kansas
BOB RILEY, Alabama
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, North Carolina
JUDY BIGGERT, Illinois
PATRICK J. TOOMEY, Pennsylvania
ERIC CANTOR, Virginia
FELIX J. GRUCCI, JR, New York
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
PATRICK J. TIBERI, Ohio

MAXINE WATERS, California
CAROLYN B. MALONEY, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
KEN BENTSEN, Texas
BRAD SHERMAN, California
MAX SANDLIN, Texas
GREGORY W. MEEKS, New York
LUIS V. GUTIERREZ, Illinois
FRANK MASCARA, Pennsylvania
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
PAUL E. KANJORSKI, Pennsylvania
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BARBARA LEE, California
HAROLD E. FORD, JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York

CONTENTS

	Page
Hearings held on:	
March 14, 2002	1
April 25, 2002	35
Appendixes:	
March 14, 2002	57
April 25, 2002	166

WITNESSES

THURSDAY, MARCH 14, 2002

Buck, Carolyn, Chief Counsel, Office of Thrift Supervision	7
Dollar, Hon. Dennis, Chairman, National Credit Union Administration	10
Kroener, William F. III, General Counsel, Federal Deposit Insurance Corporation	6
Little, Roger W., Deputy Commissioner, Credit Unions Office of Insurance and Financial Services, State of Michigan, on behalf of the National Association of State Credit Union Supervisors	28
McCaul, Elizabeth, Superintendent of Banks, New York State Banking Department, on behalf of the Conference of State Bank Supervisors	26
Olson, Hon. Mark W., Member, Board of Governors, Federal Reserve System	1
Williams, Julie L., First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency	4

APPENDIX

Prepared statements:	
Bachus, Hon. Spencer	58
Capito, Hon. Shelley Moore	59
Gillmor, Hon. Paul E.	60
Royce, Hon. Ed	61
Buck, Carolyn	111
Dollar, Hon. Dennis	130
Kroener, William F. III	91
Little, Roger W.	157
McCaul, Elizabeth	140
Olson, Hon. Mark W.	62
Williams, Julie L. (with attachment)	72

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Williams, Julie L.:	
Information requested by Hon. Eric Cantor	90

WITNESSES

THURSDAY, APRIL 25, 2002

Page

Cheney, William, President/CEO, Xerox Federal Credit Union, on behalf of the National Association of Federal Credit Unions 42

Duke, Elizabeth A., Senior Vice President, Government Relations, South Trust Corporation, Birmingham, AL, on behalf of the American Bankers Association 47

Gaither, Charlene R., Manager, Eastern Panhandle Community Federal Credit Union, Martinsburg, WV, on behalf of the Credit Union National Association 40

Hage, Curtis L., Chairman and CEO, Home Federal Bank, Sioux Falls, SD, Chairman, America's Community Bankers, Washington, DC 46

Stone, Pierce, Chairman, President & CEO, Virginia Community Bank, Louisa, VA, on behalf of the Independent Community Bankers of America .. 44

APPENDIX

Prepared statements:

- Bachus, Hon. Spencer 168
- Oxley, Hon. Michael G. 167
- Gillmor, Hon. Paul E. 169
- Cheney, William 184
- Duke, Elizabeth A. 271
- Gaither, Charlene R. 170
- Hage, Curtis L. 237
- Stone, Pierce 229

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Gaither, Charlene R.:

- Written response to questions from Hon. Felix Grucci 183

Hage, Curtis L.:

- Written response to a question from Hon. Spencer Bachus 268
- Written response to a question from Hon. Melissa Hart 270

Financial Services Roundtable, prepared statement 282

H.R. 3951—THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2002

THURSDAY, MARCH 14, 2002,

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The subcommittee met, pursuant to call, at 9:56 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus, [chairman of the subcommittee], presiding.

Present: Chairman Bachus; Representatives Weldon, Castle, Kelly, Ryun, Royce, Cantor, Grucci, Hart, Capito, Rogers, Tiberi, Bentsen, Meeks, Kanjorski, Hooley, Lucas, J. Maloney of Connecticut, and Sherman.

Chairman BACHUS. The subcommittee, after a brief postponement, meets today for a legislative hearing on H.R. 3951, the Financial Services Regulatory Relief Act of 2002, a bill introduced earlier this week by my colleagues on the subcommittee, Ms. Capito of West Virginia, and Mr. Sandlin of Texas.

We are going to go right to the witnesses. We'll start with the first panel. We are going to dispense with opening statements because of the delay, and hopefully, that will put us right back on time.

Our first panel is the Honorable Mark Olson, member of the Board of Governors of the Federal Reserve System. We thank you for your attendance and congratulate you on your appointment.

Ms. Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency; Mr. William Kroener, General Counsel for the Federal Deposit Insurance Corporation; Ms. Carolyn Buck, Chief Counsel, Office of Thrift Supervision, and Dennis Dollar, Chairman, National Credit Union Administration.

We welcome our witnesses to the subcommittee. I think there is agreement we are going to go from left to right. We should have probably discussed that with you, but if it is all right with the panel, we will start with Governor Olson and then proceed with Ms. Williams on down the line. Thank you, Governor Olson.

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

Mr. OLSON. Thank you very much, Mr. Chairman, and Members of the subcommittee. We're delighted to have the opportunity to testify today on H.R. 3951. The Federal Reserve Board responded

last summer to a request by Chairman Oxley to suggest ways to improve the banking laws and to relieve unnecessary burden.

In the context of that request, we did submit a number of options, several of which have been included in your bill. And I would like to speak briefly to those this morning. We have a complete statement which I will submit for the record, but I will abide by the time constraint in the opening statement.

Chairman BACHUS. And I will say this. We are not going to, with this panel, we are not going to enforce the 5-minute rule.

Mr. OLSON. In the spirit of the moment, I will stick with brevity also.

Chairman BACHUS. Some of your fellow panel members may enforce a 10 or 12-minute rule.

[Laughter.]

Mr. OLSON. OK. Our first suggestion involves de novo interstate branching. Members of the subcommittee may recall that interstate banking legislation was achieved largely, if not totally, by the various States during the 1980s and during the 1990s as they passed laws allowing for interstate bank ownership.

The question of interstate branching was dealt with with the Riegle-Neal Act of 1994. There are two ways that branching was allowed. One was by a bank purchasing a bank across State lines and then converting it to a branch or branching from there, and the other option was for de novo branching, but that would only be allowed if the State in which the bank wanted to enter wold invite them in, essentially an opt in provision.

There are two competitive issues involving that provision. The first one is that Federal thrifts are allowed to branch de novo across State lines now. So there is a current imbalance between the competitive environment for Federal thrifts and for commercial banks, and this supported amendment would address that issue.

The second issue involves a significant difference between the impact on small banks and large banks. Now remember that there are 17 States that have the opt-in provision and 33 States plus the District of Columbia that have not adopted the opt-in, so there is not the opportunity to enter those States by de novo branching.

The distinction is that the smaller banks, whose natural markets would be across State lines, are at a slight disadvantage in that environment because the largest banks are able, with some ease, to purchase a bank and then accomplish the branching, but the smallest banks would be a significant burden to do so. We think it would level the playing field if the de novo option were to be eliminated from the statute.

Having looked at that provision again, though, after we submitted it, there is one issue that we would like to call to the subcommittee's attention, and that concerns industrial loan companies. ILCs, as I think the subcommittee knows, are FDIC insured institutions whose parent ownership falls outside of the restrictions provided by the Gramm-Leach-Bliley Act. As we've looked at this amendment, one unintended consequence might be to allow ILCs to establish a nationwide presence completely outside of the parent being under the Federal restrictions of the Gramm-Leach-Bliley Act. That we don't see as a minor streamlining. We see that as a major policy issue.

We, Mr. Chairman, have drafted language that if it would be helpful to the subcommittee we could submit as a further follow-up.

The second issue that we would like to suggest involves cross-marketing restrictions between a bank and a company in which it has ownership in its merchant banking portfolio. When the Gramm-Leach-Bliley Act was passed, to assure that institutions were not avoiding the limitations of Gramm-Leach by putting an entity into its merchant banking portfolio and then operating it as if it were an affiliate, there were cross-marketing restrictions. There was one exception to that, however, involving insurance companies in a financial holding company. There is a narrow limitation for cross-marketing that insurance companies can do with institutions that the insurance company has an equity interest in their merchant banking portfolio.

We are suggesting that banks in financial holding companies ought to have the same opportunity.

A third issue involves the removal of the post-approval wait period. Currently in the statute under mergers and acquisitions, once they have been approved by the regulatory authorities, there is a mandatory 30-day wait period for the attorney general to review the merger or acquisition for antitrust or anticompetitive implications, the 30 days now can be lowered to a 15-day period. We are suggesting that after the approval has been made, and with the explicit approval of the Attorney General, the 30-day period be eliminated entirely.

The fourth item that we would like to talk about involves certain unnecessary reports regarding insider loan transactions. And before I talk about the three provisions, I would like to assure the subcommittee that the insider loan issue covered by Reg O is an important regulatory concern. And nothing that we are suggesting here would diminish either the bank's responsibility or the regulator's oversight responsibility in that area. However, there are three small reporting requirements that in our judgment don't contribute to safety and soundness, the recordkeeping responsibility of the institution or the oversight role of the Fed. So we would suggest that they be eliminated. Had the reports been regulatory, we would have dropped them. But, they are mandated by statute, and we are suggesting that the statutory requirement be eliminated.

Two more exceptions. One involves director interlocks on small institutions. In 1978 when the Depository Institution Management Interlock Act was passed, there was a provision that allowed, in a large metropolitan area—an MSA—for a small bank or financial depository institution to be able to have a director on its board but have that same person be a director of another small bank in that same metropolitan area so long as they were not in the same immediate market. That was a good provision in 1978 when the dollar figure was $20 million. We are suggesting that that dollar figure today perhaps should be $100 million, and that's what we're suggesting.

The final suggestion that we have involves exceptions to attribution rules. A bank holding company is not allowed to own more than 5 percent of the voting shares of any company, and that includes, under the current statute, shares held in trust for the com-

pany or its employees or shareholders. We are aware of instances that involved pension plans or 401K plans where the institutions are allowing their employees the ability to direct their portion of a 401K or profit sharing so that they could purchase shares and they could vote those shares, so the individual would make not only the investment decision but the voting decision.

In order to monitor the 5 percent requirement, it would be a massive recordkeeping responsibility, and it doesn't in our judgment change the effectiveness of the rule. What we are asking for is on a case-by-case basis, the permission to provide exception.

Mr. Chairman, that concludes my opening remarks, and I'd be happy to answer questions.

[The prepared statement of Hon. Mark W. Olson can be found on page 62 in the appendix.]

Chairman BACHUS. Thank you.

Ms. Williams.

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

Ms. WILLIAMS. Chairman Bachus and Members of the subcommittee, I appreciate this opportunity to discuss with you ways in which unnecessary regulatory burden on America's banking system can be reduced, and to express the views of the Office of the Comptroller of the Currency on the Financial Services Regulatory Relief Act of 2002.

Let me also begin by thanking Ms. Capito and Mr. Sandlin for sponsoring this bill, which includes sensible and appropriate regulatory burden relief for national banks and other financial institutions, as well as measures that will enhance bank regulators' ability to maintain a safe and sound banking system. We and the other agencies have worked with the subcommittee staff in developing some of the provisions in the bill, and we very much appreciate the opportunity to have done so and to continue to do so through the process. My testimony this morning will highlight a few provisions of the bill that we believe are especially important.

As the subcommittee knows, effective bank supervision demands that we achieve a balance among several, sometimes competing, but equally important, objectives. One of these objectives is to foster banks' ability to conduct their business profitably and competitively, free from burdensome constraints that are not necessary to further the purposes of the banking laws.

This bill contains several provisions that promote this objective by streamlining and modernizing aspects of the corporate governance and interstate operations of national banks. The OCC strongly supports these provisions.

For example, the bill modifies the so-called "qualifying shares" requirement currently in the National Bank Act, which has made it difficult for some national banks to obtain favorable tax treatment as "Subchapter S" corporations. The "qualifying shares" provision requires every national bank director to hold a specified minimum equity interest in his or her national bank. Because of this requirement, however, some national banks end up with more shareholders than the law permits for a corporation wishing to

elect "Sub S" status. Community banks are most disadvantaged by this result.

The bill solves this problem by authorizing the Comptroller to permit the directors of banks seeking "Subchapter S" status to hold subordinated debt instead of equity shares. Holding subordinated debt does not cause a director to be counted as a shareholder for purposes of "Subchapter S." At the same time, the subordinated debt requirement achieves the same purpose as the requirement to hold equity shares because a director holding that sub debt can only be repaid in full if all other claims of depositors and non-deposit general creditors of the bank are first paid in full.

A second sensible modernization in the bill that I'll mention eliminates a provision in current law that requires a national bank to have cumulative voting in the election of its directors. The bill permits a national bank to determine, at its option, reflected in its articles of association, whether or not to permit cumulative voting. This conforms the National Bank Act to modern corporate codes and provides national banks with the same corporate flexibility available to virtually all corporations and State banks.

A third provision repeals the requirement in current law that a State must affirmatively enact legislation in order to permit national and State banks to conduct interstate expansion through de novo branching. Governor Olson has already articulated some very good reasons for this particular provision in the bill. The effect of current law is to require that, in many cases, banks must structure, if they can, artificial and unnecessarily expensive transactions in order to establish a new branch across a State border. Banks and their customers would benefit by this change, which would permit a bank to choose which form of interstate expansion makes the most sense for its business needs and its customer demands. Federal thrifts have enjoyed this type of flexibility for decades.

The bill also contains provisions that address a second, and fundamentally important, objective of bank supervision, and that is to promote and maintain the safety and soundness of the banking system. For example, the bill expressly authorizes the Federal banking agencies to enforce an institution-affiliated party's or controlling shareholder's written commitment to provide capital to an insured depository institution. This provision would address some recent Federal court decisions which have conditioned the agencies' ability to enforce this type of written commitment on a showing that the party who made the commitment was somehow "unjustly enriched." By removing this impediment to our ability to hold parties to their commitments to provide capital, the new provision will enhance safety and soundness of insured depository institutions, and it should help to reduce losses to the Federal Deposit Insurance funds.

My written statement touches on several additional amendments to current law that we believe would enhance the banking agencies' safety and soundness authority, reduce risk to the deposit insurance funds, and facilitate our enforcement efforts when wrongdoing does occur. We are working with the other banking agencies to develop these recommendations, and we hope that they can be considered in the legislative process as it continues.

Mr. Chairman, on behalf of the OCC, thank you, and Ms. Capito, for your support of this legislation. I'd be happy to answer any questions you have.

[The prepared statement of Julie L. Williams can be found on page 72 in the appendix.]

Chairman BACHUS. Thank you.

Counsel Kroener.

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

Mr. KROENER. Mr. Chairman and Members of the subcommittee, I appreciate the opportunity to present the views of the Federal Deposit Insurance Corporation on the proposed legislation to provide regulatory burden relief.

The FDIC shares the subcommittee's continuing commitment to eliminate unnecessary burden and to streamline and modernize laws and regulations as the financial industry evolves. The FDIC itself is engaged in a number of initiatives to address the issue of regulatory burden. Chairman Powell recently formed a regulatory burden task force within the FDIC to study ways to reduce the regulatory burden. The task force will review the FDIC's operating principles, processes and practices, study ways to make the FDIC more sensitive to the burden issue, and make recommendations to the Chairman on burden reduction.

The FDIC recently initiated a comprehensive review of internal processes and operating procedures related to the supervision of State-chartered non-member banks. We are identifying ways to better allocate resources in the areas that present the greatest risk to our insurance funds: problem banks, larger financial institutions, technological change, high risk subprime lending, internal control procedures, and fraud.

We have already implemented several improvements such as making the report of examination format more user-friendly, designating Applications Subject Matter Experts as centralized resources for bankers, and contacting banks between examinations to discuss issues so that we can do a more focused and efficient examination.

We are currently also reviewing the examination process to achieve maximum efficiencies in the examination of small, well rated banks, and hope to reduce total examination hours in these institutions by up to 20 percent.

We also are revising our compliance examination approach to place a greater emphasis on an institution's administration of its compliance responsibilities. Examiners will evaluate—in depth—an institution's compliance program. Based on this review, examiners will then determine where there may be a significant risk of regulatory violations and appropriately tailor their transactional testing.

The FDIC continues to work with the other banking regulators in implementing more efficient regulations and processes such as the new "Interagency Charter and Federal Deposit Insurance Application" and the new standardized requests for electronic loan information.

The FDIC also supports statutory changes to reduce regulatory burden in a number of areas, including those in the bill that, first, clarify that an agency may suspend or prohibit individuals convicted of certain crimes from participation in the affairs of any depository institution. Second, those that modify the requirement for retention of old records of a failed insured depository institution at the time a receiver is appointed, and third, those that permit the FDIC to rely on records preserved electronically, such as optically imaged or computer scanned documents.

The FDIC also supports a number of provisions which were requested by our fellow regulators and included in the proposal, such as those that streamline merger application requirements and that grant Federal banking agencies the authority to enforce conditions imposed in certain written agreements relating to additional capital contributions.

We are working with staff at the OCC to perfect language in Section 604 of the bill expanding the prohibition of persons convicted of certain crimes from participating in the affairs of uninsured financial depository institutions.

Finally, the FDIC recommends that the subcommittee include four additional regulatory relief items in the bill. These additions relate to:

First, authority for supervisory agencies to enforce conditions on the approval of deposit insurance;

Second, clarification that conversions which result in more than one bank would continue to require deposit insurance applications from the resulting institutions, as well as review and approval by the appropriate Federal banking agency;

Third, amendments to the Bank Merger Act and Bank Holding Company Act that would require consideration of the potentially adverse effects on the insurance funds of any proposed bank merger transaction or holding company formation acquisition; and

Fourth, language that would make clear that pre-receivership liens for failure to pay property taxes are extinguished when the property is acquired by the Federal receiver.

I have included relevant language as an appendix to my written statement on these four items.

Thank you for the opportunity to present the FDIC's views on these issues. The FDIC supports the subcommittee's continued efforts to reduce unnecessary burden on insured depository institutions without compromising safety and soundness or consumer protection.

We are pleased to work with the subcommittee in accomplishing this goal. Thank you.

[The prepared statement of William F. Kroener III can be found on page 91 in the appendix.]

Chairman BACHUS. Thank you.

Chief Counsel Buck.

STATEMENT OF CAROLYN BUCK, CHIEF COUNSEL, OFFICE OF THRIFT SUPERVISION

Ms. BUCK. Mr. Chairman and Members of the subcommittee, thank you for the opportunity to present OTS's views on your initiatives to reduce regulatory burden on our depository institutions.

During periods of economic challenge, it is particularly important that we make every effort to remove unnecessary regulatory obstacles that hinder profitability, innovation and competition in our financial services industry.

In my written testimony I discuss a number of important proposals that we believe would significantly reduce existing burdens on the thrift industry, and I ask that the full text of that statement be included in the record.

In my oral statement, I'll highlight three areas where reforms would provide significant relief to the thrift industry. These are deposit insurance reform, parity with the banks under the securities laws, and mortgage simplification.

Perhaps the most straightforward and effective means to provide regulatory relief to our insured depository institutions is to reform the deposit insurance system under which they now operate. It is long past time to merge the bank insurance fund and the savings association insurance fund. There is no disagreement on this. Merger will promote efficiency in administering the funds and result in a more stable insurance system. Therefore, we strongly support fund merger.

We also believe that the free rider problem should be addressed in fairness to those who have paid into the funds over many years.

And finally, the FDIC board should have sufficient flexibility in setting the designated reserve ratio and deciding when to increase the assessment rate to assure the continued stability of the insurance fund. Providing certainty about the process for determining the amount of deposit insurance assessments is a very important regulatory burden initiative.

Another area woefully in need of reform is the mortgage process. OTS applauds HUD Secretary Martinez's initiatives in this area. Last fall, Secretary Martinez spoke about making the home buyer's experience less complicated, the paperwork requirements less demanding, and the mortgage process itself less expensive. This is no simple task, but everyone involved in making the American homeownership dream a reality shares his goals, and we pledge to do our part to help achieve this objective. Simplifying the mortgage process will reduce regulatory burden on thrifts and on all housing lenders and assist consumers. The importance of this cannot be overstated.

Turning to the bill before this subcommittee, the most important feature to thrifts and the communities they serve concerns parity with banks under the Federal securities laws. OTS strongly supports the amendments to extend the thrifts the same exemptions as banks from investment advisor and broker-dealer registration requirements. Thrifts fill an important niche in the financial services arena by focusing their activities primarily on residential, community, small business and consumer lending. The Homeowners Loan Act allows thrifts to provide trust and custody services on the same basis as national banks, and investment advisor and third-party brokerage in the same manner as banks.

Not only are the authorized activities the same, but OTS examines those activities in the same manner as the banking agencies. Some may suggest that this is a charter issue; that this SEC registration disparity is an intended advantage of the bank operating

structure. However, as I have noted, thrifts have had the ability for some time to conduct these activities, these investment advisor and broker-dealer activities, under their existing charter authority. This is not a powers issue, then, but a cost issue. The consequence of the disparity is the extra costs the thrifts must incur to exercise the same powers as banks. This is regulatory burden in its purest form.

We firmly believe that charter choice should be based on which charter is the best fit for an institution's business, not which carries the least regulatory burdens associated with the authorized business activities. The proposed parity amendments to the Federal securities laws remove distinctions that have caused thrifts to engage in regulatory arbitrage by changing charters to reduce costs even though the thrift charter is the best fit for them.

Although the details of the current situation are complex, the key points are that banks, but not thrifts, are exempt from investment advisory registration requirements under the Investment Advisors Act of 1940. In addition banks, but not thrifts, enjoy an exemption from broker-dealer registration requirements under the 1934 Act for certain activities specified under the Gramm-Leach-Bliley Act.

For purposes of broker-dealer requirements, the SEC has exercised its exemptive authority to treat thrifts the same as banks, at least for now. But it has been reluctant to extend the same parity to the investment advisor requirements. Treating thrifts and banks the same under the Federal securities laws makes sense for a number of reasons, but I think it's best stated in the SEC's own words from the preamble to their May 2001 interim final rule that did extend broker-dealer parity to thrifts. They stated, and I quote: "Insured savings associations are subject to a similar regulatory structure and examination standards as banks. Extending the exemption for banks to savings associations and savings banks is necessary or appropriate in the public interest and is consistent with the protection of investors."

Congress has already spoken on the banks' exemption. Perhaps the best way to put this matter to rest for thrifts is for Congress to affirm the SEC's extending the broker-dealer exemption to thrifts, plus have Congress extend the investment advisor exemption. This would also have the beneficial effect of avoiding the need for a series of SEC administrative exemptions, another potential regulatory burden, if additional differences come to light later.

OTS is committed to reducing burden whenever it has the ability to do so, consistent with safety and soundness and compliance with law. The proposed legislation advances this objective, and we appreciate that many of the reforms we've long desired are included in the bill. I especially thank you, Mr. Chairman, Congresswoman Capito, and all those who have shown leadership on this issue and look forward to working with the subcommittee on this legislation. Thank you.

[The prepared statement of Carolyn Buck can be found on page 111 in the appendix.]

Chairman BACHUS. Chairman Dollar.

STATEMENT OF HON. DENNIS DOLLAR, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Mr. DOLLAR. I am pleased to present the subcommittee with the following suggestions. I am going to highlight, for the sake of time, the key points of my written testimony that I have presented to the Members of the subcommittee that attempt to address the issues of regulatory relief and productivity improvements for Federal credit unions.

We feel that these proposals are consistent with the mission of credit unions and the principles foremost of safety and soundness. They address statutory restrictions that now act to frustrate the delivery of financial services because of either technological advances, current public policy priorities or practical market considerations.

First of all, the Federal Credit Union Act authorizes Federal credit unions to provide check cashing and money transfer services to members. To reach out to the unbanked, Congress should consider authorizing Federal credit unions to provide these services to anyone eligible to become a member. This is particularly important to the overwhelming majority of Federal credit unions whose field of membership includes individuals of limited income or means. These individuals often do not have mainstream financial services available to them and often pay excessive fees for check cashing, wire transfer and other services.

Allowing Federal credit unions to provide these limited services to anyone in their field of membership would provide a lower fee alternative for these individuals while at the same time encouraging them to trust conventional financial organizations. If credit unions are to be, as we feel that they are and must remain, a part of the solution to the predatory lending problem in this country, their potential members need to know the types and value of services that they can receive from a credit union they are eligible to join. I am pleased to note that a provision as it relates to this is included in the Capito-Sandlin bill, and we appreciate that consideration.

Also, Federal credit unions are authorized to make loans to members of other credit unions and to credit union organizations. The Federal Credit Union Act imposes various restrictions on these authorities, including a 12-year maturity limit that is subject to only very limited exceptions. This one-size-fits-all maturity limit should, we feel, be eliminated or at least increased. It is outdated and unnecessarily restricts Federal credit union lending authority. As in the case with other federally-chartered financial institutions, we believe appropriate rulemaking authority should be granted by statute for NCUA to establish competitive maturity limits within the bounds of safety and soundness. And again, we appreciate the inclusion of a provision related to this in the bill.

The Federal Credit Union Act authorizes Federal credit unions to invest in organizations providing services to credit unions and credit union members. An individual Federal credit union, however, may invest in aggregate no more than 1 percent of its shares and undivided earnings in these organizations which are commonly known as credit union service organizations or CUSOs. CUSOs provide important services such as data processing, check clearing for

credit unions, financial retirement planning among others. When these services are provided through a CUSO, financial risks are isolated from the credit union. So we find that the relatively low statutory 1 percent aggregate limit often forces credit unions to either bring services in house, thus potentially increasing risk to the credit union and the insurance fund, or to turn those over to outside providers and lose institutional control. We feel that the statutory 1 percent limit should be increased or eliminated and the NCUA board be allowed to set by regulation a limit that is appropriate for safety and soundness purposes. And we appreciate again the fact that the proposed legislation does include a provision to address this in some manner.

The Credit Union Membership Access Act enacted in 1998 expressly authorized multiple common bond credit unions. The Access Act, however, provided that a Federal credit union may add a new group to its field of membership only within very strict proximity guidelines. This in effect often requires a credit union to establish a costly physical presence that could potentially if unchecked present long-term safety and soundness concerns. This brick-and-mortar limitation on Federal credit union services is not we feel sound policy in today's clicks and Windows financial marketplace where most services can be provided electronically and should, we feel, be reviewed by Congress for possible regulatory relief.

The Federal Credit Union Act also limits the investment authority of Federal credit unions to loans, Government securities and deposits in other financial institutions and certain other very limited investments. This limited investment authority restricts the ability of Federal credit unions to remain competitive in the rapidly changing Federal financial marketplace. In our view, the Act should be considered for amendment to provide such additional conservative investment authority as is approved for other federally regulated financial institutions and in accordance with the regulation of the NCUA board. Again, we appreciate the fact that this provision has been addressed by the legislation.

Last, the Federal Credit Union Act, as amended by the Credit Union Membership Act in 1998, allows voluntary mergers of healthy Federal credit unions but requires that NCUA consider a spinoff of any group of over 3,000 members in the merging credit union, or, if they convert to a community-based charter, to spinoff any groups they presently serve outside the community. When two healthy multiple common bond Federal credit unions wish to merge and thus combine their financial strength and improve their safety and soundness position, as well as service to their members, or a credit union chooses to convert to a community charter to serve an entire community, we feel that it is good public policy and they should be allowed to do so without unnecessary regulatory impediments.

Again, we appreciate the fact that the proposed legislation does attempt to address this concern in some way. Again, I know that there are other issues that are in the legislation that we have mentioned in my written statement, but I wanted to touch on these highlights, Mr. Chairman, and to thank you today again for the opportunity to provide this input on this important bill before your subcommittee.

We want to continue to work with you and offer our staff as a resource in any way as you continue to move toward what I know is your goal as is ours, which is removing unnecessary regulatory burden while maintaining our first and foremost commitment to safety and soundness and the necessary regulation that is required to protect the American public. Thank you very much, Mr. Chairman. I'd be glad to answer any questions.

[The prepared statement of Hon. Dennis Dollar can be found on page 130 in the appendix.]

Chairman BACHUS. Thank you.

I thank the panel. Our primary purpose here is to free up resources of the institutions so they can actually use more of their resources to lend to consumers. So we've looked at any regulation that we think unduly costs them resources that are unnecessary—that are not necessary for safety and soundness, are outdated, or, as Counsel Buck said, where you have one requirement for thrifts and one for banks, equal protection, or equal treatment argument.

Governor Olson, you mentioned the cross-marketing restrictions. One reason that we've moved on that—I think we had a hearing last year about whether financial holding companies could cross-market products with companies they had made investments in. And there are restrictions now and I think the Federal Reserve in their regulations had recommended then relaxing those restrictions. And there was general consensus at that hearing that that could be done without, you now, that there was not a privacy concern. Some people confused at first blush that there was a privacy concern there. But what we're talking about is cross-marketing products and services, which would not violate their customers' privacy.

And there is already a provision that you can do that with insurance companies. So I think what you said today I heartily agree with is an equal treatment. And also the fact that it doesn't diminish a customer's protections. And it certainly I think was meant by Gramm-Leach-Bliley. That is in the bill. In fact, several of the things that you have discussed in your testimony are in the bill.

And Deputy Williams, you mentioned the fact that we've been working closely before we dropped this bill. This was not something that we just decided on some things. We have been in close discussion with all your agencies looking for things where there was consensus, where there was an agreement between the parties that it could be done. Now sometimes there may not be agreement between two of the regulators to do something for the thrifts or to do something for the banks. But other than those minor differences of opinion, we tried to go with non-controversial things.

The only thing in the testimony that I would, Chairman Dollar, those close proximity restrictions on credit unions, there was quite a lot of focus on that, quite a lot of discussion on that. And it is still a very controversial thing, and if for no other reason, it wasn't included in this legislation, and that there's so much opposition to that from the banks. I do sympathize as with technology and what you're saying, that it does become a problem. But having it in the bill would be a problem for us.

We have and will continue to work with all the agencies to refine this bill. I'm sure you will continue maybe to find things as we

move forward. Anything in the bill you object to, we want to hear about it. Anything that you think ought to be in the bill that isn't in the bill, we want to hear about it. We will continue to work closely with you, because you are the ultimate experts and authority on what regulations need to be in place for safety and soundness, as opposed to regulations that don't add anything, simply take resources from what could be available to consumers.

Mr. Grucci is not here, so Mr. Cantor, we are going in order of—actually, Ms. Capito. Well, actually, I'm sorry, Mr. Lucas. Counsel Carter pointed out to me that I had not looked to my right. Which I always look to my right first. I didn't know I didn't.

[Laughter.]

Chairman BACHUS. Mr. Lucas from Kentucky.

Mr. LUCAS. I find this testimony very interesting, sir, but I have no questions. Thank you.

Chairman BACHUS. Thank you. Always efficient.

[Laughter.]

Chairman BACHUS. Thank you. Ms. Capito? And if you would like to make an opening statement, a comment, I think the Members, as you are the sponsor of this bill, you will certainly not be held to the 5-minute limit.

Ms. CAPITO. Thank you, Mr. Chairman.

Chairman BACHUS. And I commend you for the work you've done on this.

Ms. CAPITO. Thank you. I appreciate your holding this hearing today, and I appreciate the testimony of our distinguished witnesses. I particularly want to congratulate Mr. Dollar on his last name. What a great name for your business.

Mr. DOLLAR. I can't say I don't have a dollar to my name.

[Laughter.]

Ms. CAPITO. I think it's interesting to point out that we spend a lot of time in this subcommittee room creating new laws, and I think that periodically it serves us well to look at provisions in our present laws to see which ones are dilapidated and old and unused and overlapping and repetitive. And so I am pleased to be a part of this effort today with this bill to relieve certain regulatory burdens certainly on the regulatory agencies, but also on the banking and financial institutions that have to go forward with these.

I think this type of review will make substantial changes and it will bring us in greater compliance with the Gramm-Leach-Bliley Act and also the recently enacted Patriot Act. I know as the result of some of the Patriot Act regulations that were put in place, we caused more regulation burden our institutions, our financial institutions, and certainly on you all in terms of oversight, and I think it is very timely that we are updating these provisions as we move through the day today.

I think you pointed out quite appropriately, Mr. Chairman, this is certainly not the final bill, and I fully expect after this hearing we will have many changes, adjustments that we will be making as we move through this process. And I look forward to working with you all to see where those changes might occur.

I would like to ask a couple of questions right now if that is appropriate to begin asking questions? Yes. Governor, Olson you addressed the situation of interstate banking. In Section 401, it would

preempt State law and allow banks to offer branch banks, branch offices in other States without first having to have an existing presence. I represent the State of West Virginia, which I believe currently allows this type of branching. And you mentioned 33 States do not offer that as an option.

I was wondering—I'm a former member of a State legislature who was very sensitive to Federal preemption, so I was wondering if there is any opposition from any of these States to this provision.

Mr. OLSON. Congresswoman, we are not aware of opposition. There might be, but it has not come to our attention at this point.

Ms. CAPITO. Thank you. The other question for you, sir, is—and you brought it up in your opening statement. I'm glad that you did. Because when we had the press conference yesterday sort of as a preview of this bill with Chairman Oxley, this was the first question out of the box, and it dealt with the insider trading provisions and insider lending. And people have expressed concerns with respect to the reporting requirements. And I think you covered in your opening statement that this would in no way diminish any requirements or regulations for oversight. But if you could just sort of restate what that insider lending provision does and how the protections are still in place.

Mr. OLSON. That's a very important point. Insider lending is covered under Reg O, and there are very specific reporting requirements and very specific limitations on lending money to their officers and directors and insiders, and also with respect to loans from their upstream correspondents. None of those regulations is altered at all with this amendment.

There are three specific reports, however, that we suggest could be eliminated, two of them having to do with loans from outside banks and one having to do with loans that occur between call report periods that report incrementally the new loans that had been made. In our judgment, those three reports don't contribute to our oversight responsibility or to the record maintenance responsibility of the institutions and therefore marginally add burden without contributing to the oversight. But nothing we're saying here diminishes the importance of monitoring insider lending.

Ms. CAPITO. Thank you. I have a couple of more questions, and this one is just sort of a toss-up, so anybody can take it. In Section 605, it deals with destruction of records. And in this day and age, destroying records is not something that we want to go about frivolously or without a great deal of thought. I realize that a judge under this provision can require that records be kept for longer than 10 years. Does anyone feel that this section allows, in the destruction of records, raise any concerns in anybody's mind on our panel?

Mr. KROENER. Let me take that question, if I may. It's a provision of great interest to the FDIC. And we are sensitive to the records problem. And indeed, as Chairman Powell indicated in a recent speech, we are looking at accountants' records and whether the FDIC should require preservation in certain circumstances where we have the authority to do so and we haven't done so in the past.

But that having been said, this provision is simply designed as a cost and burden reduction. When an institution fails, the FDIC

will come in as receiver or conservator and will inherit all the records that institution happens to have. In some instances, the records can go back more than 100 years. And we are currently required to preserve those records, and there is a cost involved—there is a storage cost. And so this will actually save us money, save our receiverships money and enable us to pay higher dividends—to more quickly recover for our insured claims and hopefully pay higher dividends to any uninsured creditors in the receivership. And so we think it's a positive, cost saving thing, and we do not see risks in the provision as drafted. We've worked with the subcommittee to get the provision as refined as we can on that.

Ms. CAPITO. OK. Thank you. Can I keep going? Although not included in the reg relief bill, we have been asked to consider a provision that would give the Federal Reserve more flexibility to allow State member banks to engage in investment activities authorized by their chartering State and approved by the FDIC as posing no significant risk to the deposit insurance fund. Currently, State member banks are limited to the activities granted to national banks, and yet State non-member banks are allowed to exercise expanded powers within the confines of safety and soundness. What are your views on that? Governor Olson? Yes?

Ms. WILLIAMS. May I take a crack at that? I think it's important to understand what the provision that would be repealed by what you described does. It's not an arcane provision; it is a safety and soundness-driven provision. And, it was very recently addressed in the Gramm-Leach-Bliley Act after painstaking negotiations.

The primary effect of the change that you've described would be to undo prudential standards and safeguards that were enacted just over 2 years ago as part of the Gramm-Leach-Bliley Act. The essence of the statutory change that you've been asked to consider would be to eliminate a standard currently in Federal law that applies parallel prudential and safety and soundness standards to financial subsidiaries of national banks and financial subsidiaries of State member banks. It would reopen a set of issues concerning what types of safeguards and prudential standards need to be in place in connection with allowing expanded activities to be conducted in subsidiaries of those types of banks.

You, of course, can decide that those prudential standards and safeguards are no longer appropriate, but there is no basis to distinguish whether they are appropriate solely for national banks or State member banks. If you think that eliminating those safeguards for State member banks is the way to go, then you should eliminate them for national banks as well. There's no basis for a distinction.

Chairman BACHUS. I thank the Member.

Mr. Kanjorski. And what we had done is we'd given—Ms. Capito is sponsor of the bill. We waived her opening statement and she took 10 minutes.

Mr. KANJORSKI. That is certainly agreeable.

Chairman BACHUS. But we welcome your membership.

Mr. KANJORSKI. Thank you, Mr. Chairman. My questions are really directed to Chairman Dollar. As you know, I have, for some time, raised concerns about the value of the Federal charter. We

want to ensure that our Nation's system of dual chartering remains vibrant and effective.

One provision in this legislation, however, would allow privately insured, State-chartered credit unions to gain access to the Federal Home Loan Bank System. Because this section of the bill raises serious concerns about safety and soundness, I think that we should consider removing it unless we can adequately address these concerns.

Additionally, at a time when many in the credit union movement have raised concerns about the continued value of the Federal charter, I wonder why we are working in Congress to increase the value of the State charters. To help the subcommittee better understand this issue, would you please outline for us some of the recent trends in charter conversions from Federal charters to State credit union charters or mutual savings bank charters?

Mr. DOLLAR. Congressman Kanjorski, there has been some trend in recent years of conversion to the State charter from the Federal charter. Quite frankly, most of it has been driven by field of membership issues as some of the States under State law have been able to provide a more liberal field of membership than is allowed under Federal law.

We have not attempted to in any way preempt the States, for we like you believe in a dual chartering system that enables a credit union to have a viable choice of a productive business opportunity within either the Federal charter or the State charter. How we have tried to address that has been through implementing the Credit Union Membership Access Act as effectively as possible. We think that we have done so. We have given opportunities for Federal credit unions to be able to grow within the Federal Credit Union Act. There are some areas, as we mentioned a moment ago on the proximity issue, where we would like to see some relief that would enable us to be even more flexible, I think, in that regard. But I think we've done a good job. I think we've done a good job in enabling them to have the powers that are necessary to be able to meet the needs of their members.

However, each State has the right to pass their own laws as well. We recognize that and we respect that. One of the reasons we are here today, and we appreciate the opportunity by the subcommittee to be a part of regulatory relief legislation, is because we do believe there are perhaps some regulatory impediments that are imposed at the Federal level through Federal statute that are not imposed at the State level that would enable us to have an even more viable Federal charter. That's what we want to see, and we appreciate the opportunity to have a seat at the table here to do that.

Mr. KANJORSKI. Thank you. You perhaps were not there, but in June of 2000, I asked former Chairman D'Amours for an update from NCUA regarding the relationship of the Federal and the State charter. I will send you a formal request to get a further update on this issue.

Mr. DOLLAR. And we will give you the most recent figures on that. It has continued. And one of the concerns that we have, of course, is that as the charter conversions continue that we ever get to a point where we're out of balance between a viable Federal charter and a viable State charter. And we think that one of the

ways to respond to that is to try to make the Federal charter as viable as possible for credit unions who want to grow and prosper as federally-chartered credit unions, but still staying within the confines of the Federal Credit Union Act.

Mr. KANJORSKI. Additionally, many of the provisions in the bill would help Federal credit unions to grow and expand. One provision, for example, would allow credit unions to cash checks for anyone eligible to join a credit union. In Northeastern Pennsylvania, entities like Choice One Federal Credit Union are working to expand access to our Nation's financial system in underserved communities. This provision would certainly help credit unions to offer the unbanked public affordable services. What are your thoughts on this issue? And should we expand the provision in the bill to include wire transfer services, too?

Mr. DOLLAR. Congressman Kanjorski, in my statement a moment ago I did state that it is the position of the NCUA board that in order to facilitate what we are trying to do in our Access Across America initiative, which is to enable credit unions to adopt underserved areas and extend credit union services into many unbanked communities that it's important that the residents of those communities know the value and the types of services that they can receive by joining a credit union.

Among those is the ability to get a check cashed at less than what many times are predatory rates. Credit unions can provide that service, but today they can only provide it to a member. And we have long believed that some of those basic services perhaps could be provided by a credit union not just to their members but to anyone who is eligible to join the credit union, not anyone who would not be eligible, but those who are eligible to join the credit union in order to help them to understand the value of joining the credit union, the type of services that they can receive, and we think it could be a part of providing a much more viable low-cost alternative to some of the check cashing outlets, the payday loan outlets and the like that are prevalent in many of these communities. We think credit unions can be a part of the answer to the predatory lending issue in this country, and we want to facilitate that.

Yes, in answer to the second part of your question, we believe that it should also be extended to wire transfers. Because particularly as it relates to international remittances, many American citizens with ties to a homeland are having to pay 28 and 30 and 32 percent of the amount of an international remittance to be able to send it back, whereas most credit unions would be willing to do it for a flat low cost rate.

Chairman BACHUS. Thank you.

Mr. Kanjorski, you have one more question.

Mr. KANJORSKI. One more question. Mr. Dollar, would you comment on how we might change the field of membership statutory guidelines to ensure that we do not place Federal credit unions at a competitive disadvantage? Should we, for example, consider amending the legislation to allow State-chartered credit unions that convert to a Federal charter to keep their entire membership base after conversion?

Mr. DOLLAR. As I said a moment ago, the reason for many of the conversions to Federal to State charter has been because of field of membership restrictions. We do not think that the answer to that, again, as I stated earlier, is to preempt State law. But we do feel like that we need some greater flexibility should a credit union decide that they wanted to convert from State to Federal for us to be able to accommodate a field of membership that they may have.

In my earlier remarks, I talked about not having to spin off groups when a credit union converts its charter to a community charter. What we want is a credit union that is already serving a community, making a difference in the lives of that community on a daily basis, or in the lives of the members of employer groups within its field of membership, to be able to choose which credit union charter would best benefit their long-term viability and safety and soundness and make that choice without being driven by whether or not they're going to lose some of those groups or some of those members.

Safety and soundness is what drives a great deal of our concern, but yet field of membership restrictions sometimes make credit unions make decisions that we would like to see them to have greater options to make otherwise.

Chairman BACHUS. Thank you.

Mr. KANJORSKI. Thank you very much, Mr. Dollar. Thank you, Mr. Chairman.

Chairman BACHUS. Congressman Cantor.

Mr. CANTOR. Thank you, Mr. Chairman.

Ms. Williams, if I could just ask you, you pointed out in your testimony that you strongly support relieving the restrictions in current law of institutions operating as Subchapter S organizations, which I think everyone is in agreement or should be in agreement with. But do you know what the percentage of institutions that operate with that status is?

Ms. WILLIAMS. I don't know the figure off the top of my head, but I'd be very happy to get back to you with that information.

Mr. CANTOR. Thank you very much.

[The information referred to can be found on page 90 in the appendix.]

Ms. Buck, if I could direct the next question to you. You said the OTS supports parity for thrifts under the Investment Advisors Act of 1940. You pointed out in your testimony that some individuals have objected to this change because it would give thrifts a competitive advantage over registered investment advisors. You further stated that this change will have a relatively minor impact on the investment advisor industry because banks are already exempt. Could you just explain that a little further?

Ms. BUCK. Yes. What we've experienced is as our institutions have increasingly been using trust powers, when they find that they are subject to registration themselves under the Investment Advisor Act, and sometimes, depending on which State they're located in, the individuals who do that work within the institution may have to register, that they sometimes are choosing to move to a bank charter where they don't have to engage in those registration requirements. And so if the effect here from the investment advisor community is to believe that somehow preventing thrifts

from getting this parity with banks would give them an advantage over investment advisors, we've got probably at least a dozen thrifts that we know of that have converted to banks to be able to escape the SEC registration requirements.

When you're talking about parity here, we should be talking about parity as among financial institutions. OTS has the same regulatory structure as banks. We exercise the same trust powers as banks have. We have the same structure for examination. In fact, we just changed our handbook procedures last year to make them more comprehensive and more in line in terms of examination procedures with the banks, and we are about to issue a revised regulation dealing with trust powers, again to make it more consistent with those that apply to the banking industry.

So we think that the comparison here should be thrifts with banks, and not with the investment advisor community.

Mr. CANTOR. Thank you very much.

Mr. Chairman, I just have one additional question for Chairman Dollar. You state that the Administration should be authorized to establish any maturity limits on loans made by Federal credit unions in accordance with conventional marketplace maturities. Could you just describe what the current limits are on the ability for a credit union to make a loan and the lending terms, and then the higher maturity limits that you recommend?

Mr. DOLLAR. Basically, a credit union, Congressman, cannot make a loan for a longer term than 12 years with the exception of a mortgage loan. There are certain other types of lending, such as recreational vehicles, sometimes certain types of loans as relates to second homes and the like that the marketplace carries beyond the 12 year, but do not classify strictly as a mortgage loan. We don't see this as being an area where there is a tremendous amount of market that credit unions cannot meet, but there is some. And the bill as it is proposed extends that from 12 to 15 years. And frankly, that would very likely cover any situation that would arise. If the subcommittee and the Congress were to elect to go from 12 to 15, it would help the situation tremendously.

We always try to recommend away from those one-size-fits-all types of caps, because we could set through regulation a 15 year cap and be able to go beyond that if the market changes in the future. We would prefer that approach. But as the bill provides, to go from 12 to 15 would cover almost any situation that we would foresee at this time.

Mr. CANTOR. Thank you, Mr. Chairman. Mr. Chairman, I yield back.

Chairman BACHUS. Thank you.

Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman. I just have three quick questions in three different areas. And I guess the first question I'll address to Mr. Olson. Just in considering the elimination of the State opt-in program of a de novo branching, has there been any concern—what have you heard from the States? Have the States made any comments in regards to that? What are their opinions or has there been any comment at all from the States in regards to the elimination of the opt-out?

Mr. OLSON. Congressman, that question was asked earlier. I believe you had just stepped out for a minute. To the best of our knowledge, we have not had any concerns expressed by the State, at least to this point.

Mr. MEEKS. Thank you.

Chairman BACHUS. And, Mr. Meeks, we'll hear from the New York regulators in the second panel too and you may want to also address those questions to them in addition.

Mr. MEEKS. Thank you, Mr. Chairman. I hope there's not other questions that I've missed. What about in regards to, and again, Mr. Olson, to the post-approval waiting period for bank acquisitions and mergers? Have there been any adverse effects to the 15-day waiting period? And do you see any adverse effects in eliminating the waiting period?

Mr. OLSON. Congressman, there have not been. The presumption here is that the regulators have already approved and that the Attorney General has already reviewed the circumstances and the facts and have found that there are no anticompetitive effects of the merger. At that point, right now the wait period can go from 30 days to 15 days. It would seem logical that it could go from 30 days to waiving it entirely. But the underlying presumption is that the regulators have already approved and the Department of Justice, the Attorney General, has looked at it as well.

Mr. MEEKS. Thank you. My last question, maybe I'll address this to Ms. Williams, that we live in the post-Enron scandal days. And just in looking and talking about the elimination of certain reports and things of that nature, are you concerned or do you see any concern about the elimination of these reports that bank officers may be receiving from other banks? And if possible, are there any conflicts of interest that they may have as a result thereof?

Ms. WILLIAMS. Congressman, I'll defer to Governor Olson on that. We do support the provisions that are in this bill on that subject.

Mr. OLSON. I think it's important to note that none of the requirements are being eliminated regarding the reporting of loans to the bank and the bank's requirements for monitoring any loans that are covered under Reg O. So all of those provisions remain. There are three reports, reports that they are required to file, with respect to those loans that we are saying are not necessary for either our enforcement or our regulatory process or for the bank's own responsibility for those loans. On the margin we're looking to streamline the process, and we think that those reports are not central to the process either the bank's or the Fed's responsibilities.

But the underlying issue of insider lending is a very important one and one that all of the regulators at the table take very seriously.

Mr. MEEKS. Thank you. And I would yield back, Mr. Chairman.

Chairman BACHUS. Yes. And Mr. Meeks, I want to say to you just for the record, at the earlier hearing on FDIC, you had expressed some concerns about the restrictions on New York thrifts in accepting municipal deposits. And I wanted to say for the record that we are working together on that issue to address your concerns. And I know that New York is actually the only State that makes that distinction between banks and thrifts. So we are aware

of that. We are aware of your concerns. And I did want to put that in the record at this hearing.

Mr. MEEKS. We appreciate it, Mr. Chairman, and we are working together on that. Thank you very much.

Chairman BACHUS. Mr. Royce. And I want to commend you. You have a provision in this bill or two.

Mr. ROYCE. Thank you, Mr. Chairman. Yes. And on that same vein, I wanted to ask Mr. Dollar, because as the Chairman said, Mr. Dollar, a portion of this bill deals with a piece of legislation I introduced, which was the Faith Based Lending Protection Act, and specifically deals with member business loans made by credit unions to non-profit religious organizations. And the reason this is important to us is because these are the types of loans that go for the construction of hospices or that go for soup kitchens or shelters or churches. And there is a problem with availability of credit.

Under the current law, credit unions are prevented from loaning, as you know, more than twelve and a quarter percent of their total assets to business, and credit unions engaged primarily in faith-based lending, they're the ones that are exempted from the cap. But there aren't many engaged in that line of work, and these faith-based institutions obtain their liquidity, then, by selling these loans to other credit unions who are not exempt from the cap. And as a result, the lending needs of small non-profit organizations are frankly being crimped, and I think part of the problem is that these institutions are often ignored by larger banks and thrifts for a rational reason. I mean, they have very slim profitability margins.

But the result has been over time that as a number of credit unions approach their overall business loan caps, these local enterprises, especially hospices, are seeing their access to capital steadily decline. And we can fix this problem. And in this particular bill for regulatory relief, we have included provisions from H.R. 760, which was the Faith Based Lending Protection Act, exempting loans made by credit unions to non-profit religious organizations from the member business loan cap. And my question to you was going to be what is the position of the National Credit Union Association's stand on H.R. 760 and on incorporating that into this regulatory relief bill?

Mr. DOLLAR. Congressman Royce, as I said in my original statement and in answer to one of the questions a moment ago, anytime that a statutorily one-size-fits-all approach is applied, you're going to miss something. And when Congress in 1998 applied that 12.25 percent, one-size-fits-all member business loan cap, it did miss something. And among the very serious areas that was missed was those credit unions who do make loans to faith-based organizations.

I want to commend you for introducing the legislation that you did last year to try to correct that. The National Credit Union Administration at that time stated its support for that legislation and has analyzed it and finds no safety and soundness concerns whatsoever to be able to either pass your legislation or as is a part of this legislation, to have it included as a part of a regulatory relief initiative. We certainly would support that.

Mr. ROYCE. Well, let me ask you another question then, and that goes to the performance of these loans for the record in the past,

for the Members. How have these loans to religious organizations, these loans that go for either churches or shelters or soup kitchens or hospices, how have they performed over time? And how would you expect them to perform during these rather more difficult economic times? Have you got data going back and can you share that with us?

Mr. DOLLAR. For the record, very little of credit union lending is member business lending to begin with. It's less than a percent and a half of credit union lending. So it is a very small part of what credit unions do, because it is not traditional commercial lending as the banks do. It is member business lending. However, we do monitor this very closely, because it is an area, of course, that we feel is worthy of our very close supervision.

We have found that the delinquency rates on all member business lending in credit unions is lower than the delinquency rates on personal loans. And among faith-based institutions in particular is the best delinquency rate in virtually any area of member business lending. There are, as you stated correctly earlier, credit unions allowed to do faith-based lending today. Those that are chartered primarily for that purpose or exempted from the Act, and those that are below the 12.25 percent cap are able to make some. We are able to track those loans. We are tracking the loans. The payment history and the performance of those loans, are very, very solid.

Mr. ROYCE. It's in the lowest category of delinquency?

Mr. DOLLAR. Yes.

Mr. ROYCE. As you look at your portfolio?

Mr. DOLLAR. Yes.

Mr. ROYCE. Thank you very much, Mr. Chairman.

Chairman BACHUS. Thank you.

The gentlelady from Oregon.

Ms. HOOLEY. Thank you, Mr. Chair. I'm sorry I missed your testimony. I was in another Committee meeting. I just have one question. Any one of you can answer it. When we talk about streamlining bank mergers, are you concerned—do you think we'll see a lot more mergers if this passes? Is that what the expectation is, that we'll see additional mergers or more than what's currently happening? Anyone want to take a shot at that?

Mr. OLSON. Congresswoman, I think this bill will be neutral on that issue, because I think what we've done here is consistent with the whole idea of reg reduction. We have looked at the reg burden and identified the issues that appear not to contribute to supervisory oversight and their elimination would help achieve an appropriate regulatory environment for the banking industry and the thrifts industry.

And so it would be my judgment off the top of my head that this bill would be neutral in that regard.

Ms. HOOLEY. OK. Thank you.

Ms. Buck, when it talks about Federal thrifts investing in small business investment companies, do you see that as a conflict of interest? Do you see—tell me what you think about that whole area.

Ms. BUCK. This particular provision was really just moving authority from the Small Business Act over into the Homeowners

Loan Act. It really does not change our authority at all. It was really a technical change.

Ms. HOOLEY. OK. Thank you.

Mr. Dollar, when you look at credit unions and you have a change here that goes from, it says an individual Federal credit union may invest right now 1 percent of its shares in organizations. This amendment raises the limit to 3 percent. Talk to me about that.

Mr. DOLLAR. Credit unions are authorized under the statute to invest up to 1 percent in credit union service organizations. These are organizations that are formed by credit unions, either an individual credit union or a group of credit unions, to offer services to credit unions and credit union members. It is usually an economy of scale type of organization that is formed by, particularly, small credit unions who may need to come together to offer a particular type of service.

Ms. HOOLEY. Give me a couple of examples.

Mr. DOLLAR. There are some that have been formed by individual credit unions that do such things as check clearing for smaller credit unions, groups of credit unions who come together who may not do that on their own. Perhaps even to come together to have a financial planning initiative, a retirement planning initiative that a single credit union might have a difficult time providing but by combining together and investing in a credit union service organization, which is a separate entity, separate from the credit union itself, they are able to provide these services.

The 1 percent limit, particularly for smaller credit unions, somewhat limits their ability to achieve these economies of scale. And so instead of being able to form a credit union service organization and keeping it within the credit union community, if you will, they end up having to outsource that to some other third party, thus losing institutional control.

We feel like that an increase such as the one proposed in the legislation at least from 1 to 3 percent, if not higher, would at least enable those credit unions to have more opportunities to be able to invest in credit union service organizations where appropriate.

Ms. HOOLEY. Does that knock out the small person that maybe has a niche market that you currently use? Does that knock them out of business?

Mr. DOLLAR. Usually what it does is provide an alternative to what would probably be a larger nationwide organization that is providing that service and enables them to have that local niche.

Ms. HOOLEY. Thank you. Thank you, Mr. Chair.

Chairman BACHUS. Thank you.

The gentlelady from Pennsylvania, Ms. Hart.

Ms. HART. Thank you, Mr. Chairman. I'm sorry I did miss the testimony. But thanks to the Chairman and a lot of his information, I do have one question and it actually has to do with credit unions' parity sort of with thrifts and banks. I guess, unfortunately, I'm going back to Mr. Dollar as well. You're working hard this morning. What are the reasons to support parity for credit unions with banks and thrifts under the SEC Act and the Investment Act of 1940? This has been a really controversial issue for quite a long time, and I've never really had a chance to get it sort

of direct from somebody who might be able to give me an answer that isn't as bent as some of the ones I've gotten.

Mr. DOLLAR. We'll see if we can give you a straight up answer. Federal credit unions are authorized to engage in certain broker-dealer activities such as third party brokerage arrangements, sweep accounts, and to purchase and sell municipal securities for their own accounts. That is an allowable investment. And to the extent—and it is a very limited extent, admittedly, but to the extent that credit unions engage in these activities or some other authorized activity in the future, we feel that they should be afforded the same treatment as banks and thrifts, and the thrifts are included in this legislation, with respect to the registration under the broker-dealer statute. It is very limited, admittedly, as many of the things that credit unions provide that the other institutions provide on a much broader scale. But even in the small areas where they are provided, we think that the credit unions should have that parity.

Ms. HART. And once again, the question always arises is if they have that parity, then obviously under this bill, they're not given more responsibility as far as disclosure?

Mr. DOLLAR. Absolutely not. There is nothing in this bill that would enable a credit union to engage in any type of broker-dealer authority that it does not already have. It just says that if a credit union were to, for example, want to buy municipal securities for its own investment account, that there would be no question but that they would not have to register as a broker-dealer to be able to do that. A credit union is not a broker-dealer, but they do have certain limited authority in this regard. This does not expand that authority.

Ms. HART. OK. Is there a concern by any other member of the panel about the situation as it exists today regarding the opportunity for credit unions to participate as well as other institutions? General question. Mr. Olson?

Mr. OLSON. We don't have an opinion on that this morning.

Ms. HART. OK. Ms. Williams.

Ms. WILLIAMS. We don't have a position either.

Ms. HART. Wow. OK.

Mr. KROENER. Nor does the FDIC, Congresswoman.

Ms. HART. Ms. Buck.

Ms. BUCK. I haven't discussed it with our new director yet.

Ms. HART. OK.

Ms. BUCK. So we don't have one as yet.

Ms. HART. Thank you. Thanks, Mr. Dollar. Thank you, Mr. Chairman.

Chairman BACHUS. You ought to go back to law school.

[Laughter.]

Chairman BACHUS. You're like those lawyers in Alabama that just have one short question.

[Laughter.]

Chairman BACHUS. Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman. I just have one question.

Ms. Williams, Section 401 of the bill easing restrictions on interstate branching and mergers, am I right in understanding this

would overturn Riegle-Neal and preempt existing State law for de novo interstate mergers?

Ms. WILLIAMS. It would modify provisions in Riegle-Neal dealing with de novo branching, not mergers.

Mr. BENTSEN. So if a State had not opted in under Riegle-Neal, and I'm trying to think of a couple of States that that might apply to, then if this were to become enacted, then that would be meaningless and any, you know, Acme Bank national association based in Wisconsin would be able to branch, say, in Texas de novo or whatever?

Ms. WILLIAMS. This is a change that would apply to both State-chartered and national banks to permit de novo branching.

Mr. BENTSEN. And how many States have not opted in?

Ms. WILLIAMS. Governor Olson had that number.

Mr. OLSON. Congressman, 33 States have not. Seventeen States have and 33 States, plus the District of Columbia, have not opted in.

Mr. BENTSEN. Is there—and I know you have a second panel coming up. This would strike me as a somewhat substantial item in this bill, given the fact that since Riegle-Neal passed in what, 1993 or 1994, that the States have had some time. I'm thinking. I don't think my State has opted in, if I recall correctly, the State of Texas. And I know there have been a number of cases between the Comptroller of the Currency and the Texas Department of Banking over questions of whether or not some banks have violated that. Do you have any indication, or anybody on the panel, that the States are more complacent to this idea at this point in time? Or do you think this is something that they would have a problem with?

Mr. OLSON. We have not heard, but I guess as you said earlier, that's a great question for the next panel. And they probably have more input on that issue. In our judgement, this is in every sense the epilogue on this issue. Because the issue of interstate ownership was long since determined by the State legislatures. The issue, as you correctly pointed out, the issue of interstate branching was dealt with in Riegle-Neal. And what we have now is a certain competitive imbalance caused by the opt-in option with respect to the competition between banks and Federal thrifts and large banks versus small banks.

And in our judgment, it's a level playing field, particularly with respect to smaller banks whose natural markets are right along the State line.

The issue that you talked about of a Wisconsin bank branching into Texas is not a major issue for a large organization. And the fact that they could purchase an organization and then branch from there isn't a problem. A smaller bank in an environment where the State line impedes their natural market would have a more significant issue. And that's what we're saying.

Mr. BENTSEN. So the argument in favor of this would not be that there's a competitive imbalance for a money center bank? They'll get some benefit out of this because they won't have to set up individual charters in each State in order to conduct their branching where that State has not opted in. You're saying this is a measure for smaller, non-money center banks, you know, $10 billion or less?

Mr. OLSON. Well, I have to change your premise just slightly. A larger bank could purchase a bank in the State in which it wanted to enter, and a $50 billion bank could purchase a $20 million bank or a charter of that size with relative ease, where a community bank that would try to branch into that State and would first have to make a purchase, which is the other option, as opposed to de novo, would find the purchase to be a major obligation. And yet, the competitive issue probably would be more important for the smaller institution.

Mr. BENTSEN. So this is for the smaller banks, not for the larger banks, is the intent?

Mr. OLSON. That's correct.

Mr. BENTSEN. Let me ask one other question. Would this have the effect of preempting State banking laws in those States that have not opted in for purposes of regulation? If I understand correctly, for a State that has not opted in right now and someone wants to come in with a new bank, they can acquire, they can set up a separate charter, there can be symmetry between the outside bank and the current bank, but the bank inside the non-opt-in State still is under State law as it relates to consumer protection and whatever else. To what extent would repeal of Riegle-Neal's opt-in provision preempt State law in any respect in addition to just the branching itself?

Ms. WILLIAMS. Congressman, I don't think it would at all to the extent that the State laws were applicable. There are various provisions in Riegle-Neal and in some amendments that were made to Riegle-Neal a couple of years later that deal with the applicability of State laws to interstate branches. This doesn't affect that.

Mr. BENTSEN. So the parity issues and all that are all the same?

Ms. WILLIAMS. I think that's correct.

Mr. BENTSEN. Thank you. Thank you, Mr. Chairman.

Chairman BACHUS. I thank the gentleman from Texas for those thoughtful questions. At this time, unless the sponsor of the bill has a follow-up question, we will discharge the first panel. And actually you'll note that you are being discharged early.

[Laughter.]

Chairman BACHUS. We certainly appreciate your testimony. We also appreciate your willingness prior to this hearing to work with the subcommittee and to suggest changes even to us before we started preparing these bills for some reform of the regulations. So we appreciate your testimony and your professionalism here this morning.

Mr. CANTOR. [Acting Chairman.] Thank you.

STATEMENT OF ELIZABETH McCAUL, SUPERINTENDENT OF BANKS, NEW YORK STATE BANKING DEPARTMENT, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS

Ms. MCCAUL. Good morning Chairman Bachus and Members of the subcommittee. I am Elizabeth McCaul, Superintendent of Banks for the State of New York, and Chairman of the Conference of State Bank Supervisors. Thank you for asking us to be here today to share the views of CSBS on regulatory burden reduction and the Financial Services Regulatory Relief Act of 2002.

CSBS is the professional association of State officials who charter, regulate and supervise the Nation's over 6,000 State-chartered commercial and savings banks, and more than 400 State-licensed foreign banking offices nationwide.

We applaud your commitment and efforts to reduce the burdens imposed by unnecessary or duplicative regulations that do not advance the safety and soundness of our Nation's financial institutions. This subcommittee deserves special recognition for its efforts to remove these Federal regulatory burdens, allowing our banks to compete with other financial entities at home and around the word. This competition encourages efficiency and innovation, benefiting the economy and consumers alike.

However, the most important contribution toward reducing regulatory burden may be empowering the State banking system. State banks and the State chartering system have created the vast majority of innovations in banking products, services and business structures. For this reason, we are very disappointed that a provision to allow State-chartered member banks to utilize the powers of their charter was withdrawn from the bill just prior to its introduction.

Through innovation, coordination and the dynamic use of technology, States have made great strides in reducing regulatory burden for the institutions we supervise. My submitted testimony describes these efforts in more detail.

The Financial Services Regulatory Relief Act of 2002 can be a valuable Federal complement to these efforts. With respect to interstate branching requirements, as you may know, current Federal law has taken an inconsistent view 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.

Perhaps because it was believed that the Federal thrift charter would be eliminated at the time Riegle-Neal was adopted, the law was not applied to federally-chartered thrifts. The result is that a Federal thrift can branch without regard to State law and rules of entry.

Since the passage of Riegle-Neal, the OCC has promulgated creative interpretations of the National Bank Act that effectively circumvent the application of Riegle-Neal to branch-like operations. The result is that State-chartered institutions, particularly community banks who wish to branch interstate, are at a competitive disadvantage to those institutions that can use Federal options to branch without restrictions.

While 17 States now allow de novo branching, please recognize in your review of Federal law that the majority of States have not passed de novo branching laws. Whatever the outcome, we urge Congress to eliminate the disadvantage it has created for State banks because of inconsistent application of Federal law.

CSBS also hopes that the subcommittee will rethink including the State member bank powers amendment. The provision would simply give the Federal Reserve more flexibility to allow State member banks to engage in investment activities where authorized by their chartering State and approved by the FDIC as posing no significant risk to the deposit insurance fund.

State-chartered non-member banks have always been allowed to exercise expanded powers within the confines of safety and soundness. Therefore, eliminating this prejudicial and unnecessary distinction between State-chartered member banks and non-member banks is appropriate regulatory relief.

We also ask the subcommittee and the Congress to address the implementation and implications of regulatory preemption by the OCC and the OTS. CSBS believes this request for review of preemption and applicable law is appropriately a regulatory burden reduction matter as well.

Our banking system is a complex and evolving web of State and Federal law, particularly for the State-chartered institutions. Greater sunshine on OCC and OTS interpretations of applicable law for the institutions they charter would also help to clarify applicable law for our Nation's more than 6,000 State-chartered banks, representing nearly 70 percent of all insured depositories.

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. We commend this subcommittee for its efforts in this area and thank you, Congresswoman Capito, for sponsoring this legislation.

Thank you for the opportunity to testify on this very important subject. We look forward to any questions you and any of the Members may have.

[The prepared statement of Elizabeth McCaul can be found on page 140 in the appendix.]

Mr. CANTOR. Thank you, again, Ms. McCaul.

Now I would like to again recognize Mr. Roger Little. He is Deputy Commissioner, Credit Union Division, Financial Institutions Bureau, State of Michigan, on behalf of the National Association of State Credit Union Supervisors. Again, welcome.

STATEMENT OF ROGER W. LITTLE, DEPUTY COMMISSIONER, CREDIT UNIONS, OFFICE OF INSURANCE AND FINANCIAL SERVICES, ON BEHALF OF THE NATIONAL ASSOCIATION OF STATE CREDIT UNION SUPERVISORS

Mr. LITTLE. Thank you very much, Mr. Chairman. By way of introduction, NASCUS represents credit union supervisors across the country who collectively regulate more than 4,300 State-chartered credit unions. Like our counterparts in State government across the country, the Michigan Office of Financial and Insurance Services is committed to carrying out its mission through effective, efficient chartering, regulation and supervision of our State-chartered financial institutions.

NASCUS supports your efforts to reduce the regulatory burden on all depository institutions and appreciates this opportunity to present the State regulators' perspective and views on those aspects of the regulatory relief bill that most directly impact State-chartered credit unions.

We would also like to address the broader issue of the overall safety and soundness of the State-chartered credit union system. NASCUS strongly supports the provisions contained in the regulatory relief legislation that would authorize State-chartered, pri-

vately insured credit unions to be eligible for membership in the Federal Home Loan Bank System.

All State-chartered credit unions, regardless of their insurer, are regulated and examined by agencies of State governments to ensure that they are operating in a safe manner. To properly manage and price insurance risk, deposit insurers rely significantly on the examination reports of the institution's primary regulator. Most State credit union agencies use the same examination product, policy and procedures as the NCUA, who regulates Federal credit unions and insures all federally insured credit unions.

State agency examiners get the same training NCUA examiners do, plus any additional training the State agency may require. NASCUS agencies participate in the development and testing of NCUA's examination program and procedures. In short, there is excellent cooperation between NCUA and the State regulators and substantially similar examination standards for both federally and State-chartered credit unions.

Regarding privately insured credit unions, it's important to note that the Federal Deposit Insurance Corporation Improvement Act of 1991 specifically addressed the issue of private insurance for credit unions, establishing a series of safety and soundness requirements both for entities that would offer private deposit insurance to credit unions and for credit union that choose to have private deposit insurance.

It's also important to note that permitting non-federally-insured institutions to join the Home Loan Bank System would not establish a new membership principle for the system. More than 50 insurance companies chartered and regulated by State governments are now members of the Federal Home Loan Bank System. Opening membership to all credit unions as well would not inflict any new or unusual exposure on the Federal Home Loan Bank System.

We also need to recognize that allowing membership only provides access to the system. Each Federal Home Loan Bank has a very sophisticated credit screening system to assure that any borrower, federally insured or otherwise, is creditworthy. Arguably, access to the Federal Home Loan Bank System provides an additional level of scrutiny for credit unions and introduces additional market discipline into the system.

We would appreciate your support for including this proposal in the regulatory relief legislation and urge the subcommittee to approve this provision which will help achieve our Nation's housing and homeownership goals.

I'd also like to touch briefly on the SEC exemption issue which was discussed earlier and note that NASCUS supports extending parity to all credit unions from the exemption that would give State institutions an exemption from SEC registration requirements, the same exemption that banks were provided by the Gramm-Leach-Bliley Act. NASCUS requests that State-chartered credit unions be accorded parity of treatment in this area and therefore relief from those same requirements for basically the same reasons as articulated by Chairman Dollar earlier.

NASCUS also wants to address concerns about a perceived lack of parity in the credit union dual chartering system. We are aware of some complaints that State-chartered credit unions have grown

faster than their Federal counterparts in some States in recent years. As a result, it has been suggested that the powers of State-chartered credit unions might be rolled back by the U.S. Congress to restore parity of growth in the dual chartering system.

In recent years, a number of federally-chartered credit unions have switched to State charters, because that charter offers a better fit with the business plan of those institutions. Perhaps there were specific consumer financial services that a particular State law or regulation permitted, or there was a better field of membership provision enabling that credit union to better meet its members' needs. In other cases, there have been conversions from State to Federal charters. That simply demonstrates yet again the benefits of having a strong dual chartering system to provide that freedom of choice.

But it's important also to consider some facts to put this issue in perspective. Today there are still fewer State-chartered credit unions than federally-chartered credit unions—4,400 versus 6,200. Statistics on the data for these various institutions are included with our written testimony.

Also the total assets of State-chartered credit unions are significantly lower than those of Federal credit unions, $231 billion versus $271 billion. Some have even suggested that the rapid recent growth of the State system is the result of regulatory laxity by State regulatory agencies. We vigorously challenge that contention and would like to take this opportunity to refute it.

We have attached to our testimony a brief comparison of key financial performance characteristics of both federally and State-chartered credit unions. Current data indicates that in every essential safety and soundness category, the financial performance of State-chartered credit unions is every bit as sound as that of federally-chartered institutions.

The recent expansion of fields of membership opportunities for both Federal and State-chartered credit unions has diversified geographical risks for these institutions, enhancing their safety and soundness. In fact, the State-chartered credit union system which began in the early 1900s, was in the forefront of diversing credit union fields of membership. Encouraging diverse employee groups and making a broader range of community groups eligible for membership helps ensure the economic viability of credit unions.

There have also been major improvements in both the State and Federal systems of regulation and supervision for depository institutions since the savings and loan crisis of the 1980s and early 1990s. In fact, since 1998, all credit unions have been subject to prompt corrective action requirements that actually exceed those of commercial banks and savings institutions.

We would submit that any public policy prescription to roll back by Federal law the statues and regulations of the States to punish State-chartered credit unions for their financial success in this new era of intensified State supervision would be a disastrous public policy approach. Ebbs and flows in Federal and State charter activity are one of the benefits of the dual chartering system. It happens in the commercial banking industry and likewise occurs in the credit union industry. That ebb and flow is a desirable public policy objective, not a cause for Congressional concern.

Attempting to roll back the powers of State credit unions would be extremely damaging to the dual chartering system, to millions of credit union members across the country, and to the health and viability of the credit union system and the financial system in general. We urge this subcommittee to protect and enhance the viability of the dual chartering system for both credit unions and for banks and to approve the provisions we have discussed in our testimony.

Thank you very much for the opportunity to present our position on these issues, and I'll be happy to address any questions that you may have.

[The prepared statement of Roger W. Little can be found on page 157 in the appendix.]

Mr. CANTOR. Thank you, Mr. Little.

I'd like to direct a question to you, Ms. McCaul. You've asked us to reconsider a provision that would give the Federal Reserve more flexibility to allow State member banks to engage in investment activities authorized by their chartering States and approved by the FDIC. Behind that request, your position that there is no significant risk to the deposit insurance fund. Currently, State member banks are limited to activities granted to national banks, and yet State non-member banks are allowed to exercise expanded powers within the confines of safety and soundness. One, why do you support this provision? Two, how do you respond to the OCC's view that this would undo the prudential standards in the Gramm-Leach-Bliley Act?

Ms. MCCAUL. First I would point out that this section, this ability of State-chartered banks in general has been a bedrock of the dual banking system. Our country's successful financial system has had at its very core the concept of innovation that has begun at the State level. The States in effect have been the laboratories for change and new possibilities, new products, new services tested at the State level have become nationwide products and services that have benefited our country.

And so this innovation has been part of our law, part of system since really the inception of the dual banking system. In fact, in 1991, in FDICIA the Congress reiterated that this innovation would remain even at the height of the banking crisis. It preserved the rights of State non-member banks to continue to innovate.

If I could, I would like to point out that there has been a very strong record of that innovation within safe and sound standards that has been operable with regard to the non-member banks for a very long time. And in the FDIC's submitted testimony, they are pointing out, if you would allow me to read the following: "Indeed, Section 24 of the FDI Act states that an insured State bank may not engage as principal in any type of activity that is not permissible for a national bank unless the FDIC has determined that the activity poses no significant risk to the funds and the State bank is and continues to be in compliance with applicable capital standards prescribed by the appropriate Federal banking agency."

That statute makes no distinction between State member banks and State non-member banks. So the concept of being able to craft innovation within a State-chartered bank is an activity that currently exists for non-member banks and is subject to oversight not

only by the State regulator but also by the FDIC. Including this provision would merely allow another regulator to have the same authority with regard to State member banks. And the concept of innovation that has been at the heart of our country's dual banking system would be preserved.

Mr. CANTOR. Thank you, Ms. McCaul.

I would now like to call upon the bill's sponsor, Ms. Capito, for comments and questions.

Ms. CAPITO. Thank you, Mr. Chair.

I'd like to ask a question of Ms. McCaul. We talked about this in the last panel, and I'd like just a clarification. You touched on it in your statement, and I appreciate that, the fact that 33 States do not have the de novo statutes in place and I mentioned that I was a former State legislator who is leery of preemption by the Federal laws. We were wondering if there was any opposition that you would foresee in terms of States across the Nation.

Ms. MCCAUL. The CSBS has adopted a policy that encourages the States to consider adopting de novo branching laws. And at the same time, CSBS also has a policy that Federal law or regulation should not put a State-chartered institution at a disadvantage. And so we have had 17 States that have adopted de novo branching laws, and a number of States have not moved in that direction at this time.

The result is that the provisions in law that exist have created a competitive disadvantage for the State-chartered where they are not able to branch as easily as thrifts or nationally-chartered banks.

Ms. CAPITO. OK. Thank you. I have no further questions. I yield back.

Mr. CANTOR. Thank you.

The Chair now recognizes Mr. Ney for comments or questions.

Mr. NEY. Thank you, Mr. Chairman. I want to thank Representative Capito and also you for the inclusion of the Federal Home Loan Bank Membership Act, which I introduced earlier in this session as Section 301 of the regulatory relief legislation. I think it's going to be good news to firefighters and police, postal workers, teachers, State employees, credit unions have written to me and other Members of the subcommittee asking for the relief so they can provide home financing to their members.

Also, as you know, Mr. Chairman, State-chartered privately insured credit unions cannot apply to become members of a Federal Home Loan Bank even though nearly 11,000 federally insured credit unions already are permitted to do so. The legislation I have corrects this problem. It would give State-chartered, privately insured credit unions the same permission available to all other credit unions to apply to a Federal Home Loan Bank for membership.

After they apply, they would of course still have to meet all the Federal Home Loan Bank safety and soundness requirements on top of their existing State regulations as well as the Federal requirements, which are part of FDICIA, the bill supported by the Credit Union National Association, National Association of Credit Union Supervisors as well as a number of State credit union leagues.

I understand some Members of the subcommittee obviously may have concerns about the regulation of privately insured credit unions, so I'm working with my good friend Congressman Kanjorski, and I want to address those concerns.

I do have a couple of questions for Mr. Little. Mr. Little, I know some Members of the subcommittee are perhaps not aware of the private deposit insurance option for credit unions because it is only available in certain States, but that option was specifically sanctioned by the Congress in Federal law. Isn't that correct?

Mr. LITTLE. That's correct, sir, in the FDICIA Act of 1991.

Mr. NEY. And also, could you tell us why a credit union would want to apply for membership with a Federal Home Loan Bank and how many federally insured credit unions are already members of a Federal Home Loan Bank?

Mr. LITTLE. As I understand it, about 650 credit unions nationwide are currently members. The principal advantage of membership is an additional source of longer term credit for those institutions to use for the purpose of financing mortgage loans for their members in much the same way that banks and other businesses use the Federal Home Loan Bank now.

It's to the benefit of those credit union members to be able to receive that financing. It's to the benefit of the credit union's safety and soundness to be able to have an additional financing vehicle to use for interest rate risk management purposes. And as I stated earlier, in our view, it's beneficial to have yet another set of eyes, if you will, looking at those credit unions as they borrow from the Federal Home Loan Bank.

Mr. NEY. So another layer of Federal safety and soundness is what you're saying?

Mr. LITTLE. Yes, sir.

Mr. NEY. And I appreciate it. And I'm sorry I didn't make all your testimony, but I'll especially look at the part where you talk about the additional layer.

Mr. LITTLE. Thank you.

Mr. NEY. Thank you, Mr. Chairman.

Mr. CANTOR. Thank you. And if there are no further questions, I have none. I'd just like to thank the panel again and the audience's patience with the subcommittee, and the hearing is now adjourned.

[Whereupon, at 11:58 a.m. the hearing was adjourned.]

H.R. 3951—THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2002

THURSDAY, APRIL 25, 2002

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:10 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus, [chairman of the subcommittee], presiding.

Present: Chairman Bachus; Representatives Weldon, Roukema, Baker, Cantor, Grucci, Hart, Capito, Tiberi, Waters, Bentsen, and Hinojosa.

Chairman BACHUS. The hearing will come to order. The Chair recognizes himself for the purpose of making an opening statement. And what we do, for witnesses who have not been here before, we have brief opening statements; they will be brief. And then some of the Members wanted to introduce the witnesses who are from their home States. We will do that. The Ranking Member will speak after I speak. And then we will go right into your testimony.

We have—I don't know if any of you were told—we have a 5-minute rule. But we will waive that as long as you don't go 10 or 15 or 20 minutes. But don't—we are not going to be—some of the audience is shaking their head don't waive the 5-minute rule. But we will not be very strict on that.

The subcommittee meets today for its second hearing on H.R. 3951, the Financial Services Regulatory Relief Act of 2002. We just call that "reg relief." This bipartisan legislation was introduced last month by two of my colleagues on the subcommittee, Mrs. Capito and Mr. Sandlin.

I am an original co-sponsor, as is the Chairman of the Full Committee, Mr. Oxley of Ohio.

So I commend you, Mrs. Capito, for your hard work on this.

And at our first meeting on H.R. 3951 last month, the subcommittee heard testimony from a wide range of Federal and State banking regulatory agencies whose technical assistance and expertise has been invaluable to the subcommittee in the development of this legislation.

Having heard from the regulators, today we hear from the regulated, those institutions that must contend with the reams of bureaucratic red tape that issues forth from this city every year.

Testifying will be five of the leading financial services trade associations, representing large banks, small community banks, savings

institutions and credit unions, in no particular order. I could read that the other way around.

As Chairman Oxley and other Members pointed out at our first hearing, the regulatory burden shouldered by depository institutions increased significantly last year with the enactment of the anti-money laundering provisions of the U.S.A. PATRIOT Act.

Just this week, the Treasury Department issued new regulations implementing a key provision of that act requiring financial institutions to have in place programs designed to detect money laundering and terrorist financing.

In testimony before this subcommittee, and I think this is very good news for you all as representatives of you all's organizations, the FBI and other Government agencies have praised—and lavishly praised—the financial services industry for its cooperation with law enforcement in the post-September 11 investigations of al Qaeda and other terrorist organizations operating in the country. The cooperation of the institutions you represent couldn't have been better, and they have led to successful seizures.

It has often been said that banks and other financial institutions are our Nation's first line of defense in the financial war on terrorism that the Bush Administration is waging so effectively.

Last week's governmental warning that terrorists might be planning attacks against U.S. financial institutions in the Northeast brought home the banking industry's front line role in the fight against terrorism in stark terms.

So as we consider this important legislation to give financial institutions and their customers much needed regulatory relief, we should also take a moment to recognize the very real contributions to homeland security made by vigilant bank tellers and other financial services professionals across the country.

I now recognize the Ranking Minority Member, Ms. Waters, for an opening statement.

Ms. WATERS. Thank you very much, Mr. Chairman.

I would like to thank you for holding this hearing today. I would like to say that this hearing is certainly necessary. But, we have to remember that the name of the subcommittee is Financial Institutions and Consumer Credit. I worry that we tend to focus too much of our time on the financial institution part of the subcommittee's jurisdiction, and not enough time on issues that are very, very vital to consumers.

I am certainly not opposed to the principle of reasonable regulatory burden relief, and I will even concede that consumers could possibly experience some minor cost savings as a result of regulatory relief, but I think some of the provisions may go too far.

In particular, I am concerned about Section 301 of the bill, which would permit privately insured credit unions to become members of the Federal Home Loan Bank system. Membership in the Federal Home Loan Banks is desirable to credit unions, but is currently only open to those with Federal insurance. Unfortunately, in the past, there have been failures of private and State insurance funds.

In addition, this change could cause a number of credit unions to abandon their Federal charters and create a potential race to the bottom by State regulators to attract credit unions to their State.

We recently completed Federal deposit insurance reform legislation in this subcommittee, and while we may have had our differences on some issues, we all shared the goal of maintaining a strong and safe deposit insurance system. I can't imagine that we want to turn around and create incentives for credit unions to switch from safer Federal insurance to riskier private insurance.

H.R. 3951 needs to be a bit more balanced. There is nothing here for customers, and there are some very critical matters that need attention in that arena. For example, the numerical provisions in the Truth in Lending Act are so hopelessly outdated that many automobile loans fall outside of the act's capped amounts, which must be raised to have any meaning.

In addition, basic protections for credit card consumers are solely needed, and it is virtually an unregulated industry except for a few basic disclosures. These cards are used to entice people to take on debt that they can ill afford without giving them the tools they need to make an educated decision.

In order to meet relief from regulatory burden, there should be some regulations in place to begin with. Over the last quarter century, entire industries sprung into being largely outside of the boundaries of Federal regulation. I am talking about the check cashiers, the payday lenders, the mortgage services, and the subprime lenders who fly below radar in many of their activities.

So, Mr. Chairman, I hope that this bill develops a little bit more balance as it moves forward, because at this point, again, I am not so sure that I could point to very much for our consumers. However, I do look forward to hearing the witnesses today, and I must reiterate that I am supportive of getting rid of unnecessary burdens for our regulatory agencies. But, I would hope to have some initiation of discussion on some of those areas that I have pointed to, at some point in the work of this subcommittee.

Thank you very much.

Chairman BACHUS. I thank the Ranking Member.

Mrs. Capito, sponsor of the bill, we want to recognize you.

Mrs. CAPITO. Yes, thank you, Mr. Chairman. I appreciate you holding another day of hearings on this regulatory relief bill, and I want to thank our panel for taking the time to travel to Washington to appear before us today. I want to extend an especially warm welcome to Charlene Gaither, who comes to us today from my beautiful home State of West Virginia, and I look forward to providing the subcommittee with a more formal introduction in a few moments.

Mr. Chairman, as my colleagues will recall from our last hearing on this issue, Chairman Oxley, Mr. Sandlin and I introduced this bill in an effort to help reduce the substantial regulatory burdens imposed on the financial services industry.

While the Federal regulations play an important role in protecting consumers, instilling confidence and ensuring a level playing field, overregulation can depress innovation, stifle competition, and actually retard our economy's ability to grow.

Periodically reviewing and questioning the regulations put in place over time will ensure that as industries and technologies change, so too will the rules that govern them.

As I mentioned in our last hearing, I believe we have put together a good and balanced bill that will benefit both consumers and business. But this legislation is by no means a final draft.

These hearings are designed to flush out any potential problems that may exist, be they mistakes of omission, simple drafting errors or unintended consequences of what at first glance appear to be merely technical changes. I hope that today's witnesses will feel free to provide us with their expert opinions. I look forward to working with the Chairman as we move closer to the markup, and I thank the Chair again. Thank you.

Chairman BACHUS. Thank you.

At this time, Mrs. Roukema, do you have an opening statement?

Mrs. ROUKEMA. No.

Chairman BACHUS. We welcome you to the subcommittee.

Are there any other opening statements? Well, at this time we are going to allow Members to introduce the witnesses that are from their home States. And at this time I recognize the Ranking Member, Ms. Waters.

Ms. WATERS. Thank you very much. Mr. Chairman and Members, I would like you to join with me in welcoming Mr. Bill Cheney, who is the president and CEO of the Xerox Federal Credit Union in El Segundo, one of the small cities adjacent to my district.

Mr. Bill Cheney, who is the President and CEO of Xerox Federal Credit Union has a broad background in financial services, including more than 15 years working in the credit union industry.

Bill joined Xerox Federal Credit Union, which by the way had more than $590 million in assets in 1997, after more than 10 years with Security Service Federal Credit Union in Texas. This credit union serves employees from Xerox Corporation and related companies nationwide through 18 credit union offices in nine States, including California, New York, Illinois and Texas. In addition, the credit union owns 39 percent of Xerox Credit Union Corporation, a brokerage and insurance company serving multiple credit unions and their members throughout offices in 15 States.

Welcome, Mr. Cheney.

Chairman BACHUS. Thank you. Mr. Cantor.

Mr. CANTOR. Thank you, Mr. Chairman.

I have the distinct pleasure to welcome two fellow Virginians today. Always, hopefully inspiring to be the Virginia gentleman that Mr. Stone is, I will go to the lady first.

It is my pleasure to introduce Ms. Elizabeth, or Betsy, Duke. She is a lifelong resident of the Commonwealth and began her career in banking in 1975. She started as a drive-in teller and worked her way to President and CEO of the Bank of Tidewater by 1991.

She has also served as an instructor on the banking industry in numerous locations and is a past member of the Board of the Richmond Federal Reserve. She currently serves on the board of the American Bankers Association and is Chairman of the ABA's Government Relations Council. She is also President of SouthTrust Bank, Virginia Beach. I consider Betsy a friend, a valuable resource on banking industry resources and look forward to her testimony. Again welcome.

I would also like now to welcome, Mr. Chairman, a constituent of mine, always an honor, and he is a true Virginia gentleman, Mr.

Pierce Stone. Pierce is the Chairman, President, CEO of the Virginia Community Bank in Louisa, Virginia. He is also the Chairman of the Independent Community Bankers of America.

He earned his Bachelor of Science Degree in Business Administration from the University of South Carolina and is a graduate of the School of Banking of the South. He also served as a Director of the Federal Reserve Bank of Richmond from 1990 to 1992. He was appointed by the Governor of Virginia to serve as a Director on the Virginia Real Estate Appraisers Board.

Long active in the ICBA, Mr. Stone has served as Chairman of the Long-Term Planning and Marketing Committee and is an ICBA State Director. He serves on the board of the ICBA Credit Life Company. He is a member of the Virginia Association of Community Banks, and is past President of this organization.

He helped organize and was Chairman of Community Bankers Bank of Virginia. Other businesses and activities include many, Mr. Chairman. He is Director of a weekly newspaper company, a radio station, as well as Rockingham Group, which is a property and casualty mutual company. He is the former treasurer and board member of the Lions Club in Louisa, and most importantly, he is married and has two children.

I would say, Mr. Chairman, it is a real honor for me to welcome Pierce. He is a leader in our community, and I am proud that he is here today and look forward to his testimony. I yield back.

Chairman BACHUS. I will say this, Mr. Stone. You have been before the subcommittee before. And, Mr. Hage, you are no stranger to the subcommittee. So normally we only introduce folks that are coming before the subcommittee for the first time. But this time, in this case Mr. Cantor, since he was introducing Ms. Duke, he was afraid not to reintroduce you. And, Mr. Stone, so that you know, that is probably very diplomatic to do.

Mr. Hage, I want to commend you on your recent appointment to the President's Task Force on Retirement Savings. And, as he knows, he was appointed by Speaker of the House Denny Hastert. I think that is quite a recognition of your accomplishments and professionalism. So I commend you on that. You have important work ahead of you.

Are there further opening statements? I am sorry. Mrs. Capito. You have not introduced the gentlelady from West Virginia, have you?

Mrs. CAPITO. No, not in full.

Chairman BACHUS. All right. Thank you.

Mrs. CAPITO. Thank you. Mr. Chairman, I want to welcome Charlene Gaither to Washington and to thank her for taking her time to provide the subcommittee with her expertise on the regulatory burden facing our Nation's credit unions. I had the opportunity yesterday to spend some time with Charlene, and I was very impressed with her dedication, not only to her members but with her extensive knowledge of the industry.

As one of seven full-time employees, Charlene currently serves as the manager of Eastern Panhandle Community Federal Credit Union in Martinsburg, West Virginia. The Community Federal Credit Union is a $14 million credit union that serves more than 2,000 members. Charlene has handled the duties of Chief Financial

Officer and Chief Marketing Officer during her tenure, and is a volunteer board member of the West Virginia Credit Union League.

Charlene's 17 years of experience gives her, I think, a unique perspective on how the regulatory relief bill will help both consumers and business. I am pleased to have her here, my fellow West Virginian, and I look forward to her testimony.

Chairman BACHUS. Thank you. And we will start, Ms. Gaither with your testimony. And you can maybe explain to us starting out how Martinsburg has a 5-story FAA building. But if you don't want to you don't have to.

STATEMENT OF CHARLENE R. GAITHER, MANAGER, EASTERN PANHANDLE COMMUNITY FEDERAL CREDIT UNION, MARTINSBURG, WV, ON BEHALF OF CREDIT UNION NATIONAL ASSOCIATION

Ms. GAITHER. Chairman Bachus, Ranking Member Waters and Members of the subcommittee, especially my own Member, Representative Capito, thank you for the opportunity to provide comments on H.R. 3951 and your efforts to design legislation to lessen the regulatory burden on insured depository institutions.

I am Charlene Gaither, Manager of the Eastern Panhandle Community Federal Credit Union, a $14 million credit Union in Martinsburg, West Virginia. I appear before you today on behalf of the Credit Union National Association.

We congratulate Representative Capito for introducing this bill and including the legitimate needs of credit unions for regulatory relief. I would like to emphasize that my testimony today will focus on the provisions in the bill which pertain to credit unions as well as those we would like the subcommittee to include in any final bill.

We understand that the ABA and other bank trade associations oppose all or parts of this bill because of the credit union provisions. We will not lower ourselves to their level and attack provisions pertaining to them.

While my written statement includes a thorough analysis of each of the credit union provisions, I will only touch on a few of them in my oral statement this morning.

CUNA strongly supports Section 301 of the bill, which permits State-chartered, privately insured credit unions to become members of the Federal Home Loan Bank. This provision was originally introduced as H.R. 2796, the Federal Home Loan Bank Membership Act of 2001, by Representative Bob Ney.

As incorporated into H.R. 3951, it would provide a needed funding source for home ownership for many credit union members as well as strengthen the dual chartering system of credit unions. These 216 institutions with 1.3 million members are regulated by the States in which they were chartered. They are subject to safety and soundness requirements from the State regulator as well as the private insurer.

We also want to commend Representative Capito for including Section 306 in the bill, which incorporates legislation previously introduced by Representative Ed Royce, H.R. 760, the Faith Based Lending Protection Act. This amendment, which we strongly support, is designed to exclude loans made by Federal credit unions to

non-profit religious organizations from the statutory member business loan limit of 12.25 percent of the credit union's total assets. According to the recent testimony of NCUA Chairman Dennis Dollar, these are the safest of all loans made by credit unions.

Another very important part of the bill is Section 307, which allows Federal credit unions to cash and sell certain checks to non-members of the credit union as long as they are eligible to join or are within the field of membership of the credit union. Many of these individuals live from paycheck to paycheck and do not have established accounts for a variety of reasons, including the fact that they do not have extra money to keep on deposit.

Finally, Section 308 would clarify the Federal Credit Union Act by allowing voluntary mergers of healthy credit unions and conversions involving multiple common bond credit unions without numerical limitations. The amendment is a big step forward in facilitating voluntary mergers as other financial institutions are permitted to do.

At this point, I will turn to the additional provisions we would like to see included in a final bill. Again, my written statement fully covers what we believe are some of the worst examples of statutory micromanagement that have placed unreasonable constraints on the ability of credit unions and their boards to function efficiently and in the best interests of their members. Given time constraints, however, I will focus only on two of these items.

First, recall that H.R. 3951, as drafted, permits credit unions to cash checks for individuals within their field of membership, even if they are not members. Our original request also asked for the ability to provide wire transfer services to non-members within the field of membership.

Such an amendment would help credit unions reach the unbanked and underserved and provide an affordable and financially sound alternative to high cost payday lenders. Those who do not have access to a credit union or other financial institution must use wire services that charge outrageously high fees, up to 28 percent of the amount transferred in some cases, to execute the transaction.

Perhaps one of the most important provisions we are asking to be included in a final version of H.R. 3951 is one that would permit credit unions to issue some form of additional or alternative capital.

As the Chairman of the subcommittee notes, this issue was first raised in this subcommittee during the markup of the Deposit Insurance Reform bill. An amendment was introduced, discussed, then withdrawn. While some consideration was given to reintroducing the amendment at the full committee markup, out of deference to the Chairman it was not.

The purpose of allowing some form of alternative capital would permit credit unions to augment the only current source of capital that they have, retained earnings. Alternative capital would allow a credit union that needs to do so to quickly build its capital.

Advantages of alternative capital are that it would provide additional stability, allow growth, permit product and service enhancements and could meet a portion of statutory and regulatory capital requirements, And, frankly, although CUNA has a strong position

regarding the concept of allowing some form of alternative capital for credit unions, our position regarding how to achieve that is evolving.

We are currently in discussion with various Members and staff of the subcommittee and are seeking a consensus on how to best achieve this goal while maintaining certain guiding principles. Foremost of these guiding principles is that any form of alternative capital must not compromise the cooperative nature of credit unions.

This capital must not give its holder any voting or control rights. Additionally, this capital must not be insured and it must therefore be at risk to the investor. We continue to work on an appropriate approach that will accomplish these purposes and seek advice and guidance from Members of the subcommittee.

In conclusion, CUNA is grateful and pleased that H.R. 3951 includes several provisions that will significantly increase the effectiveness of credit unions in serving their members. And while we strongly support this bill, we urge the subcommittee to support our efforts to include the additional provisions we described in this testimony.

Thank you again for the opportunity to present CUNA's views on this very important legislation, Mr. Chairman, and I would be glad to answer any questions of the subcommittee. Thank you.

[The prepared statement of Charlene R. Gaither can be found on page 170 in the appendix.]

Chairman BACHUS. Thank you, Ms. Gaither.

Mr. Cheney.

STATEMENT OF WILLIAM CHENEY, PRESIDENT AND CEO, XEROX FCU, EL SEGUNDO, CA, ON BEHALF OF NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. CHENEY. Thank you, Mr. Chairman.

Good morning, Mr. Chairman, Ranking Member Waters and Members of the subcommittee. My name is Bill Cheney. I am the President and CEO of Xerox Federal Credit Union, located in El Segundo, California. I am here today on behalf of the National Association of Federal Credit Unions to express our views on the Financial Services Regulatory Relief Act of 2002.

Xerox Federal Credit Union was chartered in 1964 and currently serves over 72,000 members through 18 offices in nine States, and is the only credit union chartered to serve Xerox employees in the United States.

Credit Unions represent a significant cross-section of all of America's consumers. The Nation's 10,000-plus credit unions serve a different purpose than other financial institutions and have a fundamentally different structure, existing solely for the purpose of providing financial services to our members.

All members of a credit union have an equal say in the operation of the credit union. One member, one vote, regardless of the dollars in their accounts. Credit unions are second to none in providing their members with quality personal service at the lowest possible cost. According to the 2001 American Banker/Gallup Consumer Survey, credit unions had the highest rated service quality of surveyed financial institutions.

Despite their very limited market share, credit unions have been under assault by the banking industry for nearly 2 decades. The 1998 Supreme Court decision in the field of membership case brought these issues to a head. Congress' prompt passage of the Credit Union Membership Access Act, or CUMAA, in 1998 was seen as a significant victory for credit unions.

Recognizing a growing trend of credit union conversions from Federal to State charter, totaling $33 billion over the past 5 years, and accounting for over 10 percent of all assets in the Federal credit union system, NAFCU has singled out the erosion and the perceived value of the Federal charter as an important issue.

Starting with a task force convened to work on ways to enhance the Federal charter, we have identified a number of provisions in both law and regulations which, if changed, would improve the way Federal credit unions serve their members.

NAFCU believes that H.R. 3951 is a positive step in addressing many of the regulatory burdens and restrictions on Federal credit unions that have caused a number of Federal credit unions to either consider or to convert to State charter.

NAFCU applauds Representatives Capito and Sandlin for their leadership in introducing this bill and strongly supports many of the provisions in the legislation, including the sections dealing with expanded investment authority, clarification of the ability for credit unions to merge voluntarily, easing the limitation on loan terms, credit union service organization investments, check cashing services, member business lending to religious non-profit organizations, and land leasing.

We believe H.R. 3951 takes a balanced approach to regulatory relief. Nevertheless, I would like to call the subcommittee's attention to some additional issues.

First, credit unions should be exempted from the pre-merger notification requirements of the Hart-Scott-Rodino Act to the same extent as other regulated financial institutions.

Second, the usury ceiling for credit unions should be adjusted. As the Members of the subcommittee realize, Federal credit unions are the only type of insured depository institution subject to Federal usury limits on consumer loans.

Third, Congress should remove the word "local" from the definition of community charters. Today's dynamic financial marketplace characterized by cyber-banking technology rather than bricks and mortar makes the word "local" an extraneous limitation.

Fourth, eliminate the preference imposed by CUMAA for the formation of new credit unions over the addition of groups to an existing credit union. Oftentimes an existing credit union is better suited to meet the needs of a group and offer them better services than a new credit union.

Fifth, relax the reasonable proximity requirement on credit unions seeking to add additional groups to its field membership. This requirement is an undue burden requiring them to have a physical presence within a reasonable proximity of the group that the credit union wants to add to its field of membership. With the increase in internet and remote banking, this requirement is unnecessary.

Sixth, relax the current member business loan restriction imposed by CUMAA and restore the member business lending rules that were in effect prior to the passage of CUMAA.

Seventh, NAFCU supports allowing all insured credit unions, not just corporate credit unions and those designated as low income, to include secondary capital accounts when calculating net worth under regulations promulgated by NCUA.

Finally, the Federal Credit Union Act contains many antiquated credit union governance provisions that may have been appropriate in 1934, but today are outdated. NAFCU supports including language in H.R. 3951 that would give the NCUA board greater authority in establishing appropriate governance procedures.

I would like to conclude by noting that the state of the credit union community today is strong and the safety and soundness of credit unions is unquestionable. NAFCU would, however, urge the subcommittee to carefully assess the trend of conversions from Federal to State charter. We believe that H.R. 3951 is an excellent first step.

Mr. Chairman, I appreciate the opportunity to appear before you today, and I will be happy to answer any questions.

[The prepared statement of William Cheney can be found on page 184 in the appendix.]

Chairman BACHUS. Appreciate that.

Mr. Stone.

STATEMENT OF PIERCE STONE, CHAIRMAN, PRESIDENT AND CEO, VIRGINIA COMMUNITY BANK, LOUISA, VA, ON BEHALF OF INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. STONE. Good morning, Chairman Bachus, Ranking Member Waters and Members of the subcommittee. My name is Pierce Stone. I am a community banker from Louisa, Virginia. I also serve as Chairman of the Independent Community Bankers of America.

Chairman Bachus, I want to thank you and congratulate you for the ongoing efforts on behalf of community banking, especially your leadership in advancing the important deposit insurance reform bill. Community bankers across the Nation are truly indebted to you. I also want to thank the subcommittee staff for the outstanding work that they did on this bill.

I have been asked to testify on H.R. 3951, the Financial Services Regulatory Relief Act of 2002. ICBA supports a bank regulatory structure that fosters the safety and soundness of our Nation's banking system and recognizes the fact that community banks pose a very different risk to the banking system than larger banks.

We urge Congress and the agencies to continue to adopt policies that recognize this important distinction.

In the interest of time, I will limit my remarks to just a few sections of the bill. Let me first address the provision in the bill that is very important for community banks, Section 101, dealing with Subchapter S corporations.

This section removes a restriction in current law that makes it difficult for community banks to qualify for Subchapter S status. Subchapter S is very important to community bankers, because it allows them to escape double taxation by paying income tax only at the shareholder level.

Unfortunately, many small banks are having trouble qualifying for Subchapter S under the current law and cannot benefit from Congress' intended tax relief. Section 101 addresses the director/shareholder restriction in the law by making it easier for banks to comply with the requirement that directors be shareholders.

ICBA supports reducing the frequency of safety and soundness exams for small, healthy banks and supports minimally intrusive examinations. Section 601 gives the Federal banking agencies the discretion to adjust the exam cycle of insured depository institutions to ensure that examiner resources are utilized in the most efficient manner. ICBA strongly supports this position.

ICBA recommends the subcommittee include a provision in the bill to amend the Securities Investor Protection Corporation statute to provide community banks with the same protection afforded other investors and other depository institutions for their brokerage account assets when a broker dealer fails.

SIPC does not protect against market risk or fraud. It allows investors to get back their stock, bonds and cash held by a broker dealer in the event of a brokerage firm collapse. Unfortunately, banks are specifically excluded from SIPC coverage when acting on their own behalf. Thrifts and credit unions are not excluded from SIPC coverage. The change we seek in the statute simply affords banks the same SIPC protections as credit unions and thrifts.

Mr. Chairman, I would now like to address a few provisions in the bill that cause ICBA some concerns. One issue is the provision that repeals the prohibition on national and State banks to expand into another State through de novo branching. We believe that the individual States should decide whether an out-of-State national or State bank should de novo branch into their State. We believe States should be free to make this decision, because they know best what the banking structure in their State should be. Congress should not preempt this basic State right.

Chairman Bachus, there are also several credit union provisions in this bill which ICBA opposes. Our specific concerns are outlined in our written statement. Let me just say generally that Congress should tread carefully in granting credit unions new powers in areas where they do not have the experience or expertise to assure safe and sound operations.

Credit unions and community banks both serve the community and offer many of the same products and services. However, there is one major difference. Credit unions generally do not pay taxes and are not subject to CRA, giving them an enormous advantage over taxpaying and highly regulated banks and thrifts. We believe the expanded powers granted to credit unions in this bill goes against the spirit of the Credit Union Membership Act of 1998, as well as their basic charter.

Chairman Bachus, thank you for the opportunity to testify before you today on H.R. 3951, and thank you again for your stellar work on deposit insurance reform. I will be happy to answer any questions from the subcommittee.

[The prepared statement of Pierce Stone can be found on page 229 in the appendix.]

Chairman BACHUS. Thank you.

Mr. Hage.

STATEMENT OF CURTIS L. HAGE, CHAIRMAN AND CEO, HOME FEDERAL BANK, SIOUX FALLS, SD; CHAIRMAN, AMERICA'S COMMUNITY BANKERS

Mr. HAGE. Mr. Chairman, Ranking Member Waters and Members of the subcommittee. I am Curt Hage, Chairman and CEO of Home Federal Bank in Sioux Falls, South Dakota. I am testifying today as Chairman of America's Community Bankers.

Thank you for this opportunity to testify on H.R. 3951. I would like to commend the bill's primary sponsor, Representative Shelly Moore Capito, as well as Representative Max Sandlin. In addition, I would like to thank Chairman Oxley and the committee staff for working with ACB in developing this legislation.

ACB strongly supports many of the provisions contained in H.R. 3951. By eliminating unnecessary and costly regulations, these provisions will make it easier for financial institutions to better serve our customers and communities.

I would like to touch on some key provisions. A more detailed analysis of the bill can be found in my written testimony.

ACB vigorously supports Section 201, which would correct the existing statutory disparity in the way trust and fiduciary activities of savings associations are treated *vis-a-vis* those of banks.

Currently, savings associations do not enjoy the same exemption that banks do from the Investment Advisors Act and the Securities Exchange Act for trust and fiduciary activities. As a result, only savings associations face dual supervision and regulation when serving the trust and fiduciary needs of their customers. We are pleased that Section 201 provides a much needed fix for this problem.

ACB also supports Sections 401 and 105 of the bill. Section 401 would remove unnecessary restrictions on branching by national and State banks. Section 105 would eliminate the unnecessary requirement that a national bank meet the same capital requirements imposed by States on their banks. We commend the bill's sponsors for including those provisions in H.R. 3951.

ACB also recommends that the subcommittee include additional provisions in H.R. 3951. First, we strongly urge the subcommittee to consider adding a provision that would modestly increase the business lending limit for savings associations. Currently Federal savings associations are subject to a 10 percent limit on commercial lending authority and a 10 percent bucket for small business loans.

With more and more small businesses depending on smaller associations as community credit providers, those limits pose an ever increasing constraint on credit availability for small businesses. This is particularly true in smaller communities where there are fewer credit providers.

Congress should repeal the lending limit restrictions on small business loans and increase the aggregate lending limit on other commercial loans to 25 percent. By doing so, Congress can accommodate the credit needs of small business without altering the basic asset requirements of the statutory qualified thrift lender test.

Let me emphasize this last point. We are not asking for a change in the QTL test. We are only asking that redundant caps on business lending be lifted, particularly for small business loans.

In addition, ACB urges the subcommittee to consider including in H.R. 3951 the following proposals detailed in my written testimony: Repealing the $500,000 per unit limit in the residential housing development exception in the Homeowners Loan Act; increasing the limit on commercial real estate loans from 400 percent to 500 percent of capital; and permitting reimbursement for the production of corporate and organizational records under the Right to Financial Privacy Act.

Finally, Mr. Chairman, we would like to raise our strong concerns about Section 301, which would permit privately insured credit unions to join the Federal Home Loan Bank System. Unlike these institutions, every depository institution that is currently a member of the Federal Home Loan Bank must be, and is, federally-insured and regulated.

This provides a substantial layer of security for the Federal Home Loan Bank System. Permitting privately insured credit unions that undergo no Federal regulatory scrutiny to borrow from the system would undermine the careful balance Congress achieved in the Gramm-Leach-Bliley Act.

ACB also opposes the lending limit increase in Section 304, check cashing for non-members in Section 307, and the undermining of the common bond in Section 308. These sections would allow tax-exempt credit unions to assume new bank-like authorities without having to pay taxes or meet community reinvestment requirements. ACB strongly urges the subcommittee to strike those provisions.

Again, Mr. Chairman, thank you for holding today's hearing. I look forward to addressing any questions that Members of the subcommittee might have.

[The prepared statement of Curtis L. Hage can be found on page 237 in the appendix.]

Chairman BACHUS. Thank you.

Ms. Duke.

STATEMENT OF ELIZABETH DUKE, SENIOR VICE PRESIDENT, GOVERNMENT RELATIONS, SOUTHTRUST CORPORATION, VIRGINIA BEACH, VA, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Ms. DUKE. Mr. Chairman, Ranking Member Waters and Members of the subcommittee, I too want to thank you for holding this hearing. I would also personally like to thank Mr. Cantor for the introduction, therefore I don't have to use my 5 minutes explaining who I am.

Regulatory relief is critically important for banks. We appreciate the bipartisan effort in this and previous Congresses to preserve safety and soundness while reducing unnecessary regulations. I would especially like to recognize the contributions made over the years by Mrs. Roukema.

Regulation costs banks and our communities billions of dollars every year. It also puts a huge strain on manpower.

SouthTrust is a large banking firm with $48 billion in assets. We have 65 full-time employees devoted to compliance.

Small banks simply do not have this luxury. There are 3,800 banks with fewer than 25 employees and a thousand banks with

less than 10 employees. As a former CEO of a community bank, I know that these banks don't have the manpower to both run the bank and to read, understand and implement thousands of pages of regulations, directives and reporting modifications that they receive each year.

Simply put, too much time and too many resources are consumed by compliance paperwork, leaving too little time to provide actual banking services. H.R. 3951 contains many important improvements that genuinely reduce unnecessary regulatory burdens.

Unfortunately, the bill also contains provisions that are not directed at reducing regulatory red tape, but to enhance the competitive position of credit unions over taxpaying banks.

Let me mention a few of the key provisions that we support. The ABA strongly endorses Section 201, which provides thrift parity for trust activities and would eliminate an additional and unnecessary layer of examination.

We also support Section 501, which would allow all financial holding companies engaged in merchant banking to cross-market products and services. These provisions have the strong support of our industry and the Federal Reserve.

Section 502 would help banks preserve benefit plans for our employees, such as 401(k)s, without worrying about triggering aggregation rules for ownership of any one company.

We also support provisions, including Section 601, which allow discretion for regulators to adjust the exam cycle to more effectively allocate examination staff; Section 101, which enables banks to choose Subchapter S status to retain qualified directors; and Section 202, which makes the community development authority of savings institutions parallel to that of banks.

The ABA has major concerns with provisions that expand credit union powers and promotes further consolidation of the credit union industry. These provisions enhance the competitive position of credit unions over taxed financial competitors and expand the credit union tax subsidy.

Section 305 expands the authority of credit unions to invest in credit union service organizations. These CUSOs can engage in activities beyond those authorized for the credit unions themselves.

Furthermore, since most CUSOs are formed as limited liability corporations, they are taxed at the credit union's marginal tax rate of zero. Thus, any expansion of CUSOs is an expansion of the credit union tax subsidy.

Section 308 also would permit mergers at any time among credit unions. This would further the trend of large credit unions buying up small credit unions and is in direct conflict with legislation enacted just a few years ago. Specifically, Congress directed NCUA to promote the creation of independent credit unions and to limit the merger of credit unions with over 3,000 members to situations involving a troubled credit union.

We also oppose Section 306, which would exempt from the legal lending limits loans to non-profit religious organizations. We do appreciate the intent of the provision's author. However, we are first concerned with eliminating any categories of business loans from the business cap. There are already exceptions to the business lending cap. We oppose the addition of yet another.

Second, the provision is so broad that businesses with only a remote connection to a religious organization could qualify. Moreover, many religious organizations operate significant business enterprises, therefore allowing for a substantial increase in business lending.

There are two provisions related to credit unions that could reasonably be considered to eliminate burdens without expanding powers or enhancing competitive position. The first authorizes a 15-year maturity limit for loans, and the second provides additional investment authority for credit unions.

In conclusion, Mr. Chairman, reducing unnecessary paperwork is a serious long-term goal. The ABA is committed to working with you and the Members of this subcommittee to achieve this objective.

Thank you, Mr. Chairman.

[The prepared statement of Elizabeth Duke can be found on page 271 in the appendix.]

Mr. BACHUS. Thank you. That was interesting testimony. That was actually more exciting and entertaining than I thought it would be.

Were any of you all home-schooled? None of you? You all went to public school, right? Have you ever been in a food fight? You know, food fights get you in trouble when you are in school. They usually are not that constructive.

Our aim here is to have win-win situations. It is to take regulations, things the regulators are doing, things that cost you money that you don't have available to loan out, and try to eliminate those regulations that make no sense, or barriers that make no sense.

Now, one of the ones that has been discussed here is this Section 301 of the bill, privately insured credit unions authorized to become members of the Federal Home Loan Bank Board. I know the banks are all opposed to this. One of the things is they are not banks. Or insurance companies participate in the Federal Home Loan Bank Board. Insurance companies can go to them, and really something that I am not sure that every banker knows, but those that are federally insured go to the Federal Home Loan Bank Board. So there are already credit unions participating in the Federal Home Loan Bank Board system.

The statement was made that credit unions should not participate. They already participate. So it is just a distinction on whether they are privately insured or federally insured.

We have every provision and belief that those that are privately insured through the right regulatory scheme will, the taxpayers will be fully protected. That is one thing.

Another thing that I really know the bankers are sensitive to, and I would be sensitive to it, too, if credit unions were taking over large amounts of bank business, just a tremendous amount of market share, and there is actually a belief out there that that is in fact happening. One of my best friends who is a banker told me that the credit unions have basically tripled their business while we have lost business. That is anecdotal evidence.

First of all, his bank has tripled in size in the past 10 years. I found no credit union in his home county that has grown anywhere near that amount. But then I came back to Washington, this was

probably 4 years ago, and I asked are credit unions eating into bank share? I don't know whether you all can answer that. Are you aware of what the answer to that is? The answer is no. The credit unions are not. As a total share of assets under deposit, it has gone from, financial assets, I think it has gone from 1.4 to 1.7 in 23 or 24 years.

We do not want to do anything in this bill that will give a credit union an unfair advantage over a bank, an unfair advantage. What we want to concentrate on is, as I said, win-win. Here are provisions that will help us.

Section 301 was not something that this Chairman actually put in the bill. It was put in there by the Full Committee Chairman, which is even more significant, if you have been around this place. When he did that, my red flag went up, because I am sensitive to bankers in my area that tell me that the credit unions have an unfair advantage. But, a lot of what has been said about it, I would have to agree with the credit unions. The arguments simply, when you look at them, they do not have as much substance as they should.

I am not sure we will get a bill. If we continue to argue about whether credit unions get something—and the last two bills did not have anything for credit unions—but, we want everybody treated fairly, and there are some of the proposals that, for instance, we do not want anything added anymore for the credit unions. They have proposals to let them sell money orders to their membership, or to be able to kick off a board member. That is their ability to manage their own organization. I cannot understand how that is unacceptable.

Let me tell you, I am not motivated about helping one group or the other. I believe we can get a bill that helps all the organizations.

But, I want to encourage all sides, if you could demonstrate that it is unfair and it ought not happen, that is one thing. But if you already have credit unions participating in the Federal Home Loan Bank Board, and some already do, I am not sure that the argument is going to fly.

I would use your dynamite and your political might in looking at things that will benefit your institutions and the consumers you serve in eliminating barriers.

A good example which the credit unions have come with is doing a money order, I think it is a wire transfer. Why should they not be able to offer that to their members? I can't see any reason why they should not. I was one of 7 people that voted against the credit unions on the floor of the House in that famous bill, so I do not think I can be accused of carrying a lot of water for the credit unions. Four of the people that voted with the banks on that bill were not running for reelection. So I am not afraid to stand up for the side I think is best.

If we are to get a bill out, then there is going to have to be some of this. You are going to have to pay more attention to what would benefit your institutions and your association and their members than say seeing that somebody else gets something that they do not have now.

Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman. I think you did a good job of basically representing how many of us are feeling about this legislation. It appears that there is going to be some relief that you will all benefit from. There is a little competition going on here. We understand that.

At the same time, we are often made to believe that all of you laissez-faire capitalists believe in competition, and that we should support that, and Government should get its hands out of the business of protecting one industry over the other. So, I think that I am going to lean to the right a little bit and join with my colleague in just saying to you that it is in the best interests of our citizens and all of us to have you operating in ways that will service the citizens of this country to the best of your ability.

Now, I want to tell you, I like the idea that credit unions will be able to provide products that they have not been able to provide to the credit union members. I do not like freestanding check cashers who do not provide any other services but to cash checks and take a percentage of those earnings from hard-working people. I don't like freestanding payday loan folks who simply tie people up for the rest of their lives lending over and over again with checks that are kind of signed in advance. I like institutions that provide multiple services, and all of you do that. You provide multiple services. And, to the degree that you do that, I think that we provide better products for our taxpayers out there.

As our Chairman has said, this bill is attempting to do the right thing for everybody and not really take sides. I think there are some legitimate questions on Section 301, but I think that you guys can work that out. The Chairman makes a good point: If you already have credit unions that are in the Federal Home Loan Bank system, it is hard to make an argument to say that somehow there are some that should be kept out.

We do want to just remind you that the numerical provisions in the Truth in Lending Act are kind of outdated, and I hope that we have an opportunity to look at that, particularly as it relates to automobile loans. The limits have failed to keep pace with inflation, and many of those loans are not covered by the limits of the act. So, we may be looking at an amendment to bring TILA up to date and index the numerical provisions for inflation so we do not have that problem.

For those of you who represent credit unions who want to lend more money to the churches, I think you need to talk to some of us. I am told that there are all these ministers who want this. I have not heard from any of them, and I do not know what that means. I do not know if that means that a disproportionate share of your resources are going to end up proliferating more and more churches, or take away from some of your business loans. I do not know what it means. So, I think I would like to hear from the advocates of eliminating that from the caps in the credit unions.

With that, let me just say we have an opportunity to tighten up this legislation a bit and have everybody in support of it, and I would hope that we would all use those opportunities prior to our votes on markup to do that. I yield back my time.

Mr. WELDON. [Presiding.] The Chair will announce it is his intention to recognize Mrs. Capito for 5 minutes of questioning, and

then recess for 20 minutes so that Members will have an opportunity to go to the floor and vote and then come back for further questions.

The gentlewoman from West Virginia, I believe the co-author of the legislation under consideration, is recognized for 5 minutes.

Mrs. CAPITO. Thank you, Mr. Chairman. Thank you all for your testimony. I think I mentioned in my opening statement that it is a work in progress, and I think all of your testimony shows that there is some work that you all would like to see from every angle, and I think that is a good thing. That is why hearings such as this are of great benefit to us as Members.

I would like to ask Ms. Gaither about a conversation we had in my office yesterday when we talked about the fact that credit unions cannot expel members or remove members from their membership roles. I would just like for you to maybe tell a little bit about that story and a personal situation that you had in your office.

Ms. GAITHER. Thank you. Yes, yesterday we were talking, I had explained to Representative Capito that we had actually had a member come into our office who was dissatisfied for one reason or another and actually told one of my tellers that if he ever saw her outside the credit union, he was going to punch her. We had no means at that point to be able to expel this member other than calling a full membership meeting.

Mrs. CAPITO. Does this bill in the present form give you that power? It will give you that power?

Ms. GAITHER. Yes, we would be able to expel for just cause.

Mrs. CAPITO. I would like, and anybody can answer this question from your different perspectives, to ask, in terms of more access for consumers to all of your institutions, it would seem to me—you mentioned, Ms. Duke, that you have what, 75 regulators that—compliance officers in your bank. I would imagine that having to deal with fewer regulations, less duplicative regulations, would not only maybe give you some relief in terms of staffing issues, but also would provide greater access along with insurance protection to the consumer that we would like to see.

Do you envision this bill in any way, because of the fewer time and the fewer details in some instances that you are going to have to work on, that it will go to the benefit of an individual consumer using one of your institutions?

Ms. DUKE. Yes. As I stated, any time that you can spend less of your resources actually working on regulations and the implementation of regulations gives you more time to serve the customer and it also—frankly, many of these regulations that are designed to protect the consumer are often more confusing to the consumer than the original issue.

The other thing, when I talk about manpower, and this goes to my experience as a community banker, is as these regulations come out, you do not have the people who are trained to actually read them, so the CEO and the upper level management of the organization are the ones that end up having to spend time with those.

When FDICIA was passed, I believe it spawned 64 separate regulations. At that time I had 65 employees. So if I had assigned one regulation to each employee and given the courier the time off, that

is what it would have taken for us to actually go through and look at each one of those regulations.

Mr. CHENEY. Thank you, Congresswoman. Given the member-owned nature of credit unions' expenses, I think it is safe to say if we could reduce our expenses associated with regulation and compliance, that those funds within the credit union would either go toward expanded services for our members, or to capital to make the credit union stronger and support our growth.

Mr. STONE. I have 62 employees in my bank, and what is really expensive is when we have to seek outside counsel to interpret regulations, from CPAs to attorneys. That really is very, very expensive when some of them can bill $200 and $300 an hour. You get regulation, and we must comply and want to comply, and we get help from the regulators we have, but we still have to get outside help so many times from an outside organization.

Mrs. CAPITO. Mr. Chairman, I yield back. I would like to say that the Financial Services Roundtable has testimony they would like to submit for the record.

Mr. WELDON. Without objection.

[The information can be found on page 282 in the appendix.]

Mr. WELDON. The Chair announces a recess for 20 minutes.

[Recess.]

Mr. WELDON. You are a great group. I did not have to bang the gavel and you came to order.

The Chair recognizes the gentleman from Texas for 5 minutes.

Mr. BENTSEN. Thank you, Mr. Chairman. I thank our panel for being here.

I want to say, Mr. Chairman, at the outset, I know that the Chairman of the subcommittee talked about the food fight aspect, but I do want to say it is somewhat of an historic moment to see that the testimony of the American Bankers Association praising the community bankers, the savings & loan industry, in such great detail, and wanting to give them more rights. It is something I may get framed just to hold on to, and actually expanding their charter to some extent as opposed to eviscerating or eliminating their charter.

I have a couple of questions. I will say on that point, with respect to the broker-dealer, I have some history in that, and I do hope that, assuming that we pass this bill and we give equal treatment for broker-dealer trust operations with thrifts, that as I hope the SEC is doing working with the Comptroller and the Fed, that the rules are equivalent to those required of broker-dealers which are under the auspices of the Securities and Exchange Commission. I am one that felt that it ought to just be the same regulation. I know the banks have felt differently about that. But at least, if nothing else, you ought to do the series 6 and 7 and all of the others and have similar requirements.

I have two issues I am interested in in this bill. One has to do with cross-marketing restrictions from Gramm-Leach-Bliley, and the other has to do with Riegle-Neal. I think I will talk about Riegle-Neal very quickly to the independent bankers.

We had the regulators before the committee a month or so ago, and I asked about the provision that would preempt Riegle-Neal's interstate banking preemption. That is an issue that obviously has

been very important in my State and other States. The argument was made by the Fed that in fact this was a small bank issue, that the intention here was to help smaller banks, particularly those who want to branch across the border to another bank. But since you represent the smaller banks, obviously that is not the way you all see it?

Mr. STONE. We think it is a States' Rights issue. The States know better what their market situation is. In Virginia—we were just discussing that at the break—that I think in Virginia we have reciprocal agreements with all of our, off the top of my head, all of our States, and we do branch back and forth across those lines. But, you know, if you have a State that has a neighbor that is not so gracious to do that, it seems like to me that would be their choice.

Mr. BENTSEN. Let me go to the cross-marketing restrictions. Perhaps you all can refresh my memory. When we did the Gramm-Leach-Bliley, we allowed certain types of cross-marketing to occur within a financial services holding company. We put restrictions on third parties and the like because of concerns about privacy and others.

I guess at the end of the day when we allowed for the merchant capital subsidiary or affiliate under the holding company, we decided, for some reason, to impose cross-marketing restrictions, at least as it applied to securities firms as opposed to insurance firms. I am not sure exactly why we did that at the time and, I do not know, maybe the ABA, since you are a proponent of this provision of the bill, you may want to refresh my memory as to why we did that and why we should not.

I see again that the ICBA is opposed to that and would like to keep the current law as it is. I would like to have some discussion from you all on that.

Ms. DUKE. I am afraid I cannot tell you why you did it for the insurance affiliates rather than the securities affiliates, because that is exactly our point. We do not see the difference between an investment bank by an insurance underwriting affiliate versus a securities writing affiliate, and we think they ought to have the same cross-marketing provisions.

The cross-marketing provisions, as I understand them, include statement stuffers and internet websites, and the restrictions on merchant banking in those investments are fairly narrow in order to avoid the merger of banking and commerce. There are anti-tying restrictions. The Board must determine that the affiliation is within the public interest and does not undermine separation of banking and commerce and is consistent with safety and soundness. We feel within those regulations there is certainly no reason that the securities affiliates should not have the same powers as the insurance affiliates.

Mr. BENTSEN. Mr. Chairman, with your indulgence, if I could get Mr. Stone's comment, because I do not understand if what is good for the goose is not good for the gander, why wouldn't we do that?

Mr. STONE. Well, here again, we strongly believe in the separation of the financial services industry and commerce. Wal-Mart would be a good example of someone that we do not think should be in the banking business. I believe the Japanese and the Ger-

mans as well have had some unfortunate experiences, and I do not know all the details on that, other just what I read, that the mixing of commerce and the financial institution business has not worked that well, and some of the banks have suffered in Japan, particularly for that.

Mr. BENTSEN. If I can have your indulgence, Mr. Chairman, on this. State Farm owns a bank. It may be operated as a holding company, I am not quite sure, but at the same time, why should they have a broader use if they establish a merchant capital subsidiary than Bank of Virginia or Chase or your bank if you choose to go down that route?

Mr. STONE. I would answer by saying I do not think they should have that right. I do not think they should be allowed in commerce. But the law is there and we would not have supported that at that time, either, when it was passed.

Mr. BENTSEN. Thank you. Thank you, Mr. Chairman.

Mr. WELDON. The Chair recognizes himself for a question.

Mr. Hage, you recommended exempting savings associations from the Securities and Exchange Act and the Investment Advisors Act. Would this affect consumer or investor protections?

Mr. HAGE. Our request is to be put on the same parity that bank trust departments already are. It would be my opinion that consumers' protection would not be weakened or put in jeopardy by including savings associations in that law.

Mr. WELDON. You have also asked for an increase in business lending authority for Federal savings institutions. How will this increase the authority and affect your ability to serve your communities? Can you comment on that, please?

Mr. HAGE. Yes, I can. The increase in this authority would enhance the thrift charter as a continuing charter that can serve communities better. I can tell you in my own bank institutional case, we are in Sioux Falls, South Dakota. We are a bank that is $700 million in size. In the last 10 years we have consciously established a strategy to offer small business loans as well as our core housing lending. Today our balance sheet is pushing the limit of the statutory limit on commercial lending. We are serving more customers. We are being asked to serve even more customers and are going to have to face a choice about how we either turn off that lending or change our charter.

There are many advantages to the thrift charter that we think we would like to preserve. So to have relief on this limitation, which seems artificial and certainly seems to restrain and constrain the credit available to communities, does not seem to make sense.

I would add that changing the formula as we proposed would not threaten the QTL test which is a core test to establish the thrift charter definition. So we think it makes sense to do this. It would allow us to offer more loans to more small businesses to more consumers.

Mr. WELDON. I assume you maintain your support for home and consumer loans if that moves forward?

Mr. HAGE. I would tell you that our portfolio has grown many times over in the last 10 years as we have continued to add services. What we found is that many of the small business people will

then bring all of their business to us, including their home lending business, and we also get access to new employees that they are bringing into the community so we can provide home lending and consumer lending to these folks as well.

Mr. WELDON. Thank you very much. I want to thank all of the witnesses for their testimony.

Mr. BENTSEN. Could I ask a follow-up question to this?

Mr. WELDON. Sure. Go ahead.

Mr. BENTSEN. I understand what you are saying is that at some point you are going to get the ABA back going against you, because at some point they are going to say why don't you convert to a bank charter? You are going to go to 25 percent commercial lending and then more.

But let me ask you, because you raised the thrift provisions, in your testimony you raised concern about the ability to branch, interstate branch thrifts. I thought federally chartered thrifts had national interstate branching authority already. Unless I misread your testimony, why would that need to be corrected in some way?

Mr. HAGE. We are not asking for a correction on the thrift branching. We are supporting the ABA request to have comparable branching for commercial banks.

Mr. BENTSEN. So it is a mutual appreciation issue. OK.

Thank you, Mr. Chairman.

Mr. WELDON. Again, I thank all of the witnesses for their testimony. The subcommittee will keep the record open for 5 additional days for further questions for the witnesses and further statements.

The hearing is now adjourned.

[Whereupon, the hearing was adjourned.]

A P P E N D I X

March 14, 2002

OPENING STATEMENT OF
CHAIRMAN SPENCER BACHUS
HEARING OF FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE ON THE FINANCIAL SERVICES REGULATORY RELIEF ACT
MARCH 14, 2002

The Subcommittee meets today for a legislative hearing on H.R. 3951, the Financial Services Regulatory Relief Act of 2002, a bill introduced earlier this week by our colleagues on the Subcommittee, Mrs. Capito of West Virginia and Mr. Sandlin of Texas.

The banking industry estimates that it spends somewhere in the neighborhood of $25 billion annually to comply with regulatory requirements imposed at the Federal and State levels. A large portion of that regulatory burden is justified by the need to ensure the safety and soundness of our banking institutions; enforce compliance with various consumer protection statutes; and combat money laundering and other financial crimes.

However, not all regulatory mandates that emanate from Washington, D.C. or other state capitals across the country are created equal. Some are overly burdensome, unnecessarily costly, or largely duplicative of other legal requirements. Where examples of such regulatory overkill can be identified, Congress should act to eliminate them.

The bill that Congresswoman Capito and Congressman Sandlin have introduced – and that I am proud to cosponsor along with Chairman Oxley – contains a broad range of constructive provisions that, taken as a whole, will allow banks and other depository institutions to devote more resources to the business of lending to consumers and less to the bureaucratic maze of compliance with outdated and unneeded regulations. Reducing the regulatory burden on financial institutions lowers the cost of credit and will help our economy as it strives to emerge from recession.

While I will defer to the primary sponsors and our witnesses at today's hearing to address the specifics of the legislation, I did want to commend Mrs. Capito and Mr. Sandlin for including a provision that eases the current legal limitations on the ability of financial holding companies to cross-market products and services with companies in which they have made investments pursuant to the merchant banking authority granted by the Gramm-Leach-Bliley Act. As Members will recall, this issue was addressed at a hearing that our Subcommittee held jointly with Mr. Baker's subcommittee last year on the Federal Reserve's proposed regulations implementing GLB's merchant banking provisions. There was general consensus at that hearing that the cross-marketing provisions were overly restrictive, and failed to afford equal treatment to different sectors of the financial services industry. Section 501 of H.R. 3951 remedies these shortcomings.

In closing, let me once again commend Mrs. Capito and Mr. Sandlin for this important legislative initiative. I also want to thank the Federal banking agencies represented on our first panel for their very helpful input and technical assistance in the drafting process.

I am now pleased to recognize the Ranking Member, Ms. Waters, for an opening statement.

Opening Statement
Representative Shelley Moore Capito
House Subcommittee on Financial Institutions and Consumer Credit
March 14, 2002
Hearing on Regulatory Relief Bill

Thank you Mr. Chairman,

I appreciate your holding this hearing today, and I want to thank our distinguished witnesses for appearing before this Subcommittee. I also want to thank Chairman Oxley and my colleague from Texas, Mr. Sandlin for working with me on this legislation.

Mr. Chairman, while we spend a lot time in this committee room creating new laws, I believe that we should also periodically take a look at the laws, which are already on the books to see if they need to be enhanced, updated or in some cases even repealed. Many of our federal laws are decades and even centuries old and while they may have been relevant in 1840, they may be redundant or even silly now.

For example, by law, cars in Oklahoma had to be "tethered" outside of public buildings. In a Florida county, it was illegal to park a pick-up truck in your driveway or in front of your house on the street, and a man in Idaho could not legally give his sweetheart a box of candy weighing less than fifty pounds.

Fortunately, (except for the one on chocolate) all of these laws have been repealed, but they serve as excellent examples of why Congress should conduct periodic reviews. As the world changes so must our legal system.

In our Subcommittee, this type of review is especially important given the substantial changes made to banking and insurance law in the Graham, Leach, Blilely Act and the recently enacted PATRIOT Act.

As a result of these changes, the Committee has asked the various regulatory agencies and even the industry itself for their assessment on what steps Congress may need to take to bring our current laws up-to-date.

The response has been gratifying, and we have been able to incorporate most of the agency recommendations into the bill we have before us today. Many of the provisions in this legislation are very technical in nature, and I would encourage my colleagues to take full advantage of the experts we have before us this morning.

Finally, Mr. Chairman, I want to point out that this is by no means a final bill. I fully expect that after this hearing, and the one I understand we will hold in April, Members will have additional changes. I look forward to working with my colleagues and the chairman in reviewing this changes in an effort to create a common sense regulatory relief bill that will help the financial services community thrive, compete and offer the best services to its consumers.

March 14, 2002

Opening Statement for Congressman Paul E. Gillmor

Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Hearing on the Financial Services Regulatory Relief Act of 2002

I would like to thank Chairman Bachus for holding this important hearing. I look forward to this subcommittee considering "the Financial Services Regulatory Relief Act of 2002 (HR 3951)," and addressing the unnecessary regulatory burdens currently faced by insured depository institutions in this country.

Many current statutes are in need of technical corrections and several constructive proposals to streamline procedures and modernize must be addressed. Debate on this legislation will accomplish this goal and allow appropriate discussion on HR 3951. Banks, savings associations, credit unions and regulatory agencies are addressed in this reform package and I look forward to hearing their opinions.

I congratulate Congresswoman Capito on her hard work in this area and am anxious to hear the regulators' views on this act.

Opening Statement
Congressman Ed Royce (CA-39)
14 March 2002
Regulatory Relief Hearing

I would like to take this opportunity to commend the Chairman and the Gentlewoman from West Virginia for their hard work and dedication in crafting this legislation to provide the financial services industry with relief from many of the unnecessary and onerous regulatory burdens under which they must currently operate. Many of the remedies included in this bill will enable America's financial services institutions to provide better and more efficient services to the American public while remaining vigilant in finding and seizing terrorist assets.

I would also like to applaud the inclusion of my own legislation, H.R. 760 - which has a broad base of support among 42 of my colleagues from both sides of the aisle - in this effort to provide wide-reaching regulatory relief. This provision amends the Federal Credit Union Act to exclude loans made to nonprofit religious organizations from the maximum amount of member business loans outstanding at a Federal credit union at any one time.

Under current law, credit unions are prevented from loaning more than 12 ¼ percent of their total assets to businesses. Credit unions engaged primarily in "faith-based" lending are exempted from this cap. However, these faith-based institutions obtain liquidity by selling these loans to other credit unions, who are not exempt from the cap. As a result, the lending needs of small non-profit organizations – whose needs are often ignored by larger banks and thrifts because of their slim profitability – regularly exceeds the supply offered by these select few credit unions.

The result is that today, as a number of credit unions approach their overall business loan caps, these local community-enhancing enterprises are seeing their access to capital steadily decline.
By fixing this problem, Congress has the opportunity to give non-profit religious organizations an opportunity to thrive by clarifying that loans to these organizations will not count toward a credit union's overall business lending cap. This bill also ensures that these loans will still be underwritten as business loans, making them subject to all the other restrictions currently contained in federal law and regulation.

In closing, I would like to thank the California Credit Union League and the Credit Union National Association for working with me to correct what I believe was an unintended consequence of the Credit Union Membership Access Act, and I look forward to hearing from our panel today about their opinions on other measure that Congress can take to remove the yoke of excessive government regulation from the financial services industry and allow them to provide the most competitive and efficient services to the American people.

Statement of

Mark W. Olson

Member

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

House of Representatives

March 14, 2002

Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify on the Financial Services Regulatory Relief Act of 2002. This is my first appearance before this subcommittee since becoming a member of the Board of Governors. In my previous careers, I have been a banker, an industry representative, and a consultant as well as a congressional staff member, so I can appreciate the importance to the banking industry, supervisors and consumers of legislation that balances burden reduction with effective supervision and good public policy. I also understand that drafting that type of legislation is no easy task. The Financial Services Regulatory Relief Act of 2002 should further improve efficiency and ultimately benefit the consumer.

This past summer, Chairman Oxley asked the banking agencies for suggestions for ways to improve the banking laws and relieve unnecessary burden. The Federal Reserve made several suggestions that have been included in the bill. Let me start by indicating that we are happy to continue to work with the subcommittee and the full committee and their staffs to improve these provisions and the bill.

De novo interstate branching

Our first suggestion--a recommendation joined in by the Office of the Comptroller of the Currency--involves removal of barriers to de novo interstate branching. Since enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, all fifty states have permitted interstate expansion through bank mergers. As a result, interstate branching is a reality. And it is a reality with good results: commercial banks currently operate more than 65,000 branches in the United States, an amount that far exceeds the 51,000 branches operated by banks in 1990. More than 2,500 branches were opened by banks in 2000 alone. The creation of new branches helps maintain the competitiveness and dynamism of the American banking

industry and improve access to banking services in otherwise under-served markets. Branch entry into new markets leads to less concentrated local banking markets, which, in turn, results in better banking services for households and small businesses, lower interest rates on loans and higher deposit interest rates. As customers become more mobile and live, work and operate across state borders, they also benefit from allowing banks to operate branches across state lines.

However, the Riegle-Neal Act permitted interstate branching through the establishment of new offices without an acquisition only if the host state enacted legislation that expressly permits entry by de novo branching (an "opt-in" requirement). To date, seventeen states have enacted some form of opt-in legislation, and thirty-three states and the District of Columbia continue to require interstate entry through the acquisition of an existing bank.

This limitation on de novo branching is an obstacle to interstate entry for all banks, and, in particular, is a costly and burdensome route for small banks to follow. Moreover, it creates an unlevel playing field between banks and federal savings associations, which have long been allowed to establish de novo branches on an interstate basis.

The Financial Services Regulatory Relief Act of 2002 would remove this last obstacle to interstate branching for all banks and level the playing field between banks and thrifts by allowing banks to establish interstate branches on a de novo basis. The bill also would remove the parallel provision that allows states to impose a minimum requirement on the age of banks that are acquired by out-of-state banking organizations. These changes would allow banks, including in particular small banks near state borders, to better serve their customers by establishing new interstate branches and acquiring newly chartered banks across state lines. It would also increase competition by providing banks a less costly method for offering their services at new locations. These new interstate branches would continue to be subject to the

regulatory provisions that were established by the Riegle-Neal Act for interstate branches, and could only be established if the opening bank meets the financial, managerial, Community Reinvestment Act and other requirements for establishing a de novo branch.

While we support the provisions expanding the de novo branching authority for full-service banks, we call the committee's attention to an important issue that these provisions raise. Industrial loan companies (ILCs) and nonbank banks operate under special exemptions that allow them to be owned by commercial companies without the activities restrictions and supervision that applies generally to bank holding companies. When these statutory exceptions were originally granted, ILCs and nonbank banks were limited in both number and the types of activities that they were permitted to conduct. However, over time these loopholes have been expanded significantly to the point that ILCs and nonbank banks have virtually all of the powers of commercial banks, and the ILC charter in particular has become available to any commercial company.

Deposits in these institutions are insured by the Federal Deposit Insurance Corporation. However, the ownership requirements and regulatory oversight of these owners fall outside of the Gramm-Leach-Bliley Act (GLB Act). They operate, therefore, in a less constrained regulatory environment than do banks and thrift institutions. We are concerned that, should ILCs and nonbank banks be permitted the new branching authority, an unintended consequence of this action would be to create FDIC-insured depository institutions with the capacity to operate nationwide without federal supervision of the parent organization or restriction on their affiliations. This lack of consolidated supervision and regulation raises supervisory and safety and soundness issues because owners and affiliates of these insured institutions are allowed to take risks and conduct operations that may have a material effect on the insured institutions. In

addition, granting expanded branching powers to these institutions would place commercial banks and their holding companies at a significant competitive disadvantage and would be a major expansion of the loopholes in which these companies are permitted to operate. For these reasons, we strongly urge this committee to exclude ILCs and nonbank banks from this proposed branching opportunity.

Reduction of cross-marketing restrictions

An important provision of the bill amends the cross-marketing restrictions imposed by the GLB Act on the merchant banking investments of financial holding companies. Currently, a depository institution controlled by a financial holding company and a nonfinancial company that is held under the GLB Act merchant banking authority by the same financial holding company are prohibited from engaging in cross-marketing activities. The primary purpose of this cross-marketing restriction is to preclude an unintended breach of the separation of banking and commerce retained in the GLB Act.

The GLB Act, however, already permits a depository institution subsidiary of a financial holding company to engage in cross-marketing activities through statement stuffers and Internet websites with nonfinancial companies held by an insurance underwriting affiliate under the parallel insurance company investment authority granted by the GLB Act. These cross-marketing activities are permitted only if they are conducted in accordance with the anti-tying restrictions of the Bank Holding Company Act Amendments of 1970 and 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.

The bill would allow depository institutions controlled by a financial holding company to engage in cross-marketing activities with companies held under the merchant banking authority to the same extent, and subject to the same restrictions, as companies held under the insurance company investment authority. We believe that this parity of treatment is appropriate and see no reason to treat the merchant banking and insurance investments of financial holding companies differently for purposes of the cross-marketing restrictions of the GLB Act.

The bill also is intended to permit a depository institution subsidiary of a financial holding company to engage in cross-marketing activities with a nonfinancial company held under the merchant banking authority if the nonfinancial company is not controlled by the financial holding company. We agree that, when a financial holding company does not control a portfolio company, cross-marketing activities are unlikely to materially undermine the separation between the nonfinancial portfolio company on the one hand and the financial holding company and its depository institution subsidiaries on the other hand. In these noncontrol situations, the separation of banking and commerce is maintained by the other restrictions contained in the GLB Act that limit the holding period of the investment as well as the authority of the financial holding company to routinely manage and operate the portfolio company. We have offered some technical assistance on this provision of the bill and, with these changes, we support both cross-marketing provisions.

Removal of the post-approval waiting period for bank acquisitions and mergers

Currently, banks and bank holding companies are required by statute to delay consummation of a proposal to merge with or acquire another bank or bank holding company for thirty days beyond the date that the transaction has been approved by the appropriate federal banking agency. This statutory delay is designed to allow the U.S. Attorney General an

opportunity to initiate legal action in cases that the Attorney General believes will have a significantly adverse effect on competition.

The Bank Holding Company Act and the Bank Merger Act allow this post-approval waiting period to be shortened to fifteen days if the relevant federal banking agency and the U.S. Attorney General concur. However, those acts do not permit the agencies to shorten the period to less than fifteen days, even in cases in which the relevant federal banking agency and the Attorney General agree that the transaction will have no adverse effect on competition.

The regulatory relief bill includes a proposed amendment that would remove this statutory minimum waiting period in cases in which the appropriate federal banking agency and the Attorney General agree that the proposal would not result in significantly adverse effects on competition in any relevant market. This revision would allow transactions that have been approved by the relevant agencies to be consummated immediately upon approval, without the costly and unnecessary delay that is currently imposed by statute. Under the amendment, unless the Attorney General agreed to a shorter period, a mandatory thirty-day waiting period would continue to be imposed (other than in cases involving a bank failure or an emergency, for which the statutes already set different periods).

Eliminate certain unnecessary reports

Another provision in the bill would eliminate certain reporting requirements that currently are imposed by statute on banks and their executive officers and principal shareholders. In particular, the bill repeals three reporting provisions. The first requires any executive officer of a bank to file a report with the bank's board of directors whenever the executive officer obtains a loan *from another bank* in an amount that exceeds the amount the executive officer could obtain from his or her own bank. The second provision requires a bank to file a separate

report with its quarterly call report regarding any loans the bank has made to its executive officers since its previous call report. The third reporting provision requires the executive officers and principal shareholders of a bank to file an annual report with the bank's board of directors if the officer or shareholder has any loan outstanding from a *correspondent bank* of the bank. This provision also authorizes the federal banking agencies to issue rules requiring a bank to disclose publicly information received from an executive officer or principal shareholder concerning his or her loans from a correspondent bank.

These reports have limited usefulness and the Board has not found them to contribute significantly to the effective monitoring of insider lending or the prevention of insider abuse. In our supervisory experience, the costs of preparing and collecting these reports are not outweighed by their benefits. Importantly, elimination of these reporting requirements would not alter the statutory restrictions on loans by banks to their executive officers and principal shareholders, or limit the authority of the federal banking agencies to take enforcement action against a bank or its insiders for violation of these statutory lending limits.

Moreover, each federal banking agency would retain authority under other provisions of law to collect information regarding insider lending. In addition, the existing record-keeping requirements in the Board's Regulation O should help to ensure that bank supervisors have access to sufficient information for determining compliance with the federal laws that restrict bank lending to insiders, and examiners would continue to be able to review these records during the examination process to verify compliance with these laws.

Update exception allowing interlocks with small depository institutions

The bill would also update an exception already granted by statute under the Depository Institutions Management Interlocks Act. That act generally prohibits depository organizations

that are not affiliated with each other from having management officials in common if the organizations are located or have a depository institution affiliate located in the same metropolitan statistical area (MSA), primary metropolitan statistical area, or consolidated metropolitan statistical area. The Act provides some modest leeway for interlocks with a depository institution that has less than $20 million in assets.

This exception for small institutions was established in 1978 and the asset limit has not been increased since that time. The bill would increase this exception to cover organizations with less than $100 million in assets that are located in an MSA. This change would allow smaller organizations increased access to management expertise and would conform the dollar limits for director interlocks with the exception already provided by statute for advisory and honorary director interlocks.

Permit exceptions to attribution rule

The bill also contains a provision that we believe will help banking organizations maintain attractive benefits programs for their employees. A bank holding company is generally prohibited from owning, in the aggregate, more than 5 percent of the voting shares of any company. The Bank Holding Company Act (BHC Act) also provides that, for purposes of determining the amount of shares owned or controlled by a bank holding company, any shares held by a trust for the benefit of the company or its shareholders, members or employees are deemed to be controlled by the holding company. This attribution provision was intended to prevent a bank holding company from evading the BHC Act's restrictions on the acquisition of shares of banks and nonbanking companies through the use of a trust established for the benefit of the management, shareholders or employees of the company.

This attribution provision, while generally a useful tool to prevent evasion of the BHC Act, does not always provide an appropriate result. For example, it may not be appropriate to apply the attribution rule when shares are acquired by a retirement trust, 401(k) plan or profit-sharing plan that operates for the benefit of employees of the bank holding company. In these situations, the bank holding company may not have the ability to influence the purchase or sale decisions of the employees or otherwise control shares that are held in trust for its employees. The bill would allow the Board to address these situations by authorizing the Board to grant exceptions from the attribution rule where appropriate.

Conclusion

The bill has quite a few other provisions, many suggested by my colleagues at the other federal banking agencies, that you will hear about this morning. I appreciate the opportunity to speak about provisions suggested by the Board and look forward to working with the subcommittee on this and other useful legislation.

TESTIMONY OF

JULIE L. WILLIAMS

FIRST SENIOR DEPUTY COMPTROLLER AND CHIEF COUNSEL

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES

of the

U. S. HOUSE OF REPRESENTATIVES

March 14, 2002

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairman Bachus, Ranking Member Waters, and members of the Subcommittee,
I appreciate this opportunity to discuss with you ways in which we can reduce unnecessary regulatory burden on America's banking system, and to express the views of the Office of the Comptroller of the Currency (OCC) on the Financial Services Regulatory Relief Act of 2002 (FSRR Act).[1] Let me also thank Ms. Capito, for sponsoring a bill that includes sensible and appropriate regulatory burden relief for national banks and other financial institutions.

Effective bank supervision demands that regulators achieve a balance among several competing, but equally important, objectives. These objectives include fostering banks' ability to conduct their business profitably and competitively, free from burdensome constraints that are not necessary to further the purposes of the banking laws. Unnecessary burdens drive up the costs of doing business for banks and their customers and prevent banks from effectively serving the public. Periodic review of the banking statutes and regulations is an essential means of ensuring that banks are not needlessly encumbered by requirements that are no longer appropriate for today's banking environment.

The OCC itself has a continuing commitment to review its regulations and make changes, consistent with safety and soundness, to enable banks to keep pace with product innovation, new technologies, and changing consumer demand. We also constantly reassess the effectiveness and efficiency of our supervisory processes to focus our efforts on the institutions and activities that present the greatest risks, and to reduce unnecessary burdens on demonstrably well-run banks. However, the results that Congress can achieve by removing or reducing regulatory burden imposed by Federal statutes can be broader and more far-reaching than regulatory changes. The FSRR Act contains a number of important provisions that will help national banks remain profitable and competitive by eliminating unnecessary burden. The first portion of my testimony will highlight several of these provisions.[2]

A second, and fundamentally important, objective of our supervision is to promote and maintain the safety and soundness of the banking system. The FSRR Act also contains provisions that further this objective, and I will mention a few of these provisions in the second section of my testimony. I will also take this opportunity to briefly discuss certain additional legislative changes that you may wish to consider as the legislation is developed, which would help promote safety and soundness.

---

[1] As of the time this testimony was required to be submitted, the FSRR Act had not been formally introduced. Accordingly, the views of the OCC set forth in this testimony are based on the March 5, 2002 Discussion Draft of the FSRR Act, including certain changes that we have been advised will be made to the draft. References to sections of the Act are based on the March 5th Discussion Draft. The OCC will be pleased to work with Subcommittee staff, as appropriate, as the legislation progresses.

[2] A detailed section-by-section review of the provisions of Title I, IV, and VI of the March 5, 2002 Discussion Draft of the FSRR Act, which are relevant to the OCC's responsibilities, is attached to this testimony as an appendix.

National Bank Provisions

The FSRR Act contains several provisions that would streamline and modernize aspects of the corporate governance and interstate operations of national banks. The OCC strongly supports these provisions.

For example, section 101 of the Act relieves a restriction in current law that makes it difficult for some national banks to operate as "Subchapter S" corporations. The National Bank Act currently requires all directors of a national bank to own at least $1,000 worth of shares of that bank or an equivalent interest in a bank holding company that controls the bank. The requirement means that all directors must be shareholders, making it difficult or impossible for some banks to comply with the 75-shareholder limit that defines eligibility for treatment as a Subchapter S corporation. These banks are thus ineligible for the benefit of Subchapter S tax treatment, which avoids a double tax on the bank's earnings. Community banks suffer most from this result.

Section 101 authorizes the Comptroller to permit the directors of banks seeking Subchapter S status to satisfy the qualifying shares requirement by holding a debt instrument that is subordinated to depositors and general creditors of the bank. The holding of such an instrument would not cause a director to be counted as a shareholder for purposes of Subchapter S. The subordinated liability is closely equivalent to an equity interest, however, since the directors could only be repaid if all other claims of depositors and nondeposit general creditors of the bank were first paid in full, including the claims of the FDIC, if any. The new requirement would thus ensure that directors retain the requisite personal stake in the financial soundness of their bank.

Similarly, section 102 of the Act eliminates a requirement in current law that precludes a national bank from prescribing, in its articles of association, the method for election of directors that best suits its business goals and needs. Unlike most other companies and unlike state banks, national banks cannot choose whether or not to permit cumulative voting in the election of their directors. Instead, current law requires a national bank to permit its shareholders to vote their shares cumulatively. Section 102 provides that a national bank's articles of association may permit cumulative voting. This amendment would conform the National Bank Act to modern corporate codes and provide national banks with the same corporate flexibility available to most corporations and state banks.

Section 401 of the Act also simplifies the requirements that apply to a national bank that wishes to expand interstate by establishing branches *de novo*. Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, interstate expansion through bank mergers generally is subject to a state "opt-out" that had to be in place by June 1, 1997. Under the time frames set by the statute, interstate bank mergers were permissible in all 50 states as of September 2001. By contrast, *de novo* branching still requires states to pass legislation to affirmatively "opt-in" to permit out-of-state banks to establish new branches in the state.

This effect of current law is to require that, in many cases, national banks must structure artificial and unnecessarily expensive transactions in order to establish a new branch across a state border -- which in some cases, is simply across town in a multi-state metropolitan area. Section 401 repeals the requirement that a state expressly must adopt an "opt-in" statute to permit the *de novo* branching form of interstate expansion for national banks and contains parallel provisions for state member and non-member banks. National banks and their customers would benefit significantly by this change, which would permit a bank to freely choose which form of interstate expansion is most efficient for its needs and customer demands.

Safety and Soundness Provisions

The FSRR Act also contains a number of provisions that further the objective of promoting and maintaining the safety and soundness of the banking system. One of the most important of these provisions (section 406 of the March 5, 2002 Discussion Draft), expressly authorizes the Federal banking agencies to enforce written agreements and conditions imposed in writing in which an institution-affiliated party or controlling shareholder agrees to provide capital to the depository institution. This provision would supersede recent Federal court decisions that conditioned the agencies' authority to enforce such conditions or agreements on a showing that the non-bank party to the agreement was "unjustly enriched." These changes will enhance the safety and soundness of depository institutions and protect the deposit insurance funds from unnecessary losses.

The Act also contains two provisions that promote safety and soundness by providing the Federal banking agencies with greater flexibility to manage resources more efficiently and deal more effectively with problem situations. Current law mandates that most banks be examined on-site on prescribed schedules. This can, in certain circumstances, interfere with the ability of the banking agencies to concentrate their supervisory oversight on deteriorating or problem institutions. Section 601 of the bill would permit the agencies, when necessary for safety and soundness purposes, to adjust their mandatory examination schedules to concentrate resources on particularly troublesome institutions.

Current law also provides for criminal penalties to be imposed on a Federal bank examiner who examines a bank from which the examiner receives an extension of credit, including a credit card issued by that institution. This limits the flexibility of the OCC and the other banking agencies to assign examiners to particular institutions or examination teams, even if the examiner's skills or expertise would contribute materially to the examination. Section 602 provides that Federal banking agency employees may have credit cards without disqualification or recusal, but subject to the safeguard that the cards must be issued under the same terms and conditions as cards issued to the general public.

Additional Safety and Soundness Enhancements

The OCC has identified several additional areas in which amendments to current law would enhance the banking agencies' safety and soundness authority, reduce risk to the deposit insurance funds, and facilitate our enforcement efforts when wrongdoing does occur. We

would be happy to work with the other banking agencies to further develop these recommendations and with Subcommittee staff to facilitate inclusion of the agencies' recommendations in the FSRR Act as it is developed through the legislative process.

Under the Change in Bank Control Act (CBCA)[3], all acquirers of insured depository institutions are required to provide notice to the appropriate Federal banking agency before proceeding with an acquisition. The CBCA gives the agency a specified time period within which to object to the transaction and specifies several bases on which the agency may disapprove a change in control notice. It does not, however, expressly permit the agency to impose conditions on the institution in connection with the agency's failure to object to an acquisition of control. While we think the ability to impose conditions designed to ensure the safety and soundness of the bank being acquired may be fairly inferred from the purpose of the statute, in order to eliminate any ambiguity, we recommend that the CBCA be amended to expressly permit the appropriate Federal banking agency to impose conditions it determines advisable for safety and soundness reasons, in connection with its decision not to pose objection to a CBCA notice.

We also recommend amending the CBCA so that acquirers of entities possessing dormant bank charters would be subject to the same standards and conditions -- including participation by the FDIC -- as are required when an applicant seeks a *de novo* bank charter. In such a case, acquirers are effectively buying a bank charter without the requirement for prior approval and without the scope of review that the law imposes when applicants seek a new charter, even though the risks presented by the two sets of circumstances may be substantively identical.

Another change that we would support is to clarify that an appropriate Federal banking agency may issue cease and desist orders against an insured depository institution or an institution-affiliated party who violates conditions imposed by agreements made with another appropriate Federal banking agency. This issue can arise, for example, when a bank that is subject to requirements imposed by one agency in connection with an application or an enforcement action, converts its charter so that it is regulated by a different agency. Another example occurs when the FDIC imposes conditions in connection with granting deposit insurance but the FDIC is not the appropriate Federal banking agency for the insured bank, e.g., a national bank or a state member bank.

In addition, we recommend amending the FDIA to remove the "knowing or reckless" element from the definition of "institution-affiliated party." Under current law, an accountant or other independent contractor of an insured depository institution may be subject to sanctions as an institution-affiliated party in an administrative enforcement action only if the accountant's (or other independent contractor's) wrongful conduct was "knowing or reckless." Accountants who serve as independent contractors to insured depository institutions play a key role in keeping institutions' books and records accurate. In recent years, banking regulators have seen an increase in audit and internal control deficiencies at many insured depository institutions, some of which have caused significant operating losses and led to failures of institutions. Elimination of the "knowing or

[3] 12 U.S.C. § 1817(j).

reckless" standard would remove a significant impediment to the agencies' ability to hold these individuals and firms accountable for violations of law, breaches of fiduciary duty, or unsafe or unsound practices.

Conclusion

Once again, Mr. Chairman, on behalf of the OCC, I thank you for your leadership in pursuing this legislation. As I have indicated, the OCC supports the Act and believes that many of its provisions will go far to promote the objectives I have described today. In those areas where we have recommended that you consider additional amendments, we would be pleased to work with your staff to develop appropriate legislative language for the Subcommittee's consideration.

I am pleased to have had this opportunity to provide our views on this important initiative, and I would be happy to answer any questions you may have.

APPENDIX

DISCUSSION DRAFT
MARCH 5, 2002
"THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2002"

SUMMARY AND COM MENTS OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY ON TITLES I, IV, AND VI

TITLE I -- NATIONAL BANK PROVISIONS

Sec. 101. National Bank Directors.

SUMMARY: This section would amend section 5146 of the Revised Statutes of the United States (12 U.S.C. § 72) to provide more flexible requirements regarding director qualifying shares for national banks operating, or seeking to operate, as Subchapter S corporations. The National Banking Act currently requires all directors of a national bank to own "shares of the capital stock" of the bank having an aggregate par value of at least $1,000, or an equivalent interest, as determined by the Comptroller, in a bank holding company that controls the bank. The amendment would permit the Comptroller to allow the use of a debt instrument that is subordinated to the interests of depositors and other general creditors to satisfy the qualifying shares requirement for directors of national banks seeking to operate in Subchapter S status.

OCC COMMENTS: The OCC supports this change to the law. The requirement in current law creates difficulties for some national banks that operate in Subchapter S form. It effectively requires that all directors be shareholders, thus making it difficult or impossible for some banks to comply with the 75-shareholder limit that defines eligibility for the benefit of Subchapter S tax treatment, which avoids double tax on the bank's earnings. Such a subordinated debt instrument would be closely equivalent to an equity capital interest, since the directors could only be repaid if all other claims of depositors and nondeposit creditors of the bank were first paid in full, and would, therefore, ensure that directors retain their personal stake in the financial soundness of the bank. However, the holding of such an instrument would not cause a director to be counted as a shareholder for purposes of Subchapter S.

Sec. 102. Voting in Shareholder Elections.

SUMMARY: This section would amend section 5144 of the Revised Statutes of the United States (12 U.S.C. § 61). Section 5144 imposes mandatory cumulative voting requirements on all national banks. This law currently requires that, in all elections of national bank directors, each shareholder has the right to (1) vote for as many candidates as there are directors to be

elected and to cast the number of votes for each candidate that is equal to the number of shares owned, or (2) cumulate his or her votes by multiplying the number of shares owned by the number of directors to be elected and casting the total number of these votes for only one candidate or allocating them in any manner among a number of candidates. This amendment would permit a national bank to provide in its articles of association which method of electing its directors best suits its business goals and needs and would provide the OCC with authority to issue regulations to carry out the purposes of this section.

OCC COMMENTS: The OCC supports this change to national banking law. The Model Business Corporation Act and most states' corporate codes provide that cumulative voting is optional. This amendment would conform this provision of the National Bank Act to modern corporate codes and would provide national banks with the same corporate flexibility available to most state corporations and state banks.

Sec. 103. Simplifying Dividend Calculations for National Banks.

SUMMARY: This section would amend section 5199 of the Revised Statutes of the United States (12 U.S.C. § 60) to simplify the formula for calculating the amount that a national bank may pay in dividends. The current law requires banks to follow a complex formula that is unduly burdensome and unnecessary for safety and soundness. The proposed amendment would permit national banks to declare a dividend of so much of its undivided profits as deemed appropriate. The proposed amendment would retain certain safeguards in the current law that provide that national banks (and state member banks)[1] need the approval of the Comptroller (or the Federal Reserve Board in the case of state member banks) to pay a dividend that exceeds the current year's net income combined with any retained net income for the preceding two years. For purposes of the approval requirement, these Federal regulators would retain the authority to reduce the amount of a bank's "net income" by any required transfers to funds, such as a sinking fund for retirement of preferred stock.

OCC COMMENTS: The OCC supports this amendment. The amendment would reduce burden on banks in a manner that is consistent with safety and soundness. Among other things, the amendment would ensure that the OCC (and the Federal Reserve Board for state member banks) will continue to have the opportunity to deny any dividend request that may deplete the net income of a bank that may be moving towards troubled condition. Importantly, the amendment would not affect other safeguards in the National Bank Act (12 U.S.C. 56). These provisions generally prohibit national banks from withdrawing any part of their permanent capital or paying dividends in excess of undivided profits except in certain circumstances.

Moreover, other laws have been enacted in the last ten years that provide additional safety and soundness protections for all insured depository institutions. The proposed amendment also would not affect the applicability of these safeguards. These additional safeguards prohibit any insured depository institution from paying any dividend if, after that payment, the institution would be undercapitalized (see 12 U.S.C. § 1831o(d)(1)).

---

[1] See 12 U.S.C. 324 and 12 C.F.R. 208.5 generally applying the national bank dividend approval requirements to state member banks.

Sec. 104. Repeal of Obsolete Limitation on Removal Authority of the Comptroller of the Currency.

SUMMARY: This provision amends section 8(e)(4) of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. § 1818(e)(4)) relating to the procedures for the removal of an institution-affiliated party (IAP) from office or participation in the affairs of an insured depository institution. With respect to national banks, current law requires the OCC to certify the findings and conclusions of an Administrative Law Judge to the Federal Reserve Board (FRB) for the FRB's determination as to whether any removal order will be issued. This amendment would remove this certification and FRB approval process and allow the OCC directly to issue the removal order with respect to national banks.

OCC COMMENTS: The OCC supports this amendment. This present system stems from historical decisions made by Congress on circumstances that are no longer applicable. Originally, the role of the OCC in removal cases was to certify the facts of the case to the FRB. The FRB then made the decision to pursue the case and made the final agency decision. At that time, the Comptroller was a member of the Federal Reserve Board and therefore participated in the FRB's final removal decision. However, Congress later removed the Comptroller from the FRB and gave the OCC the authority to issue suspensions and notices of intention to remove.

All of the Federal banking agencies, except the OCC, may remove a person who engages in certain improper conduct from the banking business. In the case of the OCC, the determination of whether to remove an individual from a national bank (and thus from the banking business) is made by the FRB. This amendment would give the Comptroller the same removal authority as the other banking agencies to issue orders to remove persons who have been determined under the statute to have, for example, violated the law or engaged in unsafe or unsound practices in connection with an insured depository institution. Like the other banking agencies, the Comptroller should make these decisions about persons who engage in improper conduct in connection with the institutions for which the Comptroller is the primary supervisor. This is a technical change to streamline and expedite these actions and has no effect on a person's right to seek judicial review of any removal order. The FRB also supports this amendment.

Sec. 105. Repeal of Intrastate Branch Capital Requirements.

SUMMARY: This provision would amend section 5155(c) of the Revised Statutes of the United States (12 U.S.C. § 36(c)) to repeal the requirement that a national bank, in order to establish an intrastate branch in a state, must meet the capital requirements imposed by the state on state banks seeking to establish intrastate branches.

OCC COMMENTS: The OCC supports this technical amendment to repeal the obsolete capital requirement for the establishment of intrastate branches by national banks. This amendment passed the House on October 9, 1998 in section 306 of H.R. 4364, the Depository Institution Regulatory Streamlining Act of 1998, and was also included in later legislation introduced in the

House. This requirement is not necessary for safety and soundness. Branching restrictions are already imposed under other provisions of law to limit the operations of a bank if it is in troubled condition. See 12 U.S.C. § 1831o(e) (prompt corrective action).

Sec. 106. Repeal of the Requirement that Notice of Bank Mergers Be Waived by the Shareholders with the Approval of the Comptroller of the Currency So As to Allow Either to Waive Notice.

SUMMARY: This section would amend sections 2(a) and 3(a)(2) of the National Bank Consolidation and Merger Act (12 U.S.C. § 215(a) and 215a(a)(2), respectively) concerning the newspaper publication requirement of a shareholder meeting to vote on a consolidation or merger of a national bank with another bank located within the same state. This change would clarify that the publication requirement may be waived by the Comptroller in the case of an emergency situation or by unanimous vote of the shareholders of the national or state banks involved in the transaction.

This amendment does not affect other requirements in the law. The current law also requires that the consolidation or merger must be approved by at least a 2/3 vote of the shareholders of each bank involved in the transaction. In addition, the shareholders of the banks generally must receive notice of the meeting by certified or registered mail at least ten days prior to the meeting. These provisions are not changed.

OCC COMMENTS: The OCC supports this amendment. The amendment would clarify the intent of the statute and remove any ambiguity as to its meaning.

TITLE IV -- DEPOSITORY INSTITUTION PROVISIONS

Sec. 401. Easing Restrictions on Interstate Branching and Mergers.

SUMMARY: This section would amend section 5155(g) of the Revised Statutes of the United States (12 U.S.C. § 36(g)), section 18(d)(4) of the FDIA (12 U.S.C. § 1828(d)(4)), section 9 of the Federal Reserve Act (12 U.S.C. § 321), and section 3(d)(1) of the Bank Holding Company Act (BHCA) (12 U.S.C. § 1842(d)(1)) to ease certain restrictions on interstate banking and branching. Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal Act), an out-of-state national or state bank may establish a de novo branch in a state only if that state has adopted legislation affirmatively "opting in" to de novo branching. This amendment would repeal the requirement that a state expressly must adopt an "opt-in" statute to permit the de novo branching form of interstate expansion.

In addition, the Riegle-Neal Act permits a state to prohibit an out-of-state bank or bank holding company from acquiring an in-state bank that has not been in existence for up to five years. This amendment also would repeal the state age requirement.

In addition, the amendment would amend the FDIA to authorize consolidations or mergers between an insured bank and a noninsured bank with different home states and amend national banking law relating to consolidations or mergers between noninsured national banks and other noninsured banks with different home states.

OCC COMMENTS: The OCC supports the changes to the law to remove the restrictions on interstate de novo branching. Enactment of this amendment should enhance competition in banking services with resulting benefits for bank customers. Moreover, it would ease burdens on banks that are planning interstate expansion through branches and would give banks greater flexibility in formulating their business plans and in making choices about the form of their interstate operations.

Under the Riegle-Neal Act, interstate expansion through bank mergers generally is subject to a state "opt-out" that had to be in place by June 1, 1997. While two states "opted out" at the time, interstate bank mergers will be permissible in all 50 states after September 2001. By contrast, de novo branching by banks requires states to pass legislation to affirmatively "opt-in" to permit out-of-state banks to establish new branches in the state. This requires banks in many cases to structure artificial and unnecessarily expensive transactions in order for a bank to simply establish a new branch across a state border. However, Federal thrifts are not similarly restricted and generally may branch interstate without the state law "opt-in" requirements that are imposed on banks.

In addition, the OCC supports the amendments that would repeal the state age requirement. This additional limitation on bank acquisitions by out-of-state banking organizations is no longer necessary if interstate de novo branching is permitted.

Sec. 402. Statute of Limitations for Judicial Review of Appointment of a Receiver for Depository Institutions.

SUMMARY: This provision would amend section 2 of the National Bank Receivership Act (12 U.S.C. § 191) and section 11(c)(7) of the FDIA (12 U.S.C. § 1821(c)(7)) to provide for a 30-day period to judicially challenge a determination by the OCC to appoint a receiver for a national bank under the National Bank Receivership Act or by the FDIC to appoint itself as receiver under the FDIA under certain conditions. Current law generally provides that challenges to a decision by the OTS to appoint a receiver or conservator for an insured savings association or the FDIC to appoint itself as receiver or conservator for an insured state depository institution must be raised within 30 days of the appointment. 12 U.S.C. §§ 1464(d)(2)(B), 1821(c)(7). There is, however, no statutory limit on a national bank's ability to challenge a decision by the OCC to appoint a receiver of an insured or uninsured national bank.[2] As a result, the general six-year statute of limitations for actions against the U.S. applies to the OCC's receiver appointments. See James Madison, Ltd. v. Ludwig, 82 F.3d 1085 (D.C. Cir. 1996).

[2] Under current law, there is a 20-day statute of limitations for challenges to the OCC's decision to appoint a conservator of a national bank. 12 U.S.C. § 203(b)(1).

Moreover, under the FDIA, there are some circumstances under which FDIC may be appointed or appoint itself as receiver or conservator for an insured depository institution that are not specifically subject to the general 30-day judicial review period. As a technical matter, the amendment also would harmonize these provisions in the FDIA with the general 30-day rule.

Finally, the amendment would provide that the changes made in the statute of limitations under these provisions applies with respect to conservators, receivers, or liquidating agents appointed on or after the date of enactment of the new law.

OCC COMMENTS: The OCC supports the amendment to national banking law. This amendment passed the House on October 9, 1998 in section 304 of H.R. 4364, the Depository Institution Regulatory Streamlining Act of 1998, and was also included in later legislation introduced in the House. The six-year protracted time period under current law severely limits the OCC's authority to manage insolvent national banks that are placed in receivership by the agency and the ability of the FDIC to wind up the affairs of an insured national bank in a timely manner with legal certainty. (In the case of an insured national bank that is placed in receivership by the OCC, the FDIC must be appointed the receiver.) This amendment would make the statute of limitations governing the appointment of receivers of national banks consistent with the time period that generally applies to other depository institutions. The amendment would not affect a national bank's ability to challenge a decision by the OCC to appointment a receiver, but simply require that these challenges must be brought in a timely manner and during the same time frame that generally applies to other depository institutions.

Sec. 403. Reduction of Reporting Burdens Relating to Insider Lending.

SUMMARY: This provision would amend section 22(g) of the Federal Reserve Act (12 U.S.C. § 375a) and section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. § 1972(2)) to eliminate certain reporting requirements concerning loans made to insiders. Specifically, the reports that would be eliminated are (1) the report that must be filed with a bank's board of directors when an executive officer of the bank obtains a loan from another bank that exceeds the amount the officer could have obtained from his or her own bank, (2) the supplemental report a bank must file with its quarterly call report identifying any loans made to executive officers during the previous quarter, and (3) an annual report filed with a bank's board of directors by its executive officers and principal shareholders regarding outstanding loans from correspondent banks.

OCC COMMENTS: The OCC supports these amendments. Nothing in these amendments affects the insider lending restrictions that apply to national banks or the OCC's enforcement of those restrictions. Moreover, the OCC believes that it will continue to have access to sufficient information during the examination process to review a national bank's compliance with the insider lending laws. Under the OCC's regulations, national banks are required to follow the FRB's regulations regarding insider lending restrictions and reporting requirements (see 12 C.F.R. § 31.2). The FRB's regulations require member banks to maintain detailed records of all insider lending. In addition, the OCC has the authority under 12 U.S.C. § 1817(k) to require any

reports that it deems necessary regarding extensions of credit by a national bank to any of its executive officers or principal shareholders, or the related interests of such persons.

Sec. 404. Amendment to Provide an Inflation Adjustment for the Small Depository Institution Exception under the Depository Institution Management Interlocks Act.

SUMMARY: This provision would amend section 203(1) of the Depository Institutions Management Interlock Act (DIMIA) (12 U.S.C. § 3202(1)). Under current law, generally a management official may not serve as a management official of any other nonaffiliated depository institution or depository institution holding company if (1) their offices are located or they have an affiliate located in the same MSA, or (2) the institutions are located in the same city, town, or village, or a city, town, or village that is contiguous or adjacent thereto. For institutions of less than $20 million in assets, the SMSA restriction does not apply. The amendment would increase the current $20 million exemption to $100 million.

OCC COMMENTS: The OCC supports this amendment. This $20 million cap has not been amended since the current law was originally enacted in 1978. However, the asset size of FDIC-insured commercial banks between 1976 and 2000 has increased over five fold. Depository institutions of all sizes will continue to be subject to the city, town, or village test.

Sec. 405. Repeal of Limitation on Dealing in and Underwriting Securities and Stocks by State Member Banks.

The OCC has been advised that this section will not be included in the bill as introduced.

Sec. 406. Enhancing the Safety and Soundness of Insured Depository Institutions.

SUMMARY: This provision would add a new section to the FDIA (12 U.S.C. § 1811, et seq.) to provide that the Federal banking agencies may enforce (1) conditions imposed in writing, and (2) written agreements, in which an IAP agrees to provide capital to the depository institution. The amendment also would clarify the existing authority of the FDIC as receiver or conservator to enforce written conditions or agreements entered into between insured depository institutions and IAPs.

Finally, the amendment would amend section 18(u) of the FDIA (12 U.S.C. § 1828(u)). This section of the law provides that certain transfers to depository institutions to bolster their capital cannot be reversed under the Bankruptcy Code or other law if the affiliate or controlling shareholder making the transfer later becomes bankrupt. The amendment would delete the requirement that the insured depository institution had to be undercapitalized at the time of the transfer for the transfer to be protected under this provision.

OCC COMMENTS: The OCC supports this change to the law. This amendment enhances the safety and soundness of depository institutions and protects the deposit insurance funds from

unnecessary losses. This amendment is intended to reverse some court decisions that question the authority of the agencies to enforce such conditions or agreements without first establishing that the IAP was unjustly enriched. In addition, the amendment would enhance safety and soundness by protecting the capital of insured depository institutions.

Sec. 407. Authorization for Identification and Criminal Background Check.

The OCC has been advised that this section will not be included in the bill as introduced.

TITLE VI -- BANKING AGENCY PROVISIONS

Sec. 601. Waiver of Examination Schedule in Order to Allocate Examiner Resources.

SUMMARY: This section would amend section 10(d) of the FDIA (12 U.S.C. § 1820(d)) to provide that an appropriate Federal banking agency may make adjustments in the examination cycle for an insured depository institution if necessary for safety and soundness and the effective examination and supervision of insured depository institutions. Under current law, insured depository institutions mus be examined by their appropriate Federal banking agencies at least once during a 12-month period in full-scope, on-site examination unless an institution qualifies for the 18-month rule. Small insured depository institutions with total assets of less than $250 million and that satisfy certain other requirements may be examined on an 18-month basis rather than a 12-month cycle. The amendment would permit the banking agencies to make adjustments in the scheduled examination cycle as necessary for safety and soundness.

OCC COMMENTS: The OCC supports this amendment. It would give the appropriate Federal banking agencies the discretion to adjust the examination cycle of insured depository institutions to ensure that examiner resources are allocated in a manner that provides for the safety and soundness of insured depository institutions. For example, as deemed appropriate by a Federal banking agency, a well-capitalized and well-managed bank's examination requirement for an annual or 18-month examination could be extended if the agency's examiners were needed to immediately examine troubled institutions. This amendment would permit the agencies to use their resources in the more efficient manner.

Sec. 602. Credit Card Accounts Permitted for Bank Examiners on Same Terms as Other Consumers.

SUMMARY: This section would amend section 212 of title 18 of the United States Code (18 U.S.C. § 212) to permit bank examiners who examine the institutions to receive credit cards from any depository institution, including the ones that they examine, subject to the requirement that the credit terms and conditions are no more favorable than those generally offered to other consumers. 18 U.S.C. §§ 212 and 213 currently prohibit financial institutions from granting a loan to a bank examiner that examines or has the authority to examine the institution and

prohibits such an examiner from accepting the loan. This prohibition on loans applies to credit cards.

OCC COMMENTS: The OCC supports this change to the law. In light of recent consolidations within the banking industry, bank examiners, particularly those who examine credit card banks, are finding it increasingly difficult to obtain nationally available credit cards without violating the Federal conflict of interest statutes. The requirement in the amendment that the credit terms cannot be more favorable than those offered to other consumers would prevent an examiner from negotiating for better terms and conditions and, thus, eliminates the potential for abuse of an examiner's position or a conflict of interest.

Sec. 603. Interagency Data Sharing.

SUMMARY: This section would amend section 7(a)(2) of the FDIA (12 U.S.C. § 1817(a)(2)). The amendment would provide that a Federal banking agency has the discretion to furnish any confidential supervisory information, including a report of examination, about a depository institution or other entity examined by the agency to another Federal or state supervisory agency that has regulatory authority and to any other IAP or entity deemed appropriate. Similar changes are also made to the Federal Credit Union Act.

OCC COMMENTS: The OCC supports the intent of this provision. This provision is intended to give the other Federal banking agencies the same authority to share confidential information that was given to the FRB in section 727 of the Gramm-Leach-Bliley Act (GLBA). To avoid confusion, however, we recommend that the language of this amendment track the GLBA language more closely.

Sec. 604. Unauthorized Participation by Convicted Individual at Uninsured Depository Institutions Subject to Penalty.

SUMMARY: This section would amend section 19 of the FDIA (12 U.S.C. § 1829) to give the Federal banking agencies the authority to prohibit a person convicted of a crime involving dishonesty or a breach of trust from participating in the affairs of an uninsured national or state bank or uninsured branch, agency, or commercial lending company of a foreign bank. Under current law, the ability of the banking agencies to keep these bad actors out of depository institutions applies only to *insured* depository institutions.

OCC COMMENTS: The OCC supports this change to the law. The amendment will help to provide for the safe and sound operations of uninsured, as well as insured, institutions.

Sec. 605. Amendment Permitting the Destruction of Old Records of a Depository Institution by the FDIC After the Appointment of the FDIC as Receiver.

SUMMARY: This provision would amend section 11(d)(15)(D) of the FDIA (12 U.S.C. § 1821(d)(15)(D)) to modify the record retention requirement of old records that must be maintained by the FDIC after a receiver is appointed for a failed insured depository institution. Under current law, the FDIC must preserve all records of a failed institution for six years from the date a receiver is appointed. This requirement is not dependent on the actual age of the records at the time the receiver is appointed. After the six-year period, the FDIC may destroy any unnecessary records, unless directed to retain the records by a court or a government agency or otherwise prohibited from destroying the records by law. The amendment would permit the FDIC to destroy unnecessary records that are 10 or more years old on the date the receiver is appointed unless prohibited from doing so by a court, a government agency, or law.

OCC COMMENTS: The OCC supports this change and recommends that a similar provision be included in national banking law. The OCC appoints receivers for all national banks, both insured and uninsured. The FDIC only is required to accept the appointment for insured national banks. Thus, a receiver for an uninsured national bank would not be the FDIC. Adding a similar provision to national banking law also would clarify for a receiver of a national bank, other than the FDIC, that these outdated records may be destroyed.

Sec. 606. Modernization of FDIC Recordkeeping Requirement.

SUMMARY: This section would amend section 10(f) of the FDIA (12 U.S.C. § 1820(f)) to provide that the FDIC may retain any records in electronic or photographic form and that such documents shall be deemed to be an original record for all purposes, including as evidence in court and administrative proceedings.

OCC COMMENTS: The OCC supports this amendment and recommends that it be expanded to apply to all of the Federal banking agencies.

Sec. 607. Repeal of Minimum Antitrust Review Period with the Agreement of the Attorney General.

SUMMARY: This provision would amend section 11(b)(1) of the BHCA (12 U.S.C. § 1849(b)(1)) and section 18(c)(6) of the Bank Merger Act (BMA) (12 U.S.C. § 1828(c)(6)) to permit the shortening of the post-approval waiting period for certain bank acquisitions and mergers. Under current law, the post-approval waiting period generally is 30 days from the date of approval by the appropriate Federal banking agency. The waiting period gives the Attorney General time to take action if the Attorney General determines that the transaction will have a significant adverse effect on competition. The waiting period under both the BHCA and BMA, however, may be shortened to 15 days if the appropriate banking agency and the Attorney General agree that no such effect on competition will occur. The proposed amendment would

eliminate the mandatory 15-day waiting period and allow the banking agency to shorten the waiting period to any period less than 30 days as long as the Attorney General concurs.

OCC COMMENTS: The OCC supports this change. It will give the banking agency and the Attorney General the flexibility to shorten the post-approval waiting period as appropriate for those transactions that do not raise competitive concerns. If such concerns exist, the 30-day waiting period will continue to apply. This change will not affect the waiting periods for transactions that involve bank failures or emergencies. In those cases, the statute already provides for other time frames.

Sec. 608. Clarification of Extent of Suspension, Removal, and Prohibition Authority of Federal Banking Agencies in Cases of Certain Crimes by Institution-Affiliated Parties.

SUMMARY: This provision would amend section 8(g) of the FDIA to clarify that the appropriate Federal banking agency may suspend or prohibit IAPs charged with or convicted of certain crimes (including those involving dishonesty, breach of trust, or money laundering) from participating in the affairs of any depository institution and not only the institution with which the party is or was last affiliated. Importantly, the amendment would also clarify that the section 8(g) authority applies even if the IAP is no longer associated with any depository institution at the time the order is considered or issued or the depository institution with which the IAP was associated is no longer is existence.

Under current law, if an IAP is charged with such a crime, the suspension or prohibition will remain in effect until the charge is finally disposed of or until terminated by the agency. If the individual is convicted of such a crime, the party may be served with a notice removing the party from office and prohibiting the party for further participating in the affairs of a depository institution without the consent of the appropriate Federal banking agency. Before an appropriate Federal banking agency may take any of these actions under section 8(g), the agency must find that service by the party may pose a threat to interests of depositors or impair public confidence in a depository institution. The statute further provides that an IAP that is suspended or removed under section 8(g) may request a hearing before the agency to rebut the agency's findings. Unless otherwise terminated by the agency, the suspension or order of removal remains in effect until the hearing or appeal is completed. Current law, however, applies only to the depository institution with which the IAP is associated.

OCC COMMENTS: The OCC supports the amendment to the FDIA. This amendment will help to ensure that, if a Federal banking agency makes the required findings, the agency has adequate authority to suspend or prohibit an IAP charged with or convicted of such crimes from participating in the affairs of any depository institution.

Sec. 609. Streamlining Depository Institution Merger Application Requirements.

SUMMARY: This section would amend the BMA (12 U.S.C. § 1828(c)). The amendment would provide that the responsible agency in a merger transaction, which is generally the Federal

banking agency that has the primary regulatory responsibility for the resulting bank, must request a competitive factors report only from the Attorney General, with a copy to the FDIC. Under current law, this report must be requested from all of the other Federal banking agencies but the other agencies are not required to file a report.

OCC COMMENTS: The OCC supports this amendment. It appropriately streamlines the agencies' procedures in processing BMA transactions.

Sec. 610. Inclusion of Director of the Office of Thrift Supervision in List of Banking Agencies Regarding Insurance Customer Protection Regulations.

SUMMARY: This provision would amend section 47(g)(2)(B)(i) of the FDIA (12 U.S.C. § 1831x(g)(2)(B)(i)) to add OTS to the list of the Federal banking agencies that must jointly make certain determinations before certain state customer protection laws may be preempted. Under current law, OTS is one of the Federal banking agencies that is required to adopt the Federal regulations that would provide the basis for the preemption determination but is not included in the agencies that must make the preemption determination.

OCC COMMENTS: The OCC does not object to this provision.

TYBK CODE	INSTITUTION TYPE	# BANKS	# SUB-CHAPTER S	% SUB-CHAPTER S
1	NATIONAL BANKS	2,137	388	18.2%
2	STATE MEMBER BANKS	972	146	15.0%
3	STATE NON-MEMBER BANKS	4,971	1,094	22.0%
4	INSURED SAVING BANKS	513	13	2.5%
6	NON-INSURED BANK & NON-DEPOSIT TRUST COMPANIES	96	4	4.2%
TOTAL		8,689	1,645	18.9%

SOURCE: NBSVDS 4Q2001 CALL DATA

STATEMENT OF

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

on the

"Financial Services Regulatory Relief Act of 2002"

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

March 14, 2002
Room 2128, Rayburn House Office Building

Mr. Chairman, Representative Waters, and Members of the Subcommittee, I appreciate the opportunity to present the views of the Federal Deposit Insurance Corporation (FDIC) on proposed legislation to provide regulatory burden relief. The FDIC shares the Subcommittee's continuing commitment to eliminate unnecessary burden and to streamline and modernize laws and regulations as the financial industry evolves.

In my testimony today, I will highlight the FDIC's efforts to reduce regulatory burden in areas where statutory change may not be necessary. Next, I will address the specific provisions in the proposed legislation that the FDIC requested to improve our performance. Finally, I will suggest additional provisions for inclusion in the proposed legislation.

FDIC EFFORTS TO RELIEVE REGULATORY BURDEN

At a leadership conference of our senior officials in early February, FDIC Chairman Don Powell unveiled his vision for the Corporation. The Chairman's approach will more actively integrate management objectives into our three strategic lines of operation—insurance, supervision, and receivership management. His theme is more business-oriented and is explicitly designed to incorporate concepts of regulatory burden reduction, following closely along with the lines of today's Subcommittee hearing.

The FDIC is committed to updating its corporate culture. We are building a culture which encourages employees to recognize new ideas as opportunities — not as

threats which so often happens in a conservative bureaucratic structure. This changing culture will be beneficial as the FDIC looks for better ways to communicate with the banking industry and consumers and to monitor and supervise the industry in a more efficient manner.

The FDIC is engaged in a number of initiatives to address the issue of regulatory burden. Some of the initiatives were recently completed while others are ongoing and will yield future improvements.

Regulatory Burden Reduction Working Group

Chairman Powell recently formed a regulatory burden task force within the FDIC to study ways to reduce the regulatory burden that may result from the agency's activities. While mindful of the FDIC's statutory and regulatory obligations, the task force will review the FDIC's operating principles, processes, and practices; study ways to make the FDIC more sensitive to the burden issue; and make recommendations to the Chairman on burden reduction. For example, one of the group's tasks will be to develop a better definition of "burden" from the industry's point of view and to consider means of obtaining input from the industry quickly and efficiently on a continuing basis. The task force's activities will be ongoing and we expect this group to make an initial report to Chairman Powell by the end of April.

Regulatory Relief through Streamlining Examination Processes and Procedures

The FDIC recently initiated a comprehensive review of our internal processes and operating procedures related to the supervision of state-chartered nonmember banks. In

this Process Redesign effort, working groups reviewed: Examinations and Applications; Policy; Training and Administration; Technology; and Infrastructure. The FDIC also met with each of the other bank regulatory agencies to identify "best practices." The goal of this review is to strengthen our efforts to allocate resources to the areas that present the greatest risk to the insurance funds, such as problem banks, larger financial institutions, technological change, high risk/subprime lending, internal control procedures, and fraud detection.

By streamlining, standardizing, and consolidating more of our processes, we have improved the FDIC's operating efficiencies and have also significantly aided in the regulatory relief effort. This extensive process has already produced the following recommendations and suggestions which have been implemented:

- *Revised Report of Examination*: The FDIC changed its report of examination format to make it more user-friendly by placing regulatory comments—a key item for bank management's attention—at the beginning of the report. We also consolidated several supporting pages to reduce redundancies and make findings more understandable. The revised format should generate fewer questions and make the significant issues clearer to the bank's board of directors.

- *Establishment of Applications Subject Matter Experts*: In their regular course of business, bankers are required to file various applications for regulatory approval, such as establishing a new bank, merging with another institution, changing

control or ownership, or opening new branch offices. The FDIC has designated Applications Subject Matter Experts to serve as a centralized resource for bankers, particularly those who have more complex applications or those who file infrequently. This program has been well-received by the industry and has resulted in greater consistency and more timely processing of bank applications.

- *Increased Banker's Outreach Efforts*: New technologies, product innovations, and recent statutory changes highlighted the need for ongoing communication with supervised banks during the interval between safety and soundness examinations. We now contact each bank between examinations to discuss issues such as new business activities, local economic conditions, changes in bank management or key personnel and to solicit any concerns the bank may have about the FDIC's supervisory program. The information shared during this process helps the FDIC better understand individual bank issues which leads to a more focused and efficient examination process.

- *Establishment of a Cadre of Information Technology Examiners*: Technology continues to transform banking, leading to new ways of doing business and potentially new risks. For example, many financial institutions, both large and small, run transactional web sites, having adopted Internet banking at a rapid rate. In order to keep pace with this rapidly changing field, the FDIC selected 25 of our best technology examiners to examine the large data centers and software vendors. Bankers will benefit from a single point of contact at the FDIC for each

technology service provider, and these uniquely qualified individuals will be a valuable resource on emerging technology trends.

The FDIC is also working on an initiative for historically sound well-run institutions. We are reviewing the examination process to achieve maximum efficiencies in the examination of the best-rated banks with less than $250 million in assets. Our performance goal is to reduce total examination hours in these institutions by 20 percent, while maintaining the quality and integrity of the examination process. We are developing guidelines to assist our examiners in determining which examination procedures can be streamlined, or even entirely eliminated, depending on the bank's risk profile and quality of management. There will be an emphasis on using the bank's loan review and other internal grading systems. Similar programs are being developed for information technology and trust examinations.

The FDIC has had preliminary discussions with the other federal banking agencies regarding streamlined examination programs that the agencies have or may be considering. In addition, we will discuss our new programs that are under development with the Conference of State Bank Supervisors to see if some of the efficiencies can be transferred to state exams as well.

Along with these changes to the safety and soundness examination process, we also are revising our compliance examination approach to place a greater emphasis on an institution's administration of its compliance responsibilities. While we currently

consider an institution's compliance program, the compliance examination process has been heavily slanted toward transaction testing. We draw conclusions about the institution's compliance program and its management from the results of this testing.

Our revised approach will change the process so that examiners begin by evaluating—in depth—an institution's compliance management. Examiners will assess, for example, how a bank keeps abreast of regulatory requirements, and how it incorporates these requirements into specific business processes such as mortgage loan applications. The examiners will particularly consider the bank's internal monitoring and audits of regulatory compliance, since a strong internal audit program may significantly reduce the risk that regulatory violations are going undetected and uncorrected. Based on their review of the compliance program, examiners will determine where there may be significant risk of regulatory violations and appropriately tailor their transactional testing.

In addition, we are developing enhanced guidance for compliance examiners that will strengthen their ability to not only evaluate an institution's compliance program and management, but also to provide practical suggestions about how to rectify any weaknesses that may be found. For example, if examiners find that an institution has a training program, but the training has not been effective, they will suggest steps the institution might take to either modify the training or follow up so that employees are prepared to carry out their responsibilities correctly. The compliance examination report provided to the institution also will be revised to concentrate on the examiner's

assessment of the bank's administration of its compliance responsibilities, suggestions for how to strengthen it, and other significant regulatory matters.

The revised compliance examination approach will be implemented in early 2003. We expect that, over time, the number of hours spent examining institutions with strong compliance programs or functions will be reduced. This will allow more examiner attention to be focused on those institutions with weak compliance functions and a greater risk of violating consumer protection laws or regulations.

Interagency Coordination

In addition to our internal efforts, the FDIC continues to work with the other banking regulators in implementing more efficient regulations and processes. A recent example of our interagency efforts is the new "Interagency Charter and Federal Deposit Insurance Application" — a coordinated effort between the FDIC, the OCC, and the OTS. The new form will eliminate duplicative information requests by consolidating into one uniform document the different reporting requirements of the three regulatory agencies. The agencies already have four other common forms to promote uniformity: Interagency Notice of Change in Control, Interagency Notice of Change in Director and Senior Executive Officer, Interagency Biographical and Financial Report, and Interagency Bank Merger Act Application.

Another interagency effort aimed at burden reduction was also announced this week. The federal bank regulatory agencies and the Conference of State Bank

Supervisors have developed standardized requests for electronic loan information. Regulators use this information primarily to conduct community and mid-size bank safety and soundness examinations. The information is currently provided in various formats, making the collection a time-consuming and costly task. The new standard, which is voluntary on the part of institutions, will improve the efficiency of the examination process and reduce the burden on banks, service providers, and vendors.

Along with the initiatives discussed above, the FDIC supports statutory changes to reduce regulatory burden in a number of areas which are in the draft bill. Let me turn to these specific provisions of the proposed legislation.

"FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2002"

The FDIC's staff has worked closely with the Subcommittee in developing several of the provisions contained in the proposed legislation. These provisions promote the Subcommittee's goal of burden reduction by making the FDIC's operations more efficient and more effective.

Clarification of Section 8(g) Prohibition Authority

Section 8(g) of the Federal Deposit Insurance Act (FDI Act) provides the appropriate Federal banking agency with the authority to suspend or prohibit individuals charged with certain crimes from participation in the affairs of the depository institution with which they are affiliated. The FDIC supports the provision in the proposal that clarifies that the agency may suspend or prohibit those individuals from participation in

the affairs of any depository institution and not solely the insured depository institution with which the institution affiliated party is or was associated. The provision will make clear that a Federal banking agency may use the section 8(g) remedy even where the institution that the individuals were associated ceases to exist.

Judicial Review of Conservatorship and Receivership Appointments

The FDIC supports the amendments in the proposed legislation that would specify the time period during which the appointment, in certain circumstances, of the FDIC as conservator or receiver of a failed insured depository institution could be challenged. These amendments would provide greater consistency in the Federal law governing how much time an insured depository institution has to challenge the appointment of a receiver. Moreover, they would provide greater certainty to the receiver's activities and those doing business with the receiver.

Currently, some provisions of Federal law specify a 30-day period for challenges after appointment. In contrast, other provisions of the FDI Act, which govern appointment of a conservator or receiver by the appropriate Federal banking agencies for a State institution under prompt corrective action provisions and the FDIC's appointment of itself as conservator or receiver for an insured depository institution to reduce risk to the deposit insurance fund respectively, are silent on the limitations period for challenges to those appointments. At least one court has previously held that the Administrative Procedure Act applied because the National Bank Receivership Act was silent regarding the time period for challenging such an appointment. The court held that the national

bank had six years from the date of appointment to challenge the action. The proposed legislation would remedy the silence in the National Bank Receivership Act and in the Federal Deposit Insurance Act consistent with the parallel provisions in section 5 of the Home Owners' Loan Act and another appointments provision of the Federal Deposit Insurance Act.

Recordkeeping Amendment

The FDIC supports the provision to modify the requirement for retention of old records of a failed insured depository institution at the time a receiver is appointed. Currently, the statute requires the FDIC to preserve all records of a failed institution for six years from the date of its appointment as receiver, regardless of the age of the records. After the end of six years, the FDIC can destroy any records that it determines to be unnecessary, unless directed not to do so by a court or a government agency or prohibited by law. Consequently, the FDIC must preserve for six years very old records that have no value to the FDIC or to any pending litigation.

The proposed provision would allow the FDIC to destroy records that are 10 or more years old at the time of its appointment as receiver, unless directed not to do so by a court or a government agency or prohibited by law. This change would benefit the FDIC or acquirers of failed institutions by reducing the storage costs for these outdated records.

Preservation of Records by Optical Imaging and Other Means

The FDIC supports the provision in the proposed legislation to permit the FDIC to rely on records preserved electronically, such as optically imaged or computer scanned images, as well as the "preservation of records by photography" as the statute currently provides.

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

The FDIC also supports a number of provisions that were requested by our fellow regulators and included in the proposal. In particular, we support provisions in the bill that streamline merger application requirements; that grant federal banking agencies the authority to enforce conditions imposed in certain written agreements relating to additional capital contributions; and that permit bank examiners to receive credit cards

from any insured depository institution as long as the cards are issued under the same terms and conditions as cards generally offered to the public. Moreover, the bill makes a number of changes to update or conform existing statutes that we believe are quite useful.

Finally, I would like to comment on a provision in the proposal that eases restrictions on interstate branching and mergers. Under section 18(c)(1) of the FDI Act, FDIC approval is necessary whenever an FDIC-insured institution merges with or assumes deposit liabilities of any uninsured bank or institution. We are pleased that the Subcommittee remedied a concern that we had in the language as originally drafted. Under the proposed bill, approvals for interstate mergers or consolidations are governed according to the current section 44 of the FDI Act. Section 44 of the FDI Act authorizes "the responsible agency" to approve interstate insured bank mergers. "The responsible agency" generally means the appropriate federal banking agency of the resulting institution. Without the provision that the Subcommittee added to clarify the meaning of "responsible agency" the proposed language could have been read to mean that the FDIC does not approve interstate mergers between insured banks and noninsured banks. We appreciate the Subcommittee's cooperation in alleviating this concern.

OTHER ISSUES FOR INCLUSION IN THE BILL

The FDIC recommends that the Subcommittee include four additional regulatory relief items in the bill. The appendix to my testimony contains the relevant legislative language.

Authority to Enforce Conditions on the Approval of Deposit Insurance

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

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

Deposit Insurance Related to the Optional Conversion of Federal Savings Associations

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

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

Bank Merger Act and Bank Holding Company Act

The FDIC supports amendments to the Bank Merger Act and Bank Holding Company Act that would require consideration of the potentially adverse effects on the insurance funds of any proposed bank merger transaction or holding company formation/ acquisition. As presently written, these laws do not require that any specific consideration be given to a transaction's possible impact on the deposit insurance funds. The omission is noteworthy and potentially damaging to the financial viability of the funds.

Language specifying consideration of risks to the insurance funds already exists for consideration of other transactions. For example, regarding change in control of insured banks, the FDI Act provides authority to the appropriate federal banking agency to disapprove any proposed acquisition if the agency determines that the proposed

transaction would result in an adverse effect on the Bank Insurance Fund or the Savings Association Insurance Fund.

In addition, Section 207 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) amended Section 6 of the FDI Act to include a new factor—"the risk presented by such depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund"—that must be considered in granting deposit insurance. Additional parallels can also be found in sections 24 and 28 of the FDI Act.

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

Pre-receivership Liens for Failure to Pay Property Taxes

Three Circuit Courts have construed section 15(b) of the FDI Act *not* to require the extinction of pre-receivership liens securing penalties for the nonpayment of property taxes on real property that the FDIC later acquires as receiver. The FDIC supports language which would make clear that such liens *are* extinguished when the property is acquired by the federal receiver. Allowing the liens to continue compels payment of penalties for which the FDIC is not liable and is thus inconsistent with the purposes of section 15(b).

CONCLUSION

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

APPENDIX

LEGISLATIVE LANGUAGE FOR FDIC RECOMMENDATIONS

Authority to Enforce Conditions on the Approval of Deposit Insurance

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

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

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

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

Clarification of Certain Application Requirements for Optional Conversion of Federal Savings Associations

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

(5) CONVERSION TO NATIONAL OR STATE BANK. –

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

Deposit Insurance Act shall be required for a conversion under this subparagraph.

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

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

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

(2) in paragraph (2), after "insured State" by inserting "or Federal".

Bank Merger Act and Bank Holding Company Act Amendments Risk to Insurance Funds

Bank Merger Act Amendment

Paragraph (5) of subsection (c) of section 18 of the Federal Deposit Insurance Act (12 U.S.C. § 1828(c)(5)) is amended -

by amending the last sentence of paragraph (5), by inserting ", the potential risk of loss to the Bank Insurance Fund or Savings Association Insurance Fund" before ", and".

Bank Holding Company Act Amendment

Paragraph (2) of subsection (c) of section 3 of the Bank Holding Company Act (12 U.S.C. § 1842(c)(2)) is amended -

by inserting ", the potential risk of loss to the Bank Insurance Fund or Savings Association Insurance Fund" before ", and".

Pre-receivership Liens for Failure to Pay Property Taxes

Subsection (b) of section 15 of the Federal Deposit Insurance Act (12 U.S.C. § 1825) is amended –

(1) by striking "When acting as a receiver" and inserting "In its capacity as receiver" ; and

(2) by amending paragraph (3) to read as follows:

"(3) The Corporation shall not pay, be subject to, or be liable for, directly or indirectly, any amounts in the nature of penalties or fines, including those arising from the failure of any person to pay any real property, personal property, probate, or recording tax or any recording or filing fees. Any lien that shall have attached to property before such property becomes property of the Corporation is extinguished to the extent it secures any amounts in the nature of penalties or fines.".

Statement
of

Carolyn Buck, Chief Counsel
Office of Thrift Supervision

concerning

Reducing Regulatory Burden

before the

Subcommittee on Financial Institutions and Consumer Credit
U. S. House of Representatives

March 14, 2002

Office of Thrift Supervision
Department of the Treasury

1700 G Street N.W.
Washington, D.C. 20552
202-906-6288

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on Reducing Regulatory Burden
before the
Subcommittee on Financial Institutions and Consumer Credit
U. S. House of Representatives
March 14, 2002

Carolyn J. Buck, Chief Counsel

Office of Thrift Supervision

I. Introduction

Mr. Chairman, Ranking Member Waters, and members of the Subcommittee, good morning and thank you for the opportunity to discuss the regulatory burden reduction initiatives currently being considered by the Subcommittee. We support this effort. During periods of economic challenge, it is particularly important that we make every effort to remove unnecessary regulatory obstacles that hinder profitability, innovation, and competition in our financial services industry.

Relieving institutions from these burdens meshes well with three responsibilities that our new Director, James E. Gilleran, has stressed with OTS staff:

- Protecting taxpayers by minimizing risks to the insurance fund. Any relief from regulatory burden enhances the safety and soundness of institutions by relieving them from the distraction of complying with unnecessary red tape.

- Keeping the financial institution system healthy. Reducing regulatory burden and enhancing supervision both play an important role in

support of our shared goal of assuring the continued health of the financial services system.

- Protecting consumers by fully utilizing the consumer laws we have jurisdiction to enforce.

Support for Other Pending Congressional Initiatives

During the past year, the House has been hard at work to provide regulatory relief in several pieces of pending legislation. The passage of H.R. 974, the "Small Business Interest Checking Act of 2001," by the House on April 3, 2001, is an important step in permitting depository institutions to pay interest on business transaction accounts. As you know, the current limitations are obsolete and are routinely circumvented by sweep accounts and similar vehicles. It is time to modernize this provision.

Another critical relief proposal under consideration is deposit insurance reform. It is long past time to merge the Bank Insurance Fund and the Savings Association Insurance Fund; virtually everyone agrees on this. We strongly support merger because it will promote efficiency in administering the funds and, more importantly, result in a more stable insurance system. We also believe the "free rider" problem should be addressed in the interest of fairness to those who have paid into the funds over many years. The Federal Deposit Insurance Corporation Board should also have sufficient flexibility in setting the designated reserve ratio and deciding when to increase the rate of assessments to assure the continued stability of the insurance fund. Providing certainty about the process for determining the amount of deposit insurance assessments is a very important regulatory burden reduction initiative.

Simplifying the Mortgage Process

Another area woefully in need of reform is the mortgage process. OTS applauds HUD Secretary Mel Martinez's initiatives in this area. Last fall Secretary Martinez spoke to the Mortgage Bankers Association of America about his goal of making "the homebuying experience less complicated, the paperwork requirements less demanding, and the mortgage process itself less expensive." This is no simple task, but everyone involved in making the American dream of homeownership a reality shares his goals, and we pledge to do our part to help achieve this objective. Clearly, simplifying the mortgage process will reduce regulatory burden on thrifts and all housing lenders. The importance of this cannot be overstated.

Today, I will discuss the features of the proposed legislation, the "Financial Services Regulatory Relief Act of 2002,"[1] that are of greatest importance to thrifts and the communities they serve. The most notable of these provisions concerns parity for thrifts with banks under the securities laws. I will also address a number of other provisions in the proposed legislation and suggest a few additions.

II. Streamlining for Thrift Institutions

A. Parity for Thrifts under the Investment Advisers Act of 1940 and the Securities Exchange Act of 1934 (§ 201)

OTS strongly supports the amendments in the proposed legislation that provide parity between thrifts and banks under the federal securities laws. These

[1] Discussion Draft dated March 5, 2002.

provisions primarily involve the investment adviser and broker-dealer registration requirements. Thrifts fill an important niche in the financial services arena by focusing their activities primarily on residential, community, small business, and consumer lending under the Home Owners' Loan Act (HOLA). Some thrifts also make securities services available to their customers through affiliates and contractors that are registered investment advisers or broker-dealers. In addition, thrifts provide investment advisory services as SEC-registered advisers. However thrifts may choose to provide securities services, there is no longer any logical basis to structure the regulatory oversight of thrifts and banks differently. Removing the disparity will reduce regulatory burden by providing cost savings to affected thrift institutions.

As a matter of principle, OTS believes that different purposes of the various charters make our financial services industry the most flexible and successful in the world, but obsolete disparities unrelated to those different purposes only raise costs for institutions and consumers. While OTS strongly supports giving each institution the option to pick the most appropriate charter, that decision should be based on which charter is the best fit for its business. These parity amendments to the securities laws remove distinctions that have caused some thrifts to engage in regulatory arbitrage by changing charters to avoid SEC regulation and reduce costs even though the thrift charter is the best fit for their businesses.

The details of the current situation are complex, and I refer you to the detailed explanation of the OTS proposal on this subject for a description of each problem we have identified to date under current law. The key points, however, may be summarized in a few sentences.

Banks—but not thrifts—are exempt from investment adviser registration requirements under the Investment Advisers Act of 1940. In 1999, the Gramm-

Leach-Bliley (GLB) Act narrowed the bank exemption and now requires a bank to register when it advises a registered investment company, such as a mutual fund.

Banks—but not thrifts—enjoyed a blanket exemption from broker-dealer registration requirements under the 1934 Act before changes made by the GLB Act. That Act removed the blanket exemption and permitted banks to engage only in specified activities without having to register as a broker-dealer. Other activities must be "pushed out" to a registered broker-dealer. The SEC issued interim final rules on May 11, 2001, to implement the new "push-out" requirements.

As part of the broker-dealer "push out" rule, the SEC exercised its exemptive authority to treat thrifts the same as banks. This gave thrifts parity with banks for the first time for purposes of broker-dealer registration, but did not address other problems under the 1934 Act. In the broker-dealer changes, the SEC recognized it would be wrong to continue disparate, anomalous treatment. The May 2001 rule generally gave banks and thrifts until October 1, 2001, to comply, but in response to extensive concerns raised about the rule, the SEC delayed the effective date of the rule until May 12, 2002. At the same time it gave both banks and thrifts the blanket exemption until May 2002. The SEC is now considering comments it received on the rule and will be revising and republishing the rule. It has announced its intent to further extend the effective date of the new requirements.

Treating thrifts and banks the same under the securities laws makes sense for the following reasons:

- The statutory authorities for thrifts and banks to engage in trust services are essentially the same. In 1980, Congress gave thrifts the authority to offer trust services closely based on parallel national bank authority. The Senate report for the Depository Institutions Deregulation and Monetary Control Act of 1980 explained that the HOLA amendment gives thrifts "the ability to offer trust services on the same basis as national banks."[2] Consistent with this legislative history, these amendments further promote uniformity in the way thrifts and banks provide trust services.

- 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 different requirements under the SEC's interpretation of the securities laws.

  - To the extent thrifts are subject to different rules and must register with the SEC, they are placed at a competitive disadvantage to banks due to the additional costs. For this reason, some thrifts have recently converted to a bank or state trust company charter to obtain the benefit of the registration exemption under the Investment Advisers Act. This allows them to side step SEC regulation with a one-time conversion cost. It is sound public policy to treat the bank and thrift charters the same where similarly situated. This approach promotes a level playing field among depository institutions in the marketplace.

  - Some have objected to this change based on concerns that it would give thrifts a competitive advantage over registered investment

[2] S. Rep. No. 96-368, at 13 (1979), reprinted in 1980 U.S.C.C.A.N. 236, 248.

advisers. OTS believes the stronger argument supports comparable regulatory treatment of depository institutions that already have essentially the same powers and that are subject to equivalent, frequent oversight by the appropriate federal banking agency. These amendments will have a relatively minor impact on the investment adviser industry because banks are already exempt.

- OTS agrees with the SEC analysis set forth in its preamble to the May 2001 interim final "push-out" rule. The logic of the SEC argument in the context of the broker-dealer rule applies equally for purposes of extending to thrifts the same investment adviser registration exemption to that applies to banks. The SEC explained the basis for its decision to exempt thrifts from broker-dealer registration to the same extent as banks, as follows:

> "Now that the general exception for banks has been replaced, and the differences between banks and savings associations have narrowed; it seems reasonable to afford savings associations and savings banks the same type of exemptions. Moreover, insured savings associations are subject to a similar regulatory structure and examination standards as banks. We find that extending the exemption for banks to savings associations and savings banks is necessary or appropriate in the public interest and is consistent with the protection of investors." 66 Fed. Reg. 27788 (May 18, 2001).

- The SEC preamble goes on to note that some of the bank registration exemptions, such as those for trust and fiduciary activities,

safekeeping and custody, and sweep accounts, could imply that thrifts that have routinely engaged in such activities as part of their HOLA-authorized activities without having to register as a broker-dealer must now register to continue to engage in such activities. The SEC approach and the proposed legislation remove the possibility of this wholly unintended consequence.

- OTS examinations of these activities are already conducted in the same manner as those of the other banking agencies. OTS is formalizing these policies with new regulations and guidance. For example, in August 2001 OTS issued an entirely revised trust and asset management handbook. Under OTS's regulations and examinations, thrift customers have protections equivalent to those the other banking agencies provide for bank customers.

- Securities firms that provide investment adviser or broker-dealer services by contract with thrifts and banks will not have the regulatory burden of having to follow different rules, depending on whether a thrift or a bank is involved. Where different rules apply, additional compliance costs are borne by thrifts as well as banks, by securities firms that provide services for them under contract, and, ultimately, by all of their customers.

- Wherever possible, the banking agencies establish uniform standards to protect consumers when their regulated financial institutions are engaged in exactly the same activities, in the same manner. If thrifts and banks are subject to different rules under the securities laws, the banking agencies are not able to establish a uniform regulatory scheme and a level playing field.

The SEC is currently considering giving thrifts the same exemption banks have from investment adviser registration requirements; however, it is not yet clear whether this will occur. We have been actively engaged in recent months in encouraging the SEC to grant an exemption providing full bank-thrift parity, along the lines of the broker-dealer exemption the SEC extended to thrifts last year. While the SEC is moving towards parity for thrifts and banks, we urge Congress to affirm SEC action quickly in these areas and to make the changes necessary to eliminate the numerous incidental differences that remain. This would have the beneficial effect of avoiding the need for a series of SEC administrative exemptions—another potential regulatory burden—if additional differences come to light.

B. Public Welfare Investments (§ 202)

The proposed legislation updates HOLA to give thrifts the same authority national banks and state member banks have to make investments to promote the public welfare. This amendment enhances the ability of thrifts to contribute to the growth and stability of their local communities. It replaces an outdated statutory reference to HUD's Community Development Block Grant (CDBG) program under Title I of the Housing and Community Development Act of 1974. This change will eliminate confusion that can arise when thrifts seek to invest in community development projects and companies.

Under current law, a savings association may invest up to 5 percent of its assets in real estate and in mortgage loans on property located in areas receiving concentrated development assistance by a local government under HUD's CDBG program. Of this total, no more than 2 percent of assets may be invested directly in real estate. As a result of changes to the CDBG program that occurred in

1981—more than 20 years ago—thrift investment opportunities that meet the technical requirements of the statute are rare; and OTS has found it cumbersome to promote the spirit and intent of Congress's determination to allow thrifts to make such community development investments.

Currently, using its administrative authority, OTS will issue a "no action" letter where a thrift seeks to make a community development investment that satisfies the intent of the existing provision, but does not clearly fall within the wording of the statute or the "safe harbor" criteria issued by OTS for such an investment.

To eliminate confusion and avoid the delays inherent in issuing "no action" letters, the proposed legislation would give thrifts community development investment authority comparable to the authority of national banks and state member banks to make investments "for the primary purpose of promoting the public welfare." Under the proposal, thrifts may make investments primarily designed to promote the public welfare, directly or indirectly by investing in an entity primarily engaged in making public welfare investments. As with bank authority, the proposal has an aggregate limit on investments of 5 percent of a thrift's capital and surplus, or up to 10 percent on an exception basis.

Under the amendment, thrifts may use the new investment authority without regard to the general prohibition against thrifts acquiring or retaining corporate debt that is not of investment grade.[3] No similar limitation applies to banks. A nonprofit organization engaged in community development activities may finance its activities by issuing debt securities that are not rated and, therefore, are not of investment grade. This change enhances the ability of thrifts

[3] See section 28(d) of the FDIA (12 U.S.C. 1831e(d)).

to invest in such nonprofit organizations by acquiring or retaining this category of securities.

C. Removal of Obsolete Geographic Limitation on Thrift Investments in Service Companies (§ 503)

OTS strongly supports the provision authorizing federal thrifts to invest in service companies without regard to geographic restrictions. Under current law, a federal thrift may only invest in a service company that is chartered in the savings association's home state. HOLA imposed this geographic restriction before interstate branching and before technological advances such as Internet and telephone banking, and it no longer serves a useful purpose. This requirement has complicated the ability of thrifts, which often operate in more than one state, to join together to obtain services at lower costs due to economies of scale. By removing the geographic limitations on thrift service company investments, this provision enhances a thrift's ability to invest in service companies wherever its business is located without regard to the location of the home offices of other thrifts.

Today, a thrift seeking to make investments through service companies must create an additional corporate layer—known as second-tier service companies—to invest in enterprises located outside the thrift's home state. Requiring the formation of second-tier service companies serves no rational business purpose and results in unnecessary expense and burden on federal thrifts. The effect is to discourage otherwise worthwhile investments.

D. Authority for Federal Thrifts to Merge and Consolidate with Their Nonthrift Affiliates (§ 203)

OTS favors giving federal thrifts the authority to merge with one or more of their nonthrift affiliates, equivalent to recently-enacted authority for national banks.[4] The new authority neither affects the requirement to comply with the Bank Merger Act, nor gives thrifts the power to engage in new activities.

Under current law, a federal thrift may merge only with another depository institution. This proposal reduces regulatory burden on thrifts by permitting certain mergers, where appropriate for sound business reasons and if otherwise permitted by law. Today, if a thrift wants to acquire the business of a non-depository institution affiliate, it must engage in a series of transactions, such as merging the affiliate into a subsidiary and liquidating the subsidiary into the thrift. Structuring a transaction in this way can be costly. Under this amendment, thrifts may merge with affiliates and continue to have the authority to merge with other depository institutions, but may not merge with other kinds of entities.

E. Streamlining Agency Action under the Bank Merger Act (§ 609 and § 607)

OTS supports the amendment in section 609 to streamline Bank Merger Act application requirements by eliminating the requirement that each federal banking agency request a competitive factors report from the other three banking agencies and the Attorney General. This means five agencies must consider the competitive effects of every proposed bank or thrift merger. The vast majority of proposed mergers do not raise anti-competitive issues, and these multiple reports, even for those few that do raise issues, are not necessary. Decreasing the number to two—coupled with

---

[4] See section 6 of the National Bank Consolidation and Merger Act (12 U.S.C. 215a-3), which was added by section 1206 of the Financial Regulatory Relief and Economic Efficiency Act of 2000 (Pub. L. No. 106-569, 114 Stat. 2944, 3034 (2000)).

notice to the Federal Deposit Insurance Corporation, as the insurer—streamlines the review of merger applications.

OTS also supports section 607, which amends the Bank Merger Act to shorten the post-approval waiting period before a transaction subject to the Act may be consummated. After approval, except in the case of emergencies, mergers are subject to a 30-day waiting period to give the Attorney General time to initiate legal action where the Attorney General determines the merger would have a significantly adverse effect on competition. The agencies may agree, with concurrence of the Attorney General, to shorten the waiting period to 15 days. Section 607 removes the 15-day statutory minimum. Permitting a merger to go forward sooner will reduce burden on the affected depository institutions.

F. Repeal of Statutory Dividend Notice Requirement for Thrifts in Savings and Loan Holding Companies (§ 204)

The proposed legislation repeals the requirement that any thrift owned by a savings and loan holding company must notify OTS 30 days before paying a dividend. Instead, the Director has the discretion to require prior notice and may establish reasonable conditions on the payment of dividends.

The current section 10(f) dividend notice requirement does not depend on a thrift's capital condition or relative risk to the insurance fund. No similar limitation based on the ownership of a depository institution, rather than its condition, applies to thrifts controlled by individuals, thrifts controlled by bank holding companies, or banks. There is no basis for disparate treatment based on the form of ownership of thrifts.

Federal statutes and regulations assure that thrifts held by holding companies may not pay dividends in inappropriate circumstances, and this amendment confirms this authority. All thrifts are subject to the prompt corrective action—PCA—provisions that generally prohibit an insured depository institution from paying a dividend if doing so would make it undercapitalized. In addition, based on OTS's general regulatory authority, OTS has a capital distributions regulation[5] governing when a thrift must file an application or give notice if it decides to pay a dividend. The rule conforms our dividend requirement more closely to those of the other federal banking agencies. In 1999, as part of OTS's ongoing regulatory burden reduction effort, OTS amended its regulations to exempt adequately capitalized, highly rated savings associations from providing advance notice of dividends under certain circumstances. This proposal will permit OTS to extend the same regulatory relief to thrifts that happen to be owned by holding companies if it determines such relief is appropriate.

III. Safety and Soundness Proposals

A. Examination Flexibility (§ 601)

OTS strongly supports the additional flexibility in the proposed legislation to adjust the examination cycle for depository institutions. The Federal Deposit Insurance Act (FDIA) currently requires annual examinations for all but the smallest institutions. Small institutions that have assets less than $250 million and are well-capitalized and well-managed may be examined every 18 months. A large majority of savings associations are well-run institutions that do not require full-fledged annual examinations to assure their safety and soundness. This is also true for the majority of banks. This amendment will reduce risk to the insurance

[5] 12 CFR part 563, subpart E

fund by permitting the banking agencies to focus supervisory attention on the institutions that are, or are at the greatest risk of becoming, troubled.

B. Enhanced Authority to Enforce Agreements (§ 406)

OTS welcomes inclusion of the amendments made by section 406 to enhance the safety and soundness of insured depository institutions and protect the insurance fund from unnecessary losses. The amendment clarifies that sections 8(b)(6)(A)(i) and (ii) and section 38(e)(2)(E) of the FDIA do not apply when a federal banking agency seeks to enforce certain conditions imposed on, and agreements with, institution-affiliated parties (IAPs). Some courts have interpreted these provisions to limit the ability of banking agencies to require an IAP to transfer capital to an institution under such conditions and agreements.

Neither of these two sections should apply when a banking agency seeks to require an IAP to meet its prior obligations. Agencies must be able to count on financial commitments an IAP makes to support a depository institution in connection with its application for a charter or in any other agreement. It is illogical to reduce or eliminate an IAP's commitment at the very time the institution most needs it. The sections in question make sense only in the context of an agency seeking to impose additional requirements to resolve problems at a troubled depository institution.

Section 406 also amends section 18(u)(1) of the FDIA, which prohibits a receiver for an IAP in bankruptcy from seeking the return of amounts the IAP has transferred to a depository institution if at the time of the transfer the institution is then undercapitalized, and two other conditions are met. It should not matter whether the institution is undercapitalized at the time of the transfer. The effect of

this provision could be to delay a capital infusion designed to save the institution until it is too late, or at least until the institution is in even greater trouble (i.e., until it becomes undercapitalized). This amendment removes this risky unintended consequence.

IV. Other Initiatives Not in the Proposed Bill

I would like briefly to discuss two other initiatives that OTS believes would be improvements to the legislation and urge the Subcommittee to include them in the bill.

A. Creation of Statutory OTS Deputy Directors

OTS seeks an amendment to HOLA to give the Treasury Secretary statutory authority to appoint up to four Deputy Directors for OTS. The new authority would be based closely on long-standing authority[6] for appointing Deputy Comptrollers in the Office of the Comptroller of the Currency (OCC). Consistent with the existing OCC legislation, the HOLA amendment would require the Treasury Secretary to make the OTS appointments so each Deputy Director would qualify as an "inferior officer" under the Appointments Clause of the Constitution.

The safety and soundness of the banking system depend on regular, uninterrupted oversight by the federal banking agencies. This amendment would remove any question about a Deputy Director's authority to perform the functions of the Director during a vacancy in the office of the Director or during the absence or disability of the Director. The reality of the appointments process is that there can be a delay of many months before a sub-cabinet level position is filled, and

[6] 12 U.S.C. 4

these delays have grown significantly over the last 20 years. In light of these growing delays, it is especially important to establish a chain of command within OTS that will avoid the possibility of gaps in authority to regulate and supervise savings associations, eliminate uncertainty for the thrifts OTS regulates, and avoid future litigation over whether the acts of OTS staff are valid.

OTS is the only financial services sector regulator that could be readily exposed to this vacancy problem. During a vacancy, OTS succession now occurs through the process of the Vacancies Act, which does not ensure an immediate succession when the OTS Director departs and limits the period an acting Director may serve. The organic statutes of the other financial regulators minimize or avoid vacancy problems by providing for automatic and immediate succession or by vesting authority in the remaining members of a board or commission.

B. Streamlining Thrift Multistate Multiple Savings and Loan Holding Company Acquisitions

OTS recommends replacing the current restriction in section 10(e)(3) of HOLA on multiple savings and loan holding companies (SLHCs) acquiring and holding thrifts in different states with the authority to approve such transactions subject to the requirements of the Savings and Loan Holding Company Act (section 10 of HOLA). There is no basis for retaining the existing restriction on branching, especially in light of the amendments in the proposed legislation permitting national banks to branch through the acquisition of out-of-state de novo institutions and permitting banks and bank holding companies to acquire an out-of-state bank even if it has not been in existence for a certain period of time set by a state.

A SLHC may now avoid the existing limitation by purchasing a thrift in another state and merging it with its federal thrift subsidiary. The amendment would eliminate this regulatory burden by giving SLHCs the choice of whether to merge the thrifts, subject to OTS approval in accordance with generally applicable rules governing holding company acquisitions. The current law results in two anomalies. First, it limits authority of thrift holding companies to acquire out-of-state thrifts and hold them as separate subsidiaries, but permits thrifts to branch on a nationwide basis. Second, it limits the authority of a thrift holding company to acquire an out-of-state thrift and hold it as a separate subsidiary, but permits a bank holding company to do so.

V. Conclusion

OTS is committed to reducing burden wherever it has the ability to do so consistent with safety and soundness and compliance with law. The proposed legislation advances this objective, and we appreciate that many of the reforms we have long desired are included in the proposed legislation. I especially thank you, Mr. Chairman, and the others who have shown leadership on this issue, and look forward to working with the Subcommittee to shape the best possible regulatory burden reduction legislation.

STATEMENT OF

THE HONORABLE DENNIS DOLLAR

CHAIRMAN

NATIONAL CREDIT UNION ADMINISTRATION

ON THE

"FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2002"

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

U.S. HOUSE OF REPRESENTATIVES

MARCH 14, 2002

Chairman Bachus, Ranking Member Waters and Members of the Subcommittee, thank you for providing me the opportunity to appear on this panel today on behalf of the National Credit Union Administration. The NCUA is pleased to provide your Subcommittee with our suggested legislative proposals in response to Chairman Oxley's earlier request to our agency asking for suggestions designed to reduce regulatory burden, improve productivity or make needed technical corrections to current laws affecting federally chartered credit unions.

We share your interest in seeking more efficiency in the way we conduct our regulatory responsibilities and likewise in the way the law and regulations require credit unions to conduct their business. To this end, the NCUA has been taking significant action on its own initiative to implement "regulatory relief" where appropriate for the safety and soundness and long term viability of America's credit unions. As you may know, NCUA recently enacted a final rule on a regulatory flexibility program (RegFlex) which, as of its March 1 effective date, will permit credit unions with advanced levels of net worth and consistently strong CAMEL ratings to be exempt, in whole or in part, from certain NCUA regulations that are not specifically required by statute nor required for safety and soundness purposes when applied to a credit union with such an advanced capital and financial performance position. This proposal has been well received by our stakeholders and has resulted in over 1,400 comment letters – the most ever received on a regulatory proposal issued by NCUA.

Additionally, the NCUA Board approved in 2001 and is presently in the process of implementing a policy that would permit flexible examination schedules for qualifying credit unions. This policy provides NCUA with the flexibility to identify credit unions posing little or no risk to the National Credit Union Share Insurance Fund (NCUSIF) and to extend the examination cycle beyond the 12-month cycle where feasible and appropriate. By adopting such a policy, we can better allocate agency resources and focus our efforts and technical skills where they are needed most and where the risk to the share insurance fund is greater. This policy, in conjunction with a more risk-based examination and supervision program which will also be implemented in 2002, should bring about greater efficiencies in the operational structure at NCUA even as it improves our safety and soundness program. To help strengthen this risk-focused effort, the NCUA Board this week acted to require quarterly financial reporting from all credit unions, regardless of size. These quarterly call reports will provide the current information needed to base examination, supervisory and regulatory decisions more productively than ever before. Bringing these regulatory initiatives, along with any improvements your Subcommittee chooses to initiate through legislation, to a successful conclusion should indeed be an effective way NCUA and Congress can work together to deliver appropriate regulatory relief to America's credit unions.

On behalf of the NCUA Board, I am pleased to present the Subcommittee the following suggestions, in no order of preference, to address regulatory relief and

productivity improvements for federal credit unions (FCUs). These proposals are consistent with the mission of credit unions and the principles of safety and soundness. They address statutory restrictions that now act to frustrate the delivery of financial services because of technological advances, current public policy priorities, or market conventions.

Check cashing, wire transfer and other money transfer services.

The Federal Credit Union Act authorizes FCUs to provide check cashing and money transfer services to members. 12 USC 1757(12). To reach the "unbanked," FCUs should be authorized to provide these services, within the established parameters of the Bank Secrecy Act, Patriot Act and other Treasury Department regulations, to anyone eligible to become a member of the credit union. This is particularly important to the overwhelming majority of FCUs whose field of membership includes individuals of limited income or means. These individuals often do not have mainstream financial services available to them and often pay excessive fees for check cashing, wire transfer and other services. Allowing FCUs to provide these limited services to anyone in their field of membership would provide a lower-fee alternative for these individuals while at the same time encouraging them to trust conventional financial organizations. If credit unions are to be – as we feel that they are and must remain – a part of the solution to the predatory lending problem in this country, their potential members need to know the types and value of services such as check cashing and wire

transfers that they can receive much more economically by becoming a member of their credit union.

The twelve-year maturity limit on loans.

FCUs are authorized to make loans to members, to other credit unions and to credit union organizations. The Federal Credit Union Act imposes various restrictions on these authorities, including a twelve-year maturity limit that is subject to only limited exceptions. 12 USC 1757(5). This "one-size-fits-all" maturity limit should be eliminated. It is outdated and unnecessarily restricts FCU lending authority. FCUs should be able to make loans for second homes, recreational vehicles and other purposes in accordance with conventional maturities that are commonly accepted in the market today. As is the case with other federally-chartered financial institutions, we believe appropriate rulemaking authority should be granted by statute for NCUA to establish any maturity limits necessary for safety and soundness.

One percent investment limit in CUSOs.

The Federal Credit Union Act authorizes FCUs to invest in organizations providing services to credit unions and credit union members. An individual FCU, however, may invest in aggregate no more than one percent of its shares and undivided earnings in these organizations. 12 USC 1757(7)(I). These organizations, commonly known as credit union service organizations or

"CUSOs," provide important services. Examples are data processing and check clearing for credit unions, as well as services such as financial planning and retirement planning for credit union members. When these services are provided through a CUSO, any possible financial risks are isolated from the credit union, yet the credit unions that invest in the CUSO retain control over the quality of services offered and the prices paid by the credit unions or their members. The one percent aggregate investment limit presently in the statute is unrealistically low and often forces credit unions to either bring services in-house, thus potentially increasing risk to the credit union and the Insurance Fund, or turn to outside providers and lose their institutional control. We feel the one percent statutory limit should be increased or eliminated and the NCUA Board be allowed to set a limit by regulation that is appropriate for safety and soundness purposes.

"Reasonable proximity" requirement.

The Credit Union Membership Access Act enacted in 1998 expressly authorized multiple common-bond credit unions. The Access Act provided, however, that an FCU may add a new group to its field of membership only if the credit union "is within reasonable proximity to the location of the group." 12 USC 1759(f)(1)(B). This, in effect, often requires a credit union to establish a costly physical presence that could potentially, if unchecked, present long term safety and soundness concerns and, unfortunately, in many cases serves as a financial deterrent to credit unions who otherwise have a desire to extend financial

services to the group when ATMs (or other technologies) could be used more efficiently. This "bricks and mortar" limitation on FCU services is unnecessary in today's "clicks and windows" financial marketplace, where most services can be provided electronically. This limitation prevents NCUA from allowing an FCU and a group to "match up" when it is their wish to do so, and may even prevent NCUA from adding groups to the FCU best suited to serve them. The "reasonable proximity" requirement is an unnecessary hindrance to providing credit union services and should be made more flexible, thus allowing NCUA to define and implement reasonable and appropriate "ability to serve" requirements within the provisions of established field of membership law.

Expanded investment options

The Federal Credit Union Act limits the investment authority of FCUs to loans, government securities, deposits in other financial institutions and certain other very limited investments. 12 USC 1757(7). This limited investment authority restricts the ability of FCU's to remain competitive in the rapidly changing financial marketplace. In our view, the Act should be amended to provide such additional investment authority as is approved for other federally regulated financial institutions and in accordance with regulation of the NCUA Board. This would enable the Board to approve additional safe and sound investments, such as highly rated asset-backed securities or other conservative investments that

have a proven track record with other federally-regulated, as well as state-regulated, financial institutions.

Voluntary merger and conversions authority.

The Federal Credit Union Act, as amended by the Credit Union Membership Access Act, allows voluntary mergers of healthy FCUs, but requires that NCUA consider a "spin-off" of any group of over 3,000 members in the merging credit union. 12 USC 1759(d)(2)(B)(i). When two healthy multiple common-bond FCUs wish to merge, and thus combine their financial strength to both improve service to their members as well as their long term safety and soundness position, they should be allowed to do so. There is no logical reason to require in connection with such mergers that groups over 3,000, or any group for that matter, be required to spin off and form a separate credit union. These groups are already included in a multiple group credit union in accordance with the statutory standards, and that status is unaffected by a merger. Similarly, when a multiple bond credit union either merges into, or converts to, a Federal community charter, there are cases where a limited number of presently served groups lie outside of the community boundaries. The community FCU should be allowed to serve new members from these groups, to avoid discrimination among group members and continue credit union service to all of the group members.

Again, thank you for the opportunity to provide input on these important matters before your Subcommittee. As the Subcommittee proceeds to gather responses on these proposals and additional suggestions from interested parties within and outside the credit union industry, we would be pleased to continue to work with you and your staff as a resource in your committee's deliberations.

In particular, it is our understanding that the Subcommittee has under consideration additional items of regulatory relief affecting FCUs which NCUA certainly considers appropriate and would support as public policy initiatives should the Congress decide to so enact. Included among these are parity for credit unions under the Securities Exchange Act of 1934 and the Investment Act of 1940; extension of the current allowance for leases on land on federal facilities for credit unions; permitting the NCUA to share appropriate supervisory information to other financial regulatory bodies; clarification of suspension, removal and prohibition authority in cases of institution-affiliated parties; and a number of minor technical corrections which we understand are under consideration.

Likewise, we understand that there is under consideration in early drafts of the regulatory relief bill certain revisions to NCUA's recommended items or other language that would seek to bring about the same results of regulatory relief as we seek. As always, we look forward to working with the Subcommittee to draft the most effective language possible to accomplish the purposes of the

legislation and NCUA stands ready to assist the Subcommittee in any way possible.

As we move forward from this hearing today, our goal at NCUA as we implement any regulatory relief provisions the Congress ultimately chooses to enact will be, as I know yours is here today, to take any and all actions with an eye towards removing *unnecessary* regulatory burden while maintaining, as is proven by the historical strong financial performance of America's credit unions, our first and foremost priority and commitment to both *safety and soundness* and *necessary* regulation to protect the American public.

Thank you, Mr. Chairman for providing us a place at the table. We commend you, the Subcommittee and Committee for examining areas of appropriate regulatory relief. I would be pleased to attempt to answer any questions you or members of the Subcommittee may have.

Testimony of

ELIZABETH McCAUL

SUPERINTENDENT OF BANKS

For the

STATE OF NEW YORK

on behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

before the

FINANCIAL SERVICES SUBCOMMITTEE ON

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

UNITED STATES HOUSE OF REPRESENTATIVES

March 14, 2002

Good morning Chairman Bachus, Congresswoman Waters and members of the Subcommittee. I am Elizabeth McCaul, Superintendent of Banks for the State of New York, and Chairman of the Conference of State Bank Supervisors (CSBS). Thank you for asking us to be here today to share the views of CSBS on regulatory burden reduction and the "Financial Services Regulatory Relief Act of 2002."

CSBS is the professional association of state officials who charter, regulate and supervise the nation's over 6,000 state-chartered commercial and savings banks, and more than 400 state-licensed foreign banking offices nationwide.

We applaud your commitment and efforts to reduce the burdens imposed by unnecessary or duplicative regulations that do not advance the safety and soundness of our nation's financial institutions. This committee deserves special recognition for its efforts to remove these federal regulatory burdens, allowing our banks to compete with other financial entities at home and around the world. This competition encourages efficiency and innovation, benefiting the economy and consumers alike.

However, the most important contribution toward reducing regulatory burden reduction 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.

Through innovation, coordination, and the dynamic use of technology, states have made great strides in reducing regulatory burden for the institutions we supervise. As Congress considers new regulatory burden relief measures, we ask you to ensure that we can continue to pursue these efforts. We also ask you to consider initiatives that will provide equal competitive opportunities for state-regulated and federally-chartered institutions, and that will clarify the interaction of state and federal law and the ability of state governments to protect its citizens.

Innovating to Reduce Regulatory Burden

The state banking departments have always sought to measure each regulatory requirement against its benefit to the public. In supervising state-chartered institutions, we have seen how the cumulative burden of regulatory requirements can have a detrimental effect on the public by diverting banks' resources from lending and other financial services to regulatory compliance.

Over the past few years the states, independently and in conjunction with our federal counterparts, have focused their efforts on reducing the burdens on state-chartered institutions. They have done this by streamlining regulatory procedures, rescinding unnecessary regulations, embracing technology to improve the examination process, and working together to assure the strength and survival of the state banking system.

Let me briefly mention a few examples.

Last year, the Hawaii legislature passed a law that lets banks enter the state by opening a new bank or branch even if the bank's home state does not allow *de novo* entry. Hawaii is not alone in its efforts to facilitate interstate branching. In fact, 24 states have enacted or updated streamlined interstate branching laws within the past four years.

Kansas amended its banking statutes last year to allow expedited branching and relocation procedures for well-capitalized and well-managed banks. By removing ATM and loan production office application requirements as well, Kansas now allows its banks to establish these as they wish.

Pennsylvania removed some of its restrictions on the ability of out-of-state trust companies to branch into Pennsylvania, thus expanding business opportunities for all state-chartered trust institutions.

Last year, Connecticut eased its requirements for holding companies seeking to establish or maintain an office of a subsidiary in the state. Georgia also reduced both the paperwork requirements for bank holding companies and the filing procedures for banks seeking to conduct an expanded range of financial activities.

Montana no longer requires banks to submit an application to close a branch. Instead, banks file a less burdensome notice statement.

A majority of the states, including my own state, New York, must review their statutes annually to modernize and streamline their regulatory procedures. When the Gramm-Leach-Bliley Financial Services Modernization Act became law in November 1999, many states used the occasion to conduct a wholesale review

of regulations and modernize their banking laws. The result is that more than half of all the states have recodified their banking statutes since 1995.

I do not mean to suggest, by the examples I have just cited, that these provisions will or should be enacted in all fifty states. One of the chief virtues of the dual banking system is that it permits innovation and experimentation at a more local level. That way, new ideas can be tested and refined in one or several states before they are adopted nationwide.

Many other states have focused their attentions on making bank regulation more efficient, and have implemented a "best practices" strategy toward regulation. And, of course, all of the states have worked hard to keep examination fees and supervisory assessments low for their banks.

Coordinating to Reduce Regulatory Burden in an Interstate Environment

Coordination and cooperation have been hallmarks of state bank supervision since the early 1990s. CSBS strongly believes that a system of multiple regulators can actually reduce regulatory burden by avoiding a financial regulatory oligarchy. To accomplish this, however, coordination and cooperation is necessary among all regulators involved in supervising an institution.

The state banking departments have done much to reduce regulatory burden

not just individually, but as a system. With Riegle-Neal's enactment in 1994, CSBS formed, with the FDIC and the Federal Reserve System, the State-Federal Working Group. The working group's goal is to minimize conflicts and duplication among the state and federal bank regulators in supervising interstate state-chartered banks.

Separately and through the State-Federal Working Group, the state banking departments developed two agreements: the Nationwide Cooperative Agreement, signed by all 54 state banking departments, and the Nationwide State/Federal Supervisory Agreement, signed by the states, the FDIC and the Federal Reserve. Signed in November 1996, the Nationwide Agreements – unanimously agreed to by the state banking departments, the Federal Reserve and the FDIC – were the culmination of two years of work toward a system of "seamless supervision" for the interstate operations of state-chartered banks. The agreements serve as a model for cooperation and coordination between the states and the federal regulators.

The agreements provide a single regulatory point of contact for state-chartered banks that branch across state lines. Federal and state regulators have each designated a single point of contact for the overall supervision of a multi-state bank. Most recently, the Working Group produced a single uniform

application for interstate branching. To date, over two-thirds of the states have adopted this form, and more are considering its adoption.

The states have also been helpful in contributing to the federal agencies' own coordination efforts as well. When the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Federal Deposit Insurance Corporation jointly developed a uniform charter and deposit insurance application, CSBS worked with these agencies to ensure that the forms would also meet the needs of state chartering authorities.

These coordination efforts benefit all financial institutions operating in the United States, not just domestic banks. Through a CSBS-led effort, state and federal bank regulators signed agreements in 1998 to create a streamlined system for the supervision of U.S. offices of foreign banks across state lines. These agreements, signed by the states, the Federal Reserve and the FDIC, are modeled after the domestic agreements for interstate supervision.

These Agreements seek to improve coordination and cooperation in the supervision of the multi-state operations of foreign banking organizations that operate under a state license or charter. They provide for a seamless supervisory process with minimal regulatory burden, and ensure that supervision is flexible and commensurate with the bank's structure and risk profile.

Looking beyond depository institutions, we realize that providing trust services has increasingly become an interstate business. The states have adapted by developing a model form states can use for processing requests for state-chartered institutions to operate on a multistate basis.

At the state level, to further this necessary cooperation and coordination, we have formed joint task forces with the National Association of Insurance Commissioners (NAIC), the North American Securities Administrators Association (NASAA), and the National Association of State Credit Union Supervisors (NASCUS). The purpose of these task forces is to share information and, where appropriate, to coordinate supervision toward our mutual goal: a wide range of safe, responsible, accessible financial services for our states' citizens.

To facilitate this coordination, regulators representing the Conference of State Bank Supervisors (CSBS) and the National Association of Insurance Commissioners (NAIC) jointly developed a model agreement to improve the coordinated supervision and regulation of banks engaged in insurance sales.

This effort has helped supervisors avoid imposing regulatory burdens, such as making redundant requests for information or failing to coordinate responses to consumer complaints. Coordination in these areas should benefit banks engaged

in insurance sales and lead to more efficient, streamlined supervision.

Efforts such as these recognize that while the differences in law allowed by our dual banking system often produce innovation, some differences can inhibit the competitiveness of our financial institutions. We are committed, as a state system, to fostering diversity while working toward certain consistent goals. We recognize that we must encourage a broad range of opportunity, while giving financial institutions a degree of certainty and consistency so that they can serve their customers effectively across state lines. This is the true value of the state charter – it is a charter of choices.

Role of Technology

Technology has played, and will continue to play, a large part in state regulatory relief efforts. Through the use of shared technology, state and federal banking agencies work together continuously to improve the quality of the examination process, while making the examination process less intrusive for financial institutions.

Through CSBS, the state banking departments have played a pivotal role in coordinating efforts with the federal regulators to develop and improve several automated examination tools that will strengthen the examination process and facilitate more efficient, risk-focused, quality examinations. Our goals are to

make the time examiners spend in the institution more productive, and to expedite the entire examination process, thus freeing bank management to devote their efforts to the business of banking.

Individual states have also been able to streamline their regulatory procedures through technological enhancements. Several states, such as Louisiana, have applications and other forms available on-line, and accept these applications electronically. Some have instituted other technological conveniences, such as ACH transactions for assessment payments.

"Financial Services Regulatory Relief Act of 2002"

We would like to thank the Committee for considering our views on the "Financial Services Regulatory Relief Act of 2002."

State Member Bank Parallel Treatment

In particular, CSBS commends you for including Section 405 in the draft legislation, this provision gives the Federal Reserve more flexibility to allow state member banks to engage in investment activities authorized by their chartering state and approved by the FDIC as posing no significant risk to the deposit insurance fund.

This amendment removes 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 granted to 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-chartered 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 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 helps to advance that goal.

Interstate Branching

With respect to interstate branching requirement, as you may know, current Federal law has taken an inconsistent view 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.

Perhaps because it was believed that the Federal thrift charter would be eliminated at the time Riegle-Neal was adopted, the law was not applied to federally-chartered thrifts. The result is that a Federal thrift can branch without regard to state law and rules of entry.

Since the passage of Riegle-Neal, the Office of the Comptroller of the Currency has promulgated creative interpretations of the National Bank Act that effectively circumvent the application of Riegle-Neal to "branch-like" operations. CSBS unsuccessfully opposed these interpretations in a comment letter.

The result is that state-chartered institutions, particularly community banks wishing to branch interstate, are at a competitive disadvantage to those larger institutions that can already branch without restriction through the use of Federal options.

Because of such circumventions of state branching laws, states must try to address this disadvantage imposed on their state-chartered banks. Since the passage of Riegle-Neal a number of states have been moving toward allowing *de novo* branching. Seventeen states now allow *de novo* branching, most on a reciprocal basis. In December 2001, the CSBS Board of Directors approved policy to encourage all states to consider enacting *de novo* branching laws.

In your review of how Federal law addresses branching for all charters, please recognize that the majority of states have not passed *de novo* branching laws. Whatever the outcome, we urge Congress to eliminate the disadvantage it has created for state banks because of inconsistent application of Federal law.

Other Suggestions

We also ask the Committee and the Congress to address the implementation and implications of regulatory preemption by the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

The OTS currently does not publish its preemptive decisions because of the agency's interpretation of the Home Owners' Loan Act, and because the guidelines for preemption articulated in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 were never applied to the OTS.

The OCC has also determined that many of its decisions are interpretations of the National Bank Act, and not preemption by the OCC, thus avoiding disclosure. The banking system would benefit greatly from a more open dialogue between the federal government and the states about applicable law for federally chartered financial institutions.

State bank supervisors also believe that the OCC's interpretation of whether a state law is in "conflict" with the National Bank Act has been interpreted beyond Congressional intent. CSBS further believes that the OTS assumption that HOLA "preempts the field" of state law hangs not so much on statutory language, but rather on creative interpretations of that language and court decisions. We strongly encourage the Congress to revisit and clarify the scope of the preemptive authority it has delegated to these agencies.

We also seek clarification of the "Riegle-Neal Amendments Act of 1997" that the Congress enacted to allow state-chartered banks to operate interstate with greater certainty, while respecting their chartering states' laws. The language of those amendments may need refining to better reflect the 21st-century interstate environment in areas such as trust services and non-branch operations.

CSBS believes this request for review of preemption and applicable law is appropriately a regulatory burden reduction matter. Our banking system – particularly for state-chartered institutions – is a complex and evolving web of state and federal law. Greater sunshine on OCC and OTS interpretations of applicable law for the institutions they charter would also help clarify applicable law for our nation's over 6,000 state-chartered banks, representing nearly 70% of all insured depositories.

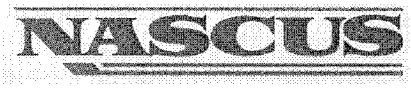
A clearer articulation of OCC and OTS standards of preemption would also lessen the legal burden of litigation over the federal regulators' sometimes tenuous interpretations of applicable law.

We need a banking system that both acknowledges the needs of multistate banks and financial services firms and protects consumers. Given that consumer needs can vary considerably across our nation, and that the states are closer to their citizens, we believe that consumer protection is often best addressed at the state level. CSBS is committed to working with the Congress to address the needs of an evolving nationwide financial services system in a way that respects the interests of all our nation's financial services providers and minimizes regulatory burden, while also protecting our nation's consumers.

CONCLUSION

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 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 subcommittee might have.



Testimony of Roger W. Little
Deputy Commissioner, Credit Unions
Office of Insurance and Financial Services
on behalf of the
National Association of State Credit Union Supervisors
before the
Subcommittee on Financial Institutions and Consumer Credit
House Financial Services Committee
March 14, 2002

NASCUS History and Purpose

Mr. Chairman and members of the Subcommittee, I am Roger W. Little, Deputy Commissioner, Credit Unions, of the Office of Insurance and Financial Services of the State of Michigan. I appear today on behalf of the National Association of State Credit Union Supervisors (NASCUS).

NASCUS has been in existence since 1965 and represents all 48 state and territorial credit union supervisors who regulate more than 4,300 state-chartered credit unions. In addition, nearly 800 CEOs of state-chartered credit unions that have a keen interest in protecting and enhancing the dual system for chartering and supervising credit unions are members of our Credit Union Council.

I serve as Vice Chairman of the NASCUS Board, am a CPA, have been both a bank and credit union regulator and served as a CSBS representative on a team to develop joint bank examination programs with the FDIC and the Federal Reserve.

Not unlike my 47 counterparts in state government, the Michigan Office of Insurance and Financial Services is committed to carrying out its mission through efficient and effective chartering, regulation and supervision of state-chartered credit unions within the statutory requirements and prudent industry standards. We serve the public through responsible regulation, effective administration and the vigorous enforcement of state laws.

NASCUS is supportive of your efforts to reduce the regulatory burden on all depository institutions and appreciates this opportunity to present the state regulators' perspective and views

The NASCUS mission is to enhance state credit union supervision and advocate a safe and sound state credit union system. Founded in 1965, NASCUS represents all 48 state and territorial credit union supervisors and the NASCUS Credit Union Council, which is made up of nearly 800 of the nation's more than 4,300 state-chartered credit unions.

National Association of State Credit Union Supervisors (NASCUS)
1655 North Fort Myer Drive, Suite 300
Arlington, VA 22209
(703) 528-8351 • FAX (703) 528-3248
E-mail: offices@nascus.org

on those aspects of the regulatory relief bill (the Committee draft dated March 5, 2002) that would directly impact state-chartered credit unions.

Our testimony on this legislation is limited to a discussion of two specific provisions contained in the regulatory relief legislation. Then we would like to address the broader issue of the safety and soundness of the state credit union system.

Specific Provisions Affecting State-Chartered Credit Unions

There are two provisions of the regulatory relief bill that NASCUS would like to address. The first is the language that would authorize Federal Home Loan Bank membership for non-federally insured credit unions.

NASCUS strongly supports the provisions contained in the Regulatory Relief legislation that would authorize state-chartered privately insured credit unions to be eligible for membership in the Federal Home Loan Banks.

Today, there are approximately 375 credit unions that are non-federally insured. All of these credit unions are regulated and examined by agencies of state governments to assure that they are operating in a safe and sound manner. Regulatory functions are the primary determinant of the safety and soundness of a credit union. The function of the credit union regulator is to assure consumers that their deposits are safe. The credit union regulator performs this mission by:

- issuing rules to assure safe and sound financial practices in credit unions;
- ensuring that violations of those safety and soundness rules are corrected;
- undertaking safety and soundness examinations of credit unions under their supervision;
- requiring the remedy of any financial deficiencies uncovered during the examination process; and
- taking enforcement actions to assure that financial remedies are implemented by the credit union (including letters of understanding and agreement, closure of the credit union, etc.).

To protect credit union shareholders both federal and private share insurance systems have been established. To manage and price insurance risk, each share insurer relies significantly on the examination reports of the institution's primary regulator. Most state credit union agencies utilize the NCUA/AIRES examination platform when they examine state-chartered credit unions for safety and soundness purposes. NASCUS agencies participate in the development and testing of NCUA's examination program and procedures. In short, there is excellent working relationship and substantially similar examination standards for both federally and state-chartered credit unions.

The NASCUS mission is to enhance state credit union supervision and advocate a safe and sound state credit union system. Founded in 1965, NASCUS represents all 48 state and territorial credit union supervisors and the NASCUS Credit Union Council, which is made up of nearly 800 of the nation's more than 4,300 state-chartered credit unions.

National Association of State Credit Union Supervisors (NASCUS)
1655 North Fort Myer Drive, Suite 300
Arlington, VA 22209
(703) 528-8351 • FAX (703) 528-3248
E-mail: offices@nascus.org

These non-federal insurers, primarily American Share Insurance on the mainland and a cooperative insurance fund that insures credit unions in Puerto Rico, have established additional solvency standards to minimize risks to their coverage portfolios from these credit unions.

With regard to privately insured credit unions, it is important to note that the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established a series of safety and soundness requirements both for entities that would offer private deposit insurance to credit unions and for credit unions which would opt for private deposit insurance.

FDICIA also requires that privately insured credit unions must be certified to meet eligibility requirements for federal deposit insurance. Specifically, the Act states that no depository institution which lacks federal deposit insurance may use "the mails or any instrumentality of interstate commerce to receive or facilitate receiving deposits, *unless* the appropriate supervisor of the State in which the institution is chartered has determined that the institution meets all eligibility requirements for Federal deposit insurance… ." (Emphasis added) As a practical matter, this requirement applies to every state-chartered, privately insured credit union, as every such credit union uses some instrumentality of interstate commerce or the mails.

FDICIA also spells out the manner and extent to which institutions opting for private deposit insurance are required to fully disclose that their deposits are privately insured.

Therefore, there should be no concern that these credit unions are not operated in a safe and sound manner.

Included in our testimony is a table that contains a comparative analysis of the financial performance of federally chartered credit unions, state-chartered federally insured credit unions and state-chartered non-federally insured credit unions. The data will demonstrate that the financial performance and safety and soundness of all three groups of credit unions are substantially equivalent.

Permitting non-federally insured institutions to join the FHLBank System would not establish a new membership principle for the System. More than 50 insurance companies, chartered and regulated by state governments, are now members of these Banks. Allowing FHLBank membership to these credit unions specializing in housing finance would not inflict any new or unusual exposure on the Bank System.

Moreover, each Federal Home Loan Bank has a sophisticated credit screening system to assure that any borrower, federally insured or not, is "credit worthy." In addition, every advance is secured by marketable collateral. Indeed, even during the savings and loan debacle, we

National Association of State Credit Union Supervisors (NASCUS)
1655 North Fort Myer Drive, Suite 300
Arlington, VA 22209
(703) 528-8351 • FAX (703) 528-3248
E-mail: offices@nascus.org

understand that no Federal Home Loan Bank suffered a loss on advances extended to their members.

In the past, Congress has expanded the membership eligibility for the Bank System as a mechanism to help local financial institutions meet the housing and home ownership needs of their communities. The inclusion of this provision, enabling state-chartered, privately insured credit unions to be eligible to join the FHLBank System, is merely one more step in bringing home ownership opportunities to these credit union members.

We would appreciate your support for including this proposal in the Regulatory Relief legislation and urge the Committee to approve this provision which will help achieve our nation's housing and home ownership goals.

Exemptions From Broker-Dealer Registration Rules

Another provision of the regulatory relief package would give savings institutions parity of treatment with commercial banks with regard to exemptions from SEC registration requirements that banks were provided by the Gramm-Leach-Bliley Act. NASCUS requests that state-chartered credit unions be accorded parity of treatment with commercial banks and savings institutions, and, therefore, relief from the same SEC requirements that have been accorded to commercial banks and would be accorded to savings institutions under this bill. We understand that the NCUA has endorsed a proposed amendment to the Regulatory Relief legislation that would grant this parity of treatment to all federal and state, federally-insured credit unions and has submitted language to the Committee to achieve these purposes. NASCUS would urge the Committee to approve such a provision for all state-chartered credit unions.

Our concern is that, unless state-chartered credit unions, both federally-insured and privately insured, are accorded the same SEC treatment as commercial banks and savings institutions, the powers granted credit unions by state legislatures and by state regulators will be unnecessarily preempted by SEC regulation. Otherwise, these credit unions will be subject to redundant and costly examination and oversight.

NASCUS urges Congress to extend the same specific exemptions that are proposed for savings associations and savings banks to the nation's state-chartered credit unions. Sufficient expertise for these purposes resides in the offices of the state regulator who regulates state-chartered credit unions.

It should be clearly understood that the amendment proposed specifically extends only to those activities that state-chartered credit unions are otherwise authorized to engage in under relevant chartering statutes and do not create any new powers for state-chartered credit unions.

The NASCUS mission is to enhance state credit union supervision and advocate a safe and sound state credit union system. Founded in 1965, NASCUS represents all 48 state and territorial credit union supervisors and the NASCUS Credit Union Council, which is made up of nearly 800 of the nation's more than 4,300 state-chartered credit unions.

National Association of State Credit Union Supervisors (NASCUS)
1655 North Fort Myer Drive, Suite 300
Arlington, VA 22209
(703) 528-8351 • FAX (703) 528-3248
E-mail: offices@nascus.org

Recent Concerns About Lack of "Parity" in the Credit Union Dual Chartering System

We understand that some federally chartered credit unions have complained that state-chartered credit unions have grown faster than their federal counterparts in some states in recent years. As a result it has been suggested that the powers of state-chartered credit unions might be "rolled back" by the U.S. Congress to restore "growth parity" in the dual chartering system.

The facts about relative growth of the assets of the two systems – federal and state – are correct. In recent years, a number of federally-chartered credit unions have switched to state charters because that charter offered a better fit with the business plan of those credit unions. Either there were specific consumer financial services that a particular state law or regulation permitted or there was a better field of membership provision in that state for that credit union. In other cases, there have been conversions from state to federal charters. However, the number of both state-chartered credit unions and federally chartered credit unions continues to steadily decline. Moreover, the numbers of such conversions from federal to state charters have not been significant enough to "tilt the playing field," or create any persistent lack of "parity" or imbalance between the two chartering systems.

Indeed, today there are fewer state-chartered credit unions than federally chartered credit unions, 4,400 versus 6,200. Moreover, the total assets of state-chartered credit unions are only $231B, substantially less than the $270B in total assets that federal credit unions hold. Finally, it is not likely that there will be any massive numbers of conversions that would weaken, in any way, the federal credit union system.

Some have suggested that the recent rapid growth of the state system is the result of regulatory laxity by state credit union supervisors.

We vigorously challenge that contention and would like to take this opportunity to refute it.

Safety and Soundness of the Federal and State Credit Union Systems

We have attached to our testimony a brief comparison of key financial performance characteristics of the federally chartered and state-chartered credit union industries. The current data indicates that, in every essential safety and soundness category, the financial performance of state-chartered credit unions is as sound as that of federally chartered institutions. The key indicators of financial health show the following.

The NASCUS mission is to enhance state credit union supervision and advocate a safe and sound state credit union system. Founded in 1965, NASCUS represents all 48 state and territorial credit union supervisors and the NASCUS Credit Union Council, which is made up of nearly 800 of the nation's more than 4,300 state-chartered credit unions.

National Association of State Credit Union Supervisors (NASCUS)
1655 North Fort Myer Drive, Suite 300
Arlington, VA 22209
(703) 528-8351 • FAX (703) 528-3248
E-mail: offices@nascus.org

At the end of 2001:

- The capital ratio of federal credit unions was 11.08%.
- The capital ratio of state-chartered federally insured credit unions was 10.74%.
- The capital ratio of state-chartered, non-federally insured institutions was 11.24%.

In short, their capital ratios were roughly the same.

- The Return on Average Assets (ROAA) for federal credit unions was 0.98%.
- The ROAA for state-chartered, federally insured credit unions was also 0.98%.
- The ROAA for state-chartered, non-federally-insured institutions was 1.19%.

In short, their ROAA ratios were roughly the same.

Finally, as the attached data demonstrates, all of the major asset quality indicators for these three groups of credit unions are roughly the same.

Moreover, the recent expansion of fields of membership for both federal and state- chartered credit unions has diversified geographical risks for many credit unions, enhancing the safety and soundness of these institutions. Credit unions with more diversified membership bases are growing more rapidly than credit unions with narrow fields of membership, often tied to employees of a single or a few local employers, and this results in a stronger and safer system.

Indeed, if we look at the origins of the Federal Credit Union Act in 1934, the practice of limiting many credit union memberships to a single, small, local employer was, in retrospect, an unsafe and unsound chartering policy. It is amazing that so many of these limited membership financial institutions survived and thrived over the years of the depression and World War II. Many of those that did survive succeeded because they were able to diversify their membership bases.

In the state-chartered credit union system, which began in the early 1900s, state legislatures were in the forefront in diversifying credit union fields of membership. Just as farmers have warned us about putting all of our eggs in one basket, regulators at both the federal and state level have come to understand that there is generally value in mixing employees in the field of membership of credit unions. Encouraging diverse employee groups and making community groups eligible for membership help ensure the economic viability of credit unions.

The NASCUS mission is to enhance state credit union supervision and advocate a safe and sound state credit union system. Founded in 1965, NASCUS represents all 48 state and territorial credit union supervisors and the NASCUS Credit Union Council, which is made up of nearly 800 of the nation's more than 4,300 state-chartered credit unions.

National Association of State Credit Union Supervisors (NASCUS)
1655 North Fort Myer Drive, Suite 300
Arlington, VA 22209
(703) 528-8351 • FAX (703) 528-3248
E-mail: offices@nascus.org

In addition, we should not forget some important lessons of commercial banking history. As financial analysts have pointed out, most of the commercial bank failures in the 1920's and 1930's occurred in unit banking states where commercial banks were not permitted to diversify geographically and, as a result, were prisoners of the local economy. As a result, these banks with highly restrictive customer bases failed because their safety and soundness was severely impacted by the economic misfortunes of their local economies.

Safety and Soundness of Regulation of State-Chartered Institutions

Moreover, there have been major improvements of state systems of supervision and regulation of all depository institutions since the savings and loan debacle of the 1980's and early 1990's. Since 1998, credit unions have been subject to PCA requirements that exceed those of commercial banks and savings institutions. As mentioned earlier, almost every state supervisor of credit unions utilizes the NCUA/AIRES examination platform to assure that all risks to the National Credit Union Share Insurance Fund (NCUSIF) are minimized. Finally, the federal share insurance fund has the right to perform insurance examinations if any aspect of the financial performance of a federally insured state-chartered is questionable.

Protecting the Dual Chartering System for Credit Unions

We would submit that any public policy "prescription" to roll back, by federal law, the statutes and regulations of the states to punish state-chartered credit unions for their financial success in this new era of intensified state supervision would be a disastrous public policy approach.

Ebbs and flows in federal-state charter activity are one of the benefits of the dual chartering system. It happens in the commercial banking industry and also occurs in the credit union industry. That ebb and flow in charter activity is a desirable public policy objective, not a cause for Congressional concern.

Attempting to roll back the powers of state-chartered credit unions would be extremely damaging to the dual chartering system, to millions of credit union members and to the health and viability of the credit union system and the financial system.

We urge this Committee to protect and enhance the viability of the dual chartering system for credit unions and to approve the provisions we have discussed in our testimony.

The NASCUS mission is to enhance state credit union supervision and advocate a safe and sound state credit union system. Founded in 1965, NASCUS represents all 48 state and territorial credit union supervisors and the NASCUS Credit Union Council, which is made up of nearly 800 of the nation's more than 4,300 state-chartered credit unions.

National Association of State Credit Union Supervisors (NASCUS)
1655 North Fort Myer Drive, Suite 300
Arlington, VA 22209
(703) 528-8351 • FAX (703) 528-3248
E-mail: offices@nascus.org

FINANCIAL PROFILE

Dec 2001 (YTD)

	Fed Chartered Fed Insured 6118	State Chartered Fed Insured 3866	State Chartered Not Insured 123	Total
Balance Sheet:				
Total assets	270,125,287	231,280,219	6,496,855	507,902,361
Percent change in total assets	15.27%	19.82%	15.50%	17.30%
Trading securities	244,765	49,478	0	294,243
Available-for-sale securities	24,113,640	19,844,759	377,001	44,335,400
Held-to-maturity securities	15,949,084	11,521,135	319,512	27,789,731
Total investments	62,285,489	49,771,504	1,570,276	113,627,269
Total loans & leases	168,849,330	150,688,622	4,125,400	323,663,352
Allowance for loan & lease losses	1,476,268	1,325,593	33,740	2,835,601
Total borrowings	2,704,628	2,350,493	556	5,055,677
Total shares & deposits	235,202,517	201,807,380	5,733,590	442,743,487
Total loans/Shares & deposits	71.79%	74.67%	71.95%	73.10%
Capital:				
Total equity	29,940,378	24,832,004	730,348	55,502,730
Equity capital/Total assets	11.08%	10.74%	11.24%	10.93%
Profitability:				
Net income(loss)	2,470,349	2,086,221	72,145	4,628,715
Return on average assets	0.98%	0.98%	1.19%	0.98%
Return on average equity	8.65%	8.96%	10.31%	8.81%
Yield on average earning assets	6.89%	7.07%	7.40%	6.98%
Cost of funds	3.79%	3.96%	3.93%	3.87%
Net interest margin	3.60%	3.62%	3.98%	3.61%
Noninterest income/Average assets	1.02%	1.12%	0.89%	1.06%
Noninterest expense/Average assets	0.00%	0.00%	0.00%	0.00%
Number of full-time employees	95,013	80,350	2,161	177,524
Number of part-time employees	16,907	15,915	398	33,220
Asset Quality:				
Provision for losses on interest-bearing assets	808,293	751,974	19,807	1,580,074
Allowance for loan & lease losses/Total loans	0.87%	0.87%	0.81%	0.87%
Allowance for loan & lease losses/Total delinquent Loans & leases	93.80%	89.47%	86.57%	91.64%
Net charge-offs(recoveries)/Average loans	0.58%	0.59%	0.55%	0.58%
Delinquent loans/Equity capital & allowance for loan & lease losses	4.46%	5.11%	4.63%	4.76%
Earnings coverage of net charge-offs	343.61%	334.29%	416.69%	340.15%
Fair value of held-to-maturity securities/Amortized cost	101.58%	101.27%	101.10%	101.44%
Unrealized gains (losses) on securities held-to-maturity	251,338	146,553	3,511	401,402
Liquidity:				
Interest-earning assets/Interest-bearing liabilities	119.31%	117.92%	117.73%	118.66%

All $'s are in thousands

Copyright © 2001 Financial Information Systems
www.FEDFIS.com

SNAPSHOT

Dec 2001 (YTD)

	Fed Chartered Fed Insured 6118	State Chartered Fed Insured 3866	State Chartered Not Insured 123	Total
BALANCE SHEET				
ASSETS				
Cash	28,533,308	21,936,628	571,565	51,041,501
Investments	62,285,489	49,771,504	1,570,276	113,627,269
Loans & Leases - Net	168,849,330	150,688,622	4,125,400	323,663,352
Other assets:				
Other Real Estate Owned	48,676	44,809	2,892	96,377
Land & Building	3,649,058	3,485,515	95,360	7,229,933
Other Fixed Assets	1,189,055	1,070,533	26,623	2,286,211
NCUA Share Insurance Capitalization Deposit	2,040,077	1,770,505	17,124	3,827,706
Other Assets	3,530,220	2,512,152	87,620	6,129,992
TOTAL ASSETS	270,125,287	231,280,219	6,496,855	507,902,361
LIABILITIES				
Borrowings	2,704,628	2,350,493	556	5,055,677
Accrued Dividends & Interest Payable on Shares & Deposits	444,316	310,262	3,998	758,576
Accounts Payable & Other Liabilities	1,839,650	1,982,644	28,369	3,850,663
Shares & Deposits	235,202,517	201,807,380	5,733,590	442,743,487
TOTAL LIABILITIES	240,191,111	206,450,779	5,766,513	452,408,403
EQUITY	29,940,378	24,832,004	730,348	55,502,730
TOTAL LIABILITIES, SHARES & EQUITY	270,125,287	231,280,219	6,496,855	507,902,361
STATEMENT OF INCOME				
Interest Income:				
Interest on Loans	13,692,337	12,117,984	349,544	26,159,865
Less: Interest Refunded	17,198	13,363	13,547	44,108
Income from Investments	3,850,640	3,002,497	89,629	6,942,766
Trading Profits & Losses	6,621	30,453	0	37,074
Total Interest Income	17,566,796	15,164,297	452,720	33,183,813
Interest Expense:				
Dividends on Shares	8,276,725	5,546,729	190,080	14,013,534
Interest on Deposits	0	1,729,592	19,264	1,748,856
Interest on Borrowed Money	112,972	117,330	78	230,380
Total Interest Expense	8,389,697	7,393,651	209,422	15,992,770
Provision for Loan & Lease Losses	808,293	751,974	19,807	1,580,074
Net Interest Income After Provision for Loan & Lease Losses	8,368,806	7,018,672	223,491	15,610,969
Noninterest Income	2,580,132	2,368,974	53,908	5,003,014
Noninterest Expense	8,478,589	7,301,425	205,254	15,985,268
Net Income (Loss)	2,470,349	2,086,221	72,145	4,628,715

All $'s are in thousands

Copyright © 2001 Financial Information Systems
www.FEDFIS.com

APPENDIX

April 25, 2002

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

H.R. 3951
Financial Services Regulatory Relief Act
April 25, 2002

I would like to thank Chairman Bachus for holding this, the second hearing on the issue of regulatory relief.

I would also like to commend Rep. Capito and Rep. Sandlin for working together to introduce H.R. 3951, the Financial Services Regulatory Relief Act of 2002 – a balanced and long overdue piece of legislation that addresses the unnecessary regulatory burdens currently faced by insured depository institutions. I hope this bill will be the first of many to remove needless and outdated laws and regulations from the books.

This Committee and the Congress have placed an incredible amount of responsibility into the hands of the private sector in an effort to stop terrorists. The financial services industry bears the brunt of this regulatory responsibility in Title III of the PATRIOT Act, which went through this Committee last October. The time and cost required to comply with the new laws and regulations compel us to help the industry find ways to pay for these efforts.

I am pleased that Rep. Capito has introduced a bill that will repeal some of the regulations that have become ineffective or outdated and that will lessen the regulatory and financial burden of those financial institutions that have worked so hard to help in the fight against terrorism.

This legislation is a compilation of recommendations provided, at my request, from federal and state financial regulators that would provide regulatory relief for insured depository institutions. The purpose is to alter or eliminate statutory provisions to lessen the regulatory burden and improve productivity, as well as make needed technical corrections to current statutes. H.R. 3951, the Financial Services Regulatory Relief Act of 2002, does this by providing regulatory relief for banks, savings associations, credit unions and federal financial regulatory agencies.

I am also very pleased that a credit union provision I cosponsored with my good friend Rep. Bob Ney was included in Section 301 of the bill. I must say I was disappointed to see that both ACB and NAFCU have joined in opposing this pro-credit union provision. I think that the Ney-Oxley legislation would help a small number of privately-insured credit unions by allowing them to apply to become a member of a Federal Home Loan Bank, and as the state credit union supervisors testified at our last hearing, it would present no safety and soundness risk. It is fully consistent with current federal law, for example, most credit unions and even insurance companies can already become Home Loan Bank members. It is a common sense provision and I am pleased it is a part of this important legislation.

This is an excellent piece of legislation that I am proud to be a co-sponsor of, and I look forward to hearing from the industry today on their perspectives and input.

I look forward to working with Mr. Bachus, Ms. Capito and Mr. Sandlin as we go forward in the legislative process. Thank you.

OPENING STATEMENT OF REP. SPENCER BACHUS HEARING ON H.R. 3951, THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2002 APRIL 25, 2002

The Subcommittee meets today for its second hearing on H.R. 3951, the Financial Services Regulatory Relief Act of 2002. This bipartisan legislation was introduced last month by our colleagues on the Subcommittee, Mrs. Capito and Mr. Sandlin. I am proud to be an original cosponsor of the bill, along with our Chairman, the gentleman from Ohio, Mr. Oxley.

At our first hearing on H.R. 3951 last month, the Subcommittee heard testimony from a wide range of Federal and State banking regulatory agencies, whose technical assistance and expertise have been invaluable to the Committee in the development of this legislation. Having heard from the **regulators**, today we will hear from the **regulated** – those institutions that must contend with the reams of bureaucratic red tape that issue forth from this city every year. Testifying will be five of the leading financial services trade associations, representing large banks, small community banks, savings institutions, and credit unions.

As Chairman Oxley and other Members pointed out at our first hearing on this legislation, the regulatory burdens shouldered by depository institutions increased significantly last year with the enactment of the anti-money laundering provisions of the USA PATRIOT Act. Just this week, the Treasury Department issued new regulations implementing a key provision of the PATRIOT Act, requiring financial institutions to have in place programs designed to detect money laundering and terrorist financing. In testimony before this Committee, the FBI and other government agencies have praised the financial services industry for its cooperation with law enforcement in the post-September 11th investigations of al Qaeda and other terrorist organizations operating in this country.

It has often been said that banks and other financial institutions are our nation's first line of defense in the financial war on terrorism that the Bush administration is waging so effectively. Last week's government alert – warning that terrorists might be planning attacks against U.S. financial institutions in the Northeast – brought home the banking industry's front-line role in stark terms. So as we consider this important legislation to give financial institutions and their customers much-needed regulatory relief, we should also take a moment to recognize the very real contributions to homeland security made by vigilant bank tellers and other financial services professionals across this country.

April 25, 2002

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
Hearing on HR 3951, the Financial Services Regulatory Relief Act of 2002

I would like to thank Chairman Bachus for holding today's hearing on the Financial Services Regulatory Relief Act and to applaud Congresswoman Capito for her hard work and leadership in crafting this important legislation.

I am happy to be an original cosponsor of HR 3951 and feel its provisions properly address several statutory provisions and unnecessary regulations that prove burdensome for American insured depository institutions. Both Chairman Oxley and Congresswoman Capito have been diligent in their efforts on this issue and in crafting this legislation they have sought extensive input from both regulators and industry representatives.

These lengthy discussions have produced sound legislation that appropriately addresses the needs of modern banks, savings associations, credit unions and Federal regulatory agencies while preserving the overall legislative intent of the affected regulations.

I appreciated hearing the constructive comments from representatives of the Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of thrift Supervision, National Credit Union Administration, Conference of State Bank Supervisors, and National Association of State Credit Union Supervisors on HR 3951 in March.

Again, I thank Chairman Bachus for holding today's hearing and look forward to learning the opinions of industry representatives on the Financial Services Regulatory Relief Act of 2002. I am sure the committee will move swiftly in our further deliberations on this issue and deliver this important modernizing legislation to the full House of Representatives for consideration without delay.

CUNA & Affiliates

Credit Union National Association, Inc.
601 Pennsylvania Avenue NW
South Building, Suite 600
Washington, D.C. 20004
(202) 638-5777

TESTIMONY OF
CHARLENE R. GAITHER
MANAGER
EASTERN PANHANDLE COMMUNITY FEDERAL CREDIT UNION
ON BEHALF OF
CREDIT UNION NATIONAL ASSOCIATION (CUNA)
ON
H.R. 3951, "The Financial Services Regulatory Relief Act of 2002"

APRIL 25, 2002

TESTIMONY OF
CHARLENE R. GAITHER
MANAGER
EASTERN PANHANDLE COMMUNITY FEDERAL CREDIT UNION
ON BEHALF OF
CREDIT UNION NATIONAL ASSOCIATION (CUNA)
ON
H.R. 3951, "The Financial Services Regulatory Relief Act of 2002"

APRIL 25, 2002

Chairman Bachus, ranking member Waters, and members of the Subcommittee, especially my own Member, Representative Capito, thank you for the opportunity to provided comments on H.R. 3951 and your efforts to design legislation to lessen the regulatory burden on insured depository institutions and improve productivity. I am Charlene Gaither, Manager of the Eastern Panhandle Community Federal Credit Union, a $17 million credit union in Martinsburg, West Virgina. I appear before you today on behalf of the Credit Union National Association (CUNA). CUNA represents over 90 percent of the nation's approximately 10,250 state and federally chartered credit unions and 82 million credit union members.

We congratulate Representative Capito for introducing this bill and including the legitimate needs of credit unions for regulatory relief. This is especially gratifying, since the last two regulatory relief bills that Congress passed did not include provisions specific to credit unions. Some might suggest that the Credit Union Membership Access Act was the credit union version of regulatory relief. While that law did provide relief from an onerous Supreme Court decision, it also imposed several new, stringent regulations on credit unions, which, in spite of assertions to the contrary, are the most stringently regulated of insured financial institutions.

I would like to emphasize that my testimony today will focus on the provisions in the bill which pertain to credit unions, as well as those we would like the committee to include in any final bill. Nearly all of these items are consistent with CUNA's Renaissance Vision Statements, the result of 18 months of input from credit unions around the country, in an effort to ensure credit unions have the tools available to meet their members' needs in the 21st century.

CUNA will not attack provisions in the bill pertaining to banks or thrifts, although the trade associations representing them seem to spend more time criticizing credit union provisions than focusing on their own. We do reserve the right, however, to point out fallacies in their arguments and point out where they may indeed have certain advantages that outweigh those of others.

Provisions in H.R. 3951

As mentioned above, CUNA is very pleased with the provisions included in H.R. 3951 pertaining to credit unions. We believe that these provisions will provide significant help for many credit unions in improving service to their members. In addition, although we understand the Committee's desire to avoid what it deems as controversial issues, we look forward to the time when we can revisit several provisions of the Federal Credit Union Act which have imposed arbitrary and unnecessary limits on credit unions, such as the cap on member business lending, certain prompt corrective action issues, and a limited number of field of membership restrictions.

The following discussion presents our views on the credit union provisions included in H.R. 3951:

Sec. 301. Privately insured credit unions authorized to become members of a Federal Home Loan Bank

CUNA strongly supports this provision, originally introduced as H.R. 2796, the Federal Home Loan Bank Membership Access of 2001, by Rep. Bob Ney. This is a bi-partisan bill that is co-sponsored by Chairman Oxley and Rep. Tubbs Jones. As incorporated into H.R. 3951, this provision would provide a needed funding source for home ownership for many credit union members, as well as strengthen the dual chartering system of credit unions.

This amendment would permit privately insured credit unions to become members of a Federal Home Loan Bank. Currently, such credit unions are excluded from FHLBank membership. The FHLBanks offer a number of products and services to financial institutions which should be available to privately insured credit unions. There is no compelling public policy reason to exclude them. According to the private insurer, presently there are only 216 privately insured credit unions in 7 states. These institutions are regulated by the states in which they were chartered. They are subject to safety and soundness requirements from the state regulator, as well as the private insurer. These requirements are similar in scope and nature to those faced by other financial institutions. Membership in a FHLBank would benefit privately insured credit unions and their members and could enhance the ability of such credit unions to broaden key programs, such as reaching out to low-income groups.

Contrary to some assertions, the beneficiary of this provision would not be a specific company, rather it would be the 1.3 million credit union members belonging to privately insured credit unions. The membership of these credit unions comprises people from all walks of life, such as fire fighters, postal workers, teachers, healthcare and agriculture workers. Under current law, these credit unions cannot access the Federal Home Loan Bank System in order to provide mortgage funding for their members. This provision would do nothing more than permit these institutions to apply to join the FHLB System and provide a new source of housing funds for these credit unions and their members.

It is critical to include this provision in H.R. 3951 in order to advance home ownership options for these credit union members. It also is important to remember that this bill provides no special treatment for these institutions. Before joining the FHLB System, any institution covered by this provision would have to be subject to approval by the appropriate Federal Home Loan Bank. Advances from the Bank System would be on the same terms as any other similar institution. This would ensure that there would be no safety and soundness concerns.

Sec. 302. Leases of land on federal facilities for credit unions

This provision would permit military and civilian authorities responsible for buildings on federal property the discretion to extend to credit unions that finance the construction of credit union facilities on federal land real estate leases at minimal charge. Credit unions provide important financial benefits to military and civilian personnel, including those who live or work on federal property. This amendment would authorize an affected credit union, with the approval of the appropriate authorities, to structure lease arrangements to enable the credit union to channel more funds into lending programs and favorable savings rates for its members.

Sec. 303. Investments in securities by federal credit unions

The Federal Credit Union Act limits the investment authority of federal credit unions to loans, government securities, deposits in other financial institutions, and certain other limited investments. The limitation is anachronistic and curtails the ability of a credit union to respond to the needs of its members. The amendment provides additional investment authority to purchase for the credit union's own account certain investment securities. The total amount of the investment securities of any one obligor or maker could not exceed 10 percent of the credit union's unimpaired capital and surplus. The NCUA Board would have the authority to define appropriate investments under this provision, thus ensuring that new investment vehicles would meet high standards of safety and soundness and be consistent with credit union activities.

Sec. 304. Increase of general 12-year limitation of term of federal credit union loans to 15 years.

Federal credit unions are authorized to make loans to members, to other credit unions, and to credit union organizations. The Federal Credit Union Act imposes various restrictions on these authorities, including a 12-year maturity that is subject to limited exceptions. The amendment would allow loan maturities up to 15 years, or longer terms as permitted by the National Credit Union Administration Board.

As a Federal credit union, my institution must comply with this limitation. We are very concerned that members seeking to purchase certain consumer items, such as a mobile home, may seek financing elsewhere in which they could repay the loan over a longer period of time than 12 years. While we would prefer for NCUA to have authority to determine the maturity on loans, consistent with safety and soundness, a 15-year maturity is preferable to the current limit. Such an increase in the loan limit would help lower monthly payments for credit union borrowers and benefit credit unions as well as their members.

Sec. 305. Increase in 1 percent investment limit in credit unions services organizations

The Federal Credit Union Act authorizes federal credit unions to invest in organizations providing services to credit unions and credit union members. An individual federal credit union, however, may invest in aggregate no more than 1% of its shares and undivided earnings in these organizations, commonly known as credit union service organizations or CUSOs. The amendment raises the limit to 3% percent.

CUSOs provide a range of services to credit unions and allow them to offer products to their members that they might not otherwise be able to do, such as check clearing, financial planning and retirement planning. Utilizing services provided through a CUSO reduces risk to a credit union and allows it to take advantage of economies of scale and other efficiencies that help contain costs to the credit union's members. Further, as federal credit union participation in CUSOs is fully regulated by NCUA, the agency has access to the books and records of the CUSO in addition to its extensive supervisory role over credit unions.

The current limit on CUSO investments by federal credit unions is out-dated and limits the ability of credit unions to participate with these organizations to meet the range of members' needs for financial services. It requires credit unions to arbitrarily forego certain activities which would benefit members or use outside vendors in which the credit union has no institutional stake. While we feel the 1% limit should be eliminated or set by NCUA through the regulatory process,

we appreciate that the increase to 3% will provide credit unions more options to investment in CUSOs to enhance their ability to serve their members.

Sec. 306. Member business loan exclusion for loans to non-profit religious organizations

We also want to commend Rep. Capito for including in the bill legislation previously introduced by Rep. Royce, H.R. 760, the Faith-Based Lending Protection Act. This amendment is designed to exclude loans made by federal credit unions to non-profit religious organizations from the statutory member business loan limit, which is 12.25% of the credit union's total assets. This amendment would offer some relief in this area by allowing federal credit unions to make member business loans to religious-based organizations without concern about the statutory limit that now covers such loans. While the limit would be eliminated, such loans would still be subject to other regulatory requirements, such as those relating to safety and soundness.

The American Bankers Association and others assert that this provision would be an end-run around congressional intent and is the beginning of a campaign to whittle away those limits in small bites. Nothing could be further from the truth. While it is true that CUNA is in favor of repealing the caps on member business loans, which we will leave for another day, it is patently untrue that this provision is designed as a way to begin that process. In fact, we believe that this is really a technical amendment designed to correct an oversight during passage of the Credit Union Membership Access Act. There was even an attempt to accomplish this on the Senate floor during the debate over the bill, but because of Constitutional questions, which have since been cleared up, the amendment was withdrawn. The law currently provides exceptions to the member business loan caps for credit unions with a history of primarily making such loans. Congress simply overlooked other credit unions that purchase parts of these loans, or participate in them. This provision would clarify that oversight and ensure that these organizations can continue meeting the needs of their members and the greater community at large.

Sec. 307. Allow federal credit unions to cash and sell certain checks to persons in the field of membership of the credit union

Federal credit unions are currently authorized to provide check cashing services to members and have limited authority to provide wire transfer services to individuals in the field of membership under certain conditions. The amendment would allow federal credit unions to provide check cashing services to anyone eligible to become a member.

This amendment is fully consistent with President Bush's initiatives to reach out to other underserved communities in this country, such as some Hispanic neighborhoods. Many of these individuals live from pay check to pay check and do not have established accounts, for a variety of reasons, including the fact that they do not have extra money to keep on deposit. We have had members join one day, deposit their necessary share balance and come in the very next day and withdraw because they need the money. This is not mismanagement on their part. They just do not have another source of funds. If we are able to cash checks and sell negotiable checks such as travelers checks, we could accomplish two things: save our staff time and effort opening new accounts for short term cash purposes which are soon closed and gain the loyalty and respect of the potential member so that when they are financially capable of establishing an account, they will look to the credit union, which will also provide financial education and other support services.

Sec. 308. Voluntary mergers and conversions involving multiple common bond credit unions without numerical limitations

In voluntary mergers of multiple bond credit unions, NCUA has determined that the Federal Credit Union Act requires it to consider whether any employee group of over 3,000 in the merging credit union could sustain a separate credit union. This provision is unreasoanble and arbitrarily limits the ability of two healthy multiple common bond federal credit unions from honing their financial resources to serve their members better.

The amendment is a big step forward in facilitating voluntary mergers, as other financial institutions are permitted to do. It provides that the numerical limitation does not apply in voluntary mergers.

The amendment also allows a multiple common bond credit union converting to or merging with a community charter credit union to retain all groups in its membership field prior to the conversion or merger. Currently, when a multiple group credit union converts to or merges with a community charter, a limited number of groups previously served may be outside of the boundaries set for the community credit union. Thus, new members within those groups would be ineligible for service from that credit union. The amendment would allow the new or continuing community credit union to provide service to all members of groups previously served.

Provisions CUNA Proposes for Inclusion in H.R. 3951

During the course of drafting H.R. 3951, CUNA staff had several conversations with the Committee staff regarding a number of proposals that were apparently not included in the bill for reasons of maintaining a "balance" between various industries. It is our understanding that once the bill was introduced, however, that it would be subject to change and that members would be open to possible additions.

The following requests, with one exception, were provisions which did not appear to present any substantive problems with the Committee staff and which we propose be included in the final version of this bill. And nearly all of them address some of the worst examples of statutory micromanagement that have placed unreasonable constraints on the ability of credit unions and their boards to function efficiently and in the best interests of their members:

1. Permits credit unions to expel members for just cause without requiring extraordinary measures.

Amend 12 USC 1764(b) in the following manner (new language is in bold italics.)

(b) The board of directors of a Federal credit union may, by majority vote of a quorum of directors, adopt and enforce a policy with respect to expulsion from membership ***based on just cause, including disruption of credit union operations,*** and nonparticipation by a member in the affairs of the credit union. ~~In establishing its policy, the board should consider a member's failure to vote in annual credit union elections or failure to purchase shares from, obtain a loan from, or lend to the Federal credit union.~~ If such a policy is adopted, written notice of the policy as adopted and the effective date of such policy shall be ~~mailed~~ ***provided*** to each member of the credit union ~~at the member's current addressing appearing on the records of the credit union~~ not less than 30 days prior to the effective date of such policy…

Explanation

Section 12 USC 1764 of the Federal Credit Union Act currently permits a member to be expelled by a two-thirds vote of the membership present at a special meeting. It also allows the credit union's board to expel a member for nonparticpation.

This amendment will allow federal credit union boards some supplementary flexibility to address situations in which a member is disruptive to the operations of the credit union, including harassing credit union personnel and creating safety concerns for the credit union. While these instances are relatively rare, a federal credit union has little latitude to address such situations efficiently and in a timely manner under the current language of the Act.

There has been more than one occasion when we would have liked to have had the ability to expel a member for just cause. I can remember one occasion when one member actually told one of my tellers he would punch her if he ever saw her out in public. Most cases are not quite that extreme; however, we have had our share of unruly members who seem to enjoy causing a ruckus.

The Act also currently requires notice to members regarding the credit union's expulsion policy. The amendment would allow a federal credit union to provide such notice by any reasonable means designed in good faith to ensure delivery, such as through the mail, by electronic delivery, or at the credit union's annual meeting.

2. Permits directors or members of supervisory committees to obtain loans of up to $50,000 without board approval.

Amend 12 USC 1757(5)(A)(iv) in the following manner (new language is in bold italics.)

A loan or aggregate of loans to a director or member of the supervisory or credit committee of the credit union making the loan which exceeds ~~$20,000~~. ***$50,000*** plus pledged shares, be approved by the board of directors....

Explanation

The Federal Credit Union Act requires the board of a federal credit union to approve a loan or aggregate of loans for a member of the credit union's board, supervisory committee or credit committee when the amount exceeds $20,000. This threshold is very low (for example, a moderately priced new car would often exceed this amount). The threshold should be raised so that credit union boards of directors will not have to continue to devote significant resources to review such loans. A reasonable increase of this very low threshold will not raise supervisory issues, as the loan file will be subject to examiner review.

3. Permits credit unions to reimburse board volunteers for reasonable expenses.

Amend 12 USC 1761(c) in the following manner (new language is in bold italics.)

No member of the board or of any other committee shall, as such, be compensated, except that reasonable health, accident, similar insurance protection, and other reimbursement of reasonable expenses, ***including lost wages,*** incurred in the execution of the duties of the position shall not be considered compensation.

Explanation

Credit unions are directed and operated by committed volunteers. Given the pressures of today's economy on many workers and the legal liability attendant to governing positions at credit unions, it is increasingly difficult to attract and maintain such individuals. Rather than needlessly discourage volunteer participation through artificial constraints, the Federal Credit Union Act should encourage such involvement by allowing volunteers to recoup wages they would otherwise forfeit by participating in credit union affairs.

Whether or not a volunteer attends a training session or conference is sometimes determined by whether or not that volunteer will have to miss work and not be paid. I've seen it happen in my own credit union, and my board is comprised of GM employees and retirees. I can imagine this would have an even more substantial impact on boards where the volunteers are not making the income my volunteers do.

4. Permits credit unions to establish term limits for board members.

Amend 12 USC 1761(a) to add the following language at the end of the subsection (new language is in bold italics.)

A federal credit union may limit the number of times a board member may be reelected, as provided by its bylaws.

Explanation

Credit unions should have the right to limit the length of service of their boards of directors as a means to ensure broader representation from the membership. Credit unions, rather than the federal government, should determine term limits for board members. Providing credit unions with this right does not raise supervisory concerns and should not, therefore, be denied by the federal government.

5. Permits credit unions to lower its level of interest in loan participations.

Amend 12 USC 1757 in the following manner (new language is in bold italics.)

Provided [T]hat a credit union which originates a loan for which participation arrangements are made in accordance with this subsection shall retain an interest of at ~~10~~ *5* per centum of the face amount of the loan ***or other lower per centum as determined appropriate by the National Credit Union Administration Board.***

Explanation

The requirement that a federal credit union originating a loan for participation must retain a 10% interest in the loan is arbitrary and has not proven to be necessary for safety and soundness reasons. At the same time, it hinders a federal credit union's ability to meet its members credit needs through participation in loan services with other credit unions or financial institutions. Credit unions are under an obligation under the FCUA to operate in a safe and sound manner, and the National Credit Union Administration has sufficient authority under the Act's safety and soundness provisions to ensure that participation loans are structured in an appropriate manner. This amendment would facilitate the ability of a credit union to increase loan participations by

incrementally lowering the required retained interest to 5% of the loan's face value. It would also authorize the NCUA Board to set a lower standard as it deems appropriate.

6. Permits credit unions to sell wire transfers to persons in the field of membership.

Amend Section 307 of H.R. 3951, page 223, line 16 in the following manner (new language is in bold italics):

"SEC. 307. SALE OF CHECKS ***AND WIRE TRANSFER SERVICES*** TO PERSONS IN THE FIELD OF MEMBERSHIP OF THE CREDIT UNION."

Amend Section 307 of H.R. 3951, page 24, line 5 in the following manner (new language in bold italics):

"checks ***and provide wire transfer services*** for persons in the field of membership, for a fee."

Explanation

While the bill as introduced would authorize federal credit unions to cash checks for non-members within the field of membership, it should be extended to authorize federal credit unions to provide wire transfer services, as well. This would help credit unions reach the "unbanked" and "underserved" and provide an affordable and financially sound alternative to high cost payday lenders. This amendment would allow credit unions to play an important role in combating predatory lending practices.

As you know, there is a growing population of Hispanic and other individuals in this country who for one reason or another, are not able to utilize traditional financial institution services. These individuals frequently send their hard-earned pay to parents, children, brothers and sisters in Mexico or other homelands. Those who do not have access to a credit union or other financial institution must use wire services that charge outrageously high fees, up to 28% of the amount transferred in some cases, to execute the transaction.

This is a deplorable situation, which a number of credit unions would like to rectify by offering international wire transfers to individuals and legal entities within the field of membership.

Allowing credit unions to offer wire services to nonmembers will not expose credit unions or the National Credit Union Share Insurance Fund to additional risk. Credit unions using such services would be expected to comply fully with NCUA guidelines and their arrangements with vendors as well as their management of such activities would be fully subject to examiner review.

7. Permits Credit Unions to Issue Some Form of Additional or Alternative Capital.

As the Chairman of the Subcommittee knows, this issue was first raised in this subcommittee during the mark-up of the deposit insurance reform bill. An amendment was introduced, discussed, then withdrawn. While some consideration was given to reintroducing the amendment at the full committee mark-up, out of deference to the Chairman it was not. And frankly, although CUNA has a strong position regarding the concept of allowing some form of alternative capital for credit unions, our position regarding how to achieve that is evolving. We are currently in discussions with various members and staff of the Committee and are seeking a consensus on

how to best achieve this goal while maintaining certain guiding principles. The foremost of these guiding principles is that any form of alternative capital must not compromise the cooperative nature of credit unions. This capital must not give its holder any voting or control rights. Additionally, this capital must not be insured and it must therefore be at risk to the investor. In adhering to these principles, there is a great need for allowing credit unions to raise some form of alternative capital.

It is also important to dispel some of the myths opponents of this concept have been spreading. Specifically, the American Bankers Association recently wrote a letter to Chairman Oxley that included many misleading allegations about the role of alternative capital. The letter was written in anticipation of an attempted amendment on the deposit insurance reform bill and therefore includes arguments about whether the amendment would have been germane. Although we believe the amendment would have been germane if it had been offered, that is a moot issue now. But below is a copy of our letter that also address the other assertions by the ABA:

April 16, 2002

The Honorable Michael J. Oxley
Chairman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Oxley:

It is with regret that I am compelled to respond to the letter addressed to you on April 12, 2002, by Ed Yingling of the American Bankers Association (ABA). The letter outlines in misleading and inaccurate detail why the ABA objects to a proposed amendment by Rep. Brad Sherman to H.R. 3717, the Federal Deposit Insurance Reform Act of 2002, to be marked up by the House Financial Services Committee on April 17.

Mr. Yingling's letter, unfortunately, once again demonstrates that the ABA is more worried about crushing competition than it is about establishing a record of service and trust on behalf of the banking industry. The ABA, as well as some of the other banking organizations, seems to spend more time trying to find ways to establish a monopoly than in strengthening their own members' operations. This is the same group that only recently petitioned the Federal Reserve Board for expanded powers in the real estate brokerage business. In advancing their argument, the ABA suggests that providing banks with this authority would expand "consumer choice," and that additional competition would be good for consumers and result in lower prices for these services. This is the ultimate in arrogance and hypocrisy. When these same arguments are used by other players in the financial services industry, the ABA consistently dismisses them.

It is appalling that the ABA continually acts as the bully on the financial services block. Their positions are detrimental not only to others in the financial services industry, whether it be the realtors, insurance agents, mutual funds and securities industries, or credit unions, but most importantly, to the consumers of America. Ultimately, the monopolistic practices advocated on behalf of the banking industry by the ABA result in fewer choices and higher prices for the consumers of America.

With respect to the ABA letter of April 12, the following will set the record straight regarding the proposed Sherman amendment:

ABA Assertion: the Sherman amendment "has nothing to do with deposit insurance reform" and is "non-germane" to the bill.

CUNA Response: the role of alternative capital is clearly germane to the proposed bill, as it directly amends a provision of the Federal Credit Union Act that pertains to the National Credit Union Share Insurance Fund (NCUSIF). In addition:

1. The bill already has a number of significant items not related to the pricing of insurance: additional allowable investments; coverage increases; merging BIF and SAIF; and Deposit Insurance Fund (DIF) restoration plans.

2. The replacement of the fixed Designated Reserve Ratio (DRR) with a Reserve Range is not only a pricing issue. It is also a safety and soundness issue in that the FDIC Board is to determine the DRR within a range of 1.15% and 1.4% based on the Board's assessment of "(1) present and future risk of losses to the deposit insurance fund;" and "(2) economic conditions." The NCUSIF Board already has the authority to set a normal operating level within the range of 1.2% to 1.5%. The NCUA could more precisely estimate "present and future losses to the fund" if credit unions had access to additional forms of capital.

3. In a similar vein, Section 8 "Requirements Applicable to the Risk-Based Assessment System" could very easily include the creation of additional capital to allow credit unions to minimize risk to the share insurance fund, and for NCUA to more accurately assess that risk.

ABA Assertion: Allowing credit unions other than low-income credit unions to access additional forms of capital moves away from the reliance on member owned equity, allowing credit unions to issue "ownership interests" to nonmembers, with the concomitant corporate governance issues of voting rights, board composition, etc.

CUNA Response: Credit unions are emphatically <u>not</u> seeking the ability to issue equity to anyone other than members. More specifically:

1. Credit unions seek the ability to issue non-voting debt instruments to investors in a way that would not dilute the cooperative ownership structure of credit unions.

2. These debt instruments would be subordinate to the share insurance fund and thus provide additional protection to the NCUSIF. They would therefore be counted as part of a credit union's capital base for purposes of prompt corrective action (PCA) rules, which are designed to minimize losses to the share insurance fund. Without access to such funds, well-run credit unions of various types and sizes may at times be unable to accept normal, healthy growth because of PCA rules. Access to additional sources of protection for the share insurance fund would not constrain growth to the sometimes slow accumulation of retained earnings.

3. These debt instruments would confer no voting or control rights to the holders.

4. To the extent credit unions may wish to issue new forms of equity to their members, they would be structured in such a way as <u>not</u> to violate the one-member, one-vote nature of credit union governance. Either an equal amount of equity could be required of all members, or special, nonvoting equity certificates could be sold to those members wishing to purchase them.

ABA Assertion: The amendment may have a negative impact on the ability of low-income credit unions to attract capital. The amendment, they say, would force these low-income credit unions to compete with other credit unions for the "pool" of capital currently available to such low-income institutions.

CUNA Response: The truth of the matter is that low-income credit unions obtain their secondary capital from an entirely different "pool" of investors from that which other credit unions would tap. More specifically:

1. Investors that provide low-income credit unions with secondary capital generally fall into one of two categories: those attempting to fulfill a social mission, and those trying to comply with regulations such as CRA requirements. The former group includes charitable trusts, foundations, and faith-based organizations. The latter are primarily banks attempting to meet CRA requirements.

2. Clearly, neither of these two groups would substitute their secondary capital investments in low-income credit unions for investments in some other type of credit union. Doing so would not help them accomplish their social or regulatory goals.

3. Investors in the subordinated debt issues of mainstream credit unions would likely be those seeking attractive market returns on investments based on their analysis of the financial condition of the issuing credit union.

ABA Assertion: The ABA asserts that Congress, in enacting the Credit Union Membership Access Act, specifically prohibited credit unions from issuing capital stock and relying on anything other than retained earnings.

CUNA Response: The ABA inaccurately portrays the issue of secondary capital for credit unions that are not low-income as one that Congress fully considered during its deliberations of the Credit Union Membership Access Act in 1998 and rejected. This is simply false. As the legislative history of the CUMAA indicates, Congress did not focus on the authority for natural person credit unions that are not low-income to issue secondary capital.

1. The ABA points to a single provision in a Senate Banking Committee report [Rept. No. 105-193, page 12] as proof that Congress "specifically reinforced its view" that credit unions may not issue capital stock. The language cited, which is in the Federal Credit Union Act, is taken out of context to distort its relevance. Only when read with the previous subsection is the intent of this language clear (12 USC 1790d(b)(1)(A);(B)). Under that language, Congress directed the NCUA Board to develop a PCA system that was comparable to Section 38 of the FDIC Act, while taking into account that, at the time CUMAA was enacted (as now) credit unions did not issue capital stock and their only method of building net worth is through retained earnings. When read as Congress intended, it is clear that the language cited is descriptive and not prohibitive. Had Congress intended to prohibit secondary capital for credit unions it would have included a clear directive to this effect in the statute.

2. The ABA also erroneously states that the same safety and soundness rules that apply to credit unions apply to banks. In fact, credit union PCA requirements are more stringent as credit unions are the only federally regulated financial institutions that have net worth levels, such as well-capitalized and adequately capitalized, specifically delineated in the statute. These levels are higher than the capital requirements imposed by regulation on banks.

In summary, the ABA has once again demonstrated that it will automatically oppose attempts by others to improve service to the consumer, and will use misleading and inaccurate information to o so. The Sherman amendment is not only germane to deposit insurance, it would strengthen what is already an incredibly safe fund for credit unions, while enabling credit union members to reap the benefit of even greater service.

Sincerely,

Daniel A. Mica
President & CEO

cc: Members of the House Financial Services Committee

I believe this letter adequately dispels the ABA's misinformation campaign. Let me repeat: credit unions must have the ability to build additional capital in a way that does not dilute the cooperative ownership and governance structure of credit unions. This additional capital should be subordinated to credit unions' share insurance fund, so that credit unions have the financial base to offer these services to adjust to fluctuating economic conditions. Structured properly, giving credit unions this ability will in fact provide an additional buffer to the NCUSIF, and make a strong fund even stronger. We continue to work on an appropriate approach that will accomplish these purposes and seek advice and guidance from members of the subcommittee.

Conclusion

In conclusion, CUNA is grateful and pleased that H.R. 3951 includes several provisions that will significantly increase the effectiveness of credit unions in serving their members. And while we strongly support this bill, we urge the Subcommittee to support our efforts to include the additional provisions we described in this testimony. With these additions, we are confident that credit unions will be willing to participate in a strong grassroots effort to help H.R. 3951 become the law of our land.

Below are the answers to the two questions from Rep. Grucci:

1. From your written statement I see that you support a provision that would permit federal credit unions to limit the number of times an individual may be elected to their board of directors. Can you elaborate on why you think this provision is necessary?

   Answer: Credit unions should have the right to limit the length of service of their boards of directors as a means to ensure broader representation from the membership. But current law does not allow for this. There are many credit unions with volunteers that have been on the board for decades. In some cases this may be a positive, but in other cases, it may prevent the credit union from infusing new leadership and fresh ideas and energy into its efforts to serve its memberships. This would not force term limits on credit unions, but would give each credit union the ability to use this option if it believes it is in their best interest. And providing credit unions with this right does not raise supervisory concerns and should not, therefore, be denied by the federal government.

2. I see from your written statement that you support a provision that would allow credit unions to expel members for just cause. Can you elaborate a little bit on this provision?

   Answer: Under current law credit unions already have the ability to expel members. But the method permitted is extraordinarily burdensome and, in some cases, nearly impossible to achieve: it requires a two-thirds vote of the membership present at a special meeting. This amendment would allow federal credit union boards some supplementary flexibility to address situations in which a members is disruptive to the operations of the credit union, including harassing credit union personnel and creating safety concerns for the credit union. In fact, during my testimony I mentioned an instance where a member publicly threatened to punch one of my tellers. While these instances are relatively rare, a federal credit union has little latitude to address such situations efficiently and in a timely manner under the current language of the Act.

   The Act also currently requires notice to members regarding the credit union's expulsion policy. The amendment would allow a federal credit to provide such notice b any reasonable means designed in good faith to ensure delivery, such as through the mail, by electronic delivery, or at the credit union's annual meeting.

Written Testimony of
William Cheney

President/CEO of
Xerox Federal Credit Union

On Behalf of
The National Association of Federal Credit Unions

Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives

"Financial Services Regulatory Relief Act of 2002"
H.R. 3951

April 25, 2002

National Association of Federal Credit Unions
31 38 10th St. North
Arlington, VA 22201
(703) 522-4770

Written Testimony of William Cheney
President/CEO of Xerox Federal Credit Union
On behalf of the National Association of Federal Credit Unions
Before the Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives
"Financial Services Regulatory Relief Act of 2002", H.R. 3951
April 25, 2002

Table of Contents

Introduction.....

CUMAA and Beyond.....

The Current Situation.....

NAFCU Meets with Policymakers to Enhance the Federal Charter.....

Financial Services Regulatory Relief Act of 2002.....

Conclusion.....

Appendix A Selected Articles.....

Appendix B NAFCU's Guiding Principles to Enhancing the Federal Charter.....

Appendix C Proposed Legislative Language.....

Introduction

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of approximately 900 federal credit unions -- financial institutions from across the nation -- representing approximately 22 million individual credit union members. NAFCU–member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate this opportunity to participate in the discussion regarding regulatory reform and other important issues affecting our nation's credit unions.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was recognized as a way to promote thrift and to make financial services available to people, many of whom otherwise would have no access to credit. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 80 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)) While more than 65 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 10,000 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union — "one member, one vote" — regardless of the dollar amount members have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Unlike their counterparts at banks and thrifts, federal credit union directors, motivated solely by a desire to be of service to others, serve without remuneration — a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Also, unlike banks, membership in a credit union is not open to the general public; a credit union may serve only those individuals within its field of membership. Federal credit unions have an independent federal regulator (the National Credit Union Administration - NCUA) and an insurance fund (the National Credit Union

Share Insurance Fund - NCUSIF) separate from the bank and thrift insurance funds managed by the FDIC.

Unlike thrifts, credit unions have never cost the American taxpayer a dime. Unlike the FDIC and the FSLIC – the precursors to BIF and SAIF – that were started with seed money that came as taxpayers' dollars from the United States Treasury, every dollar that has ever gone into the NCUSIF has come from the credit unions it insures. And unlike the thrift insurance fund, credit unions have never needed a federal bailout.

America's credit unions have remained true to their mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219). In the "findings" section of that law, Congress declared that, "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means ... [and it] continue [s] to fulfill this public purpose."[1]

Today, credit unions play an important role in the lives of millions of Americans from all walks of life. As the package of financial services offered by various financial institutions becomes ever more homogenized, the emphasis has begun to shift from types of service to quality and cost of service. Credit unions are

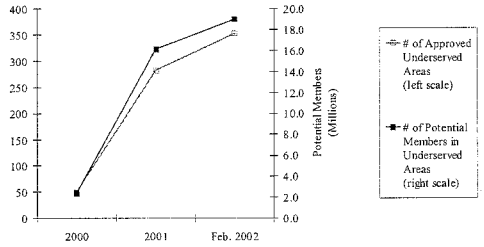
[1] 12 USC 1752(1).

second to none in providing their members with quality personal service at the lowest possible cost. According to the 2001 *American Banker*/Gallup Consumer Survey, credit unions had the highest rated service quality of surveyed financial institutions. This has held true each year since the survey was initiated -- a trend that shows no sign of change.

In addition, credit unions continue to serve those of modest means. Since the passage of CUMAA in 1998, federal credit unions have added over 350 underserved

NAFCU

UNDERSERVED AREAS ADDED TO CREDIT UNION MEMBERSHIP



Source: National Credit Union Administration

areas, providing low cost financial services to an additional 19 million individuals that now have at least one option in obtaining much needed financial services.

Xerox Federal Credit Union was chartered under California law in 1964 as the Scientific Data Systems Credit Union. In 1970, after Xerox Corporation acquired Scientific Data Systems, the credit union was granted a federal charter and changed its name to Xerox Federal Credit Union. In 1975, the NCUA approved a charter expansion allowing Xerox FCU to serve Xerox employees throughout the United States. Xerox FCU currently serves over 72 thousand members nationwide with assets of over $550 million. We currently have 18 offices in nine States. We are the only credit union chartered to serve Xerox employees in the United States.

Through the first quarter of 2001, we accepted only "Xerox-related companies" into our field of membership, in an effort to remain "single sponsor". However, given changes in legislation, regulation, and Xerox business from 1975-2000, NCUA has reclassified Xerox Federal Credit Union as "multi-sponsor".

Since that time, we have added two groups of note -- The Senceca Park Zoo Society in Rochester, New York, and an underserved area in Lewisville, Texas. All other groups that we have added have been Xerox related or very closely associated with Xerox.

CUMAA and Beyond

Credit unions have been under assault by the banking industry for nearly two decades. The Supreme Court's decision in 1998 in the *AT&T Family Federal Credit*

Union field of membership case brought the issue to a head. Congress' prompt passage of CUMAA in the summer of 1998 was seen by many as a significant victory for credit unions. When Congress sent that bill to President Clinton to be signed into law it overturned in six short months a decision that had encompassed eight years of litigation.

Make no mistake about it, CUMAA was a necessary piece of legislation for credit unions at the time of its enactment. Was it perfect? No. Would NAFCU liked to have changed various provisions in the bill? Yes. But CUMAA was an important piece of legislation at the time because it codified a number of fundamental credit union concepts embraced by both federal and state-chartered credit unions. These include:

- the multiple-group policy that NCUA had initiated in 1984;
- the "once a member always a member" principle followed by virtually every credit union in the country; and,
- the "family member" concept followed by so many credit unions.

Yet CUMAA came with some provisions that were not widely supported by the credit union community. These include:

- limitations on member business loans;

- imposition of a bank-like Prompt Corrective Action or "PCA" requirement that, given the structure of credit unions, serves in many respects as an overly restrictive constraint on growth; and
- various other artificial and arbitrary limitations on growth.

Following the passage of CUMAA, NAFCU recognized that there was still more important work to be accomplished. In January of 2000, the NAFCU Board of Directors, recognizing a growing trend of credit union conversions from federal to state charter singled out the erosion of the federal charter as a critically important issue for NAFCU and the nation. In February of 2000 NAFCU convened a "task force" of federal credit union and former federal credit union CEOs, including those who had converted to federally insured state-chartered credit unions and mutual thrifts. This group met at NAFCU's headquarters to discuss their concerns related to the federal charter in the post-CUMAA environment. Below are highlights of some of the comments heard at that session and e-mails that we received:

- If NCUA wants to do anything that will help smaller credit unions they should work to eliminate unnecessary and needless regulations and work with Congress to repeal laws which are only serving to drive small financial institutions out of business.

- The (charter expansion) process has a chilling effect on Select Employee Group (SEG) acquisition efforts.

- Mergers seem to be a viable and necessary method to create a substantial number of financially strong credit union entities that can compete with each other as well as with banks and other financial institutions. The business about greater or less than 3000 potential members is a serious obstacle.... The solution may well be in additional legislation.

- It is important that the regulatory environments allow for ...continued growth and not impair our ability to remain competitive.

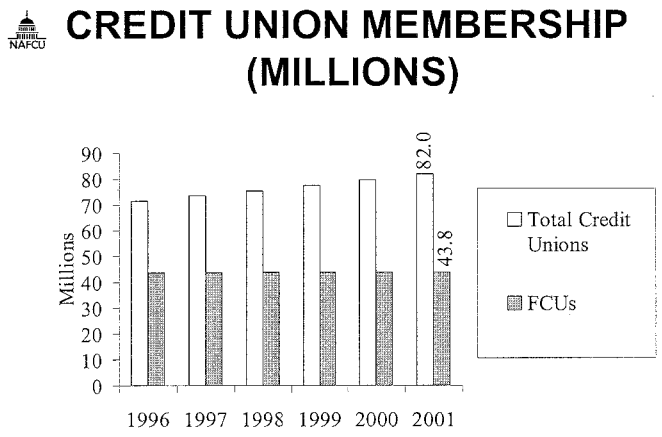
As a result of that meeting, it became clear that both regulatory and legislative action was needed in the post-CUMAA environment.

In the wake of this meeting, NAFCU wrote to the NCUA Board on February 18, 2000 recommending proposed changes to the agency's Chartering and Field of Membership Manual (IRPS 99-1). (As NCUA has reconstituted its field of membership task force, a subsequent letter was sent on April 5, 2002.) On March 1, 2000, NAFCU sent a separate letter to each of the NCUA Board members expressing concern that "the value of the federal charter is being eroded" and urged each Board member "to consider the long-term implications of [the trends in charter conversions] and take immediate steps to reverse these trends." NAFCU further stated that "*now* is the time to address ... [the] concerns" set forth in the letter and

asked for each Board member's "strongest support in preventing the erosion of the federal charter."

The Current Situation

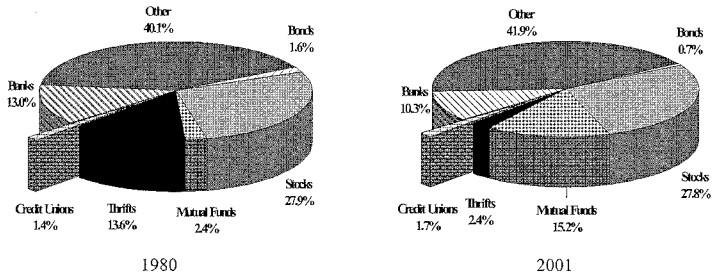
NAFCU is pleased to report to the Subcommittee that America's credit unions are vibrant and healthy and that membership in credit unions continues to grow with



credit unions serving over 80 million Americans--more than at any time in history. At the same time, it is important to note that while credit union membership continues to grow, over the past 21 years credit unions have increased their market share only minimally and as a consequence provide little competitive threat to other financial institutions. According to data obtained from the Federal Reserve Board, during the

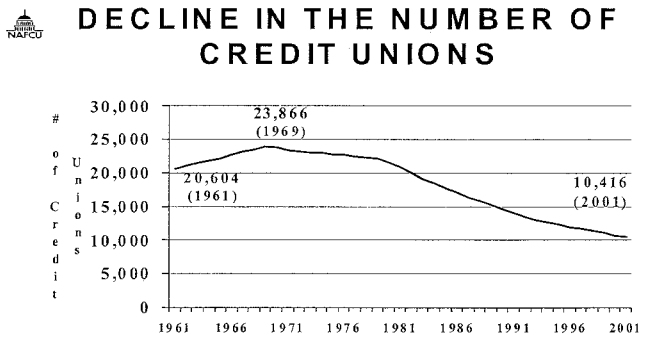
21 year period from 1980 to 2001 the percentage of total household financial assets held by credit unions increased from 1.4% to 1.7% or merely 0.3% over the course of 21 years.

Household Financial Assets*



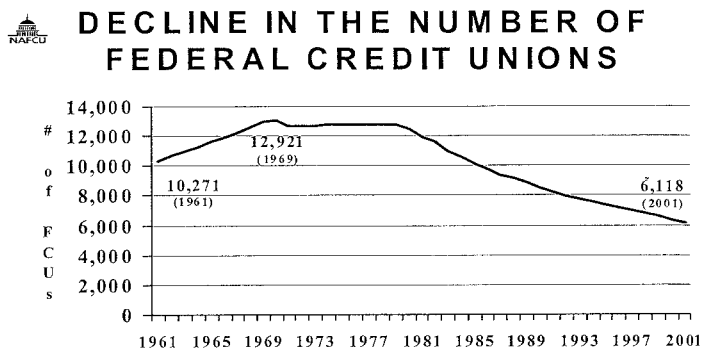
*** Information provided by the Federal Reserve Board and the National Association of Federal Credit Unions (NAFCU).**

As is the case with the banks and thrifts, there has been substantial consolidation within the credit union community in recent years. The number of



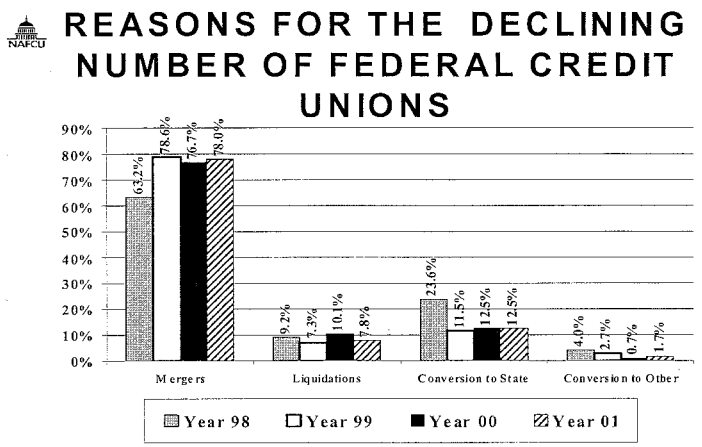
credit unions has declined significantly – by more than 50% - over the course of the

past 30 years, from an all time high of 23,866 in 1969 to 10,416 at year-end 2001. Similarly, the number of federal credit unions has declined as well, declining by just about 50% over that same period, from a high of 12,921 in 1969 to 6,118 at year-end 2001.



This decline has been consistent, with each year since the mid-1970's seeing a net decline in the number of credit unions. The experience of federal credit unions in this regard tracks that of all credit unions.

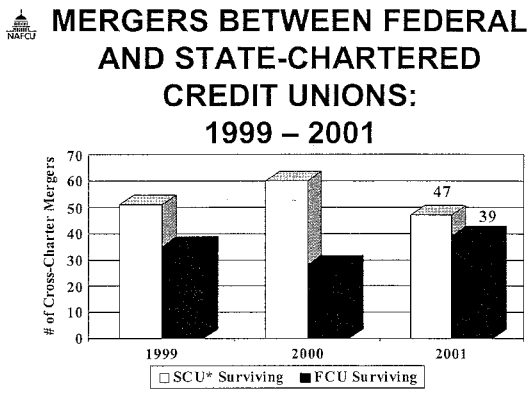
Looking solely at federal credit unions, the single most significant factor



Source: National Credit Union Administration

contributing to the decline in the number of federal credit unions is merger activity. Between 1998 and 2001 more than 50% of the decline in the number of federal credit unions was due to mergers. (In fact, 56.3% of the decline in federal credit union charters outstanding was due to mergers in 1998, 78.6% in 1999, 76.7% in 2000 and 78% in 2001). The effect of mergers on the federally chartered credit union system in terms of assets has, however, been significantly smaller totaling just $0.8 billion in 2001.

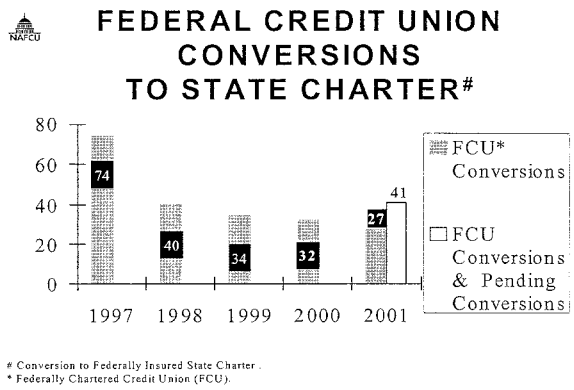
The second most significant factor contributing to the decline in the number of federal credit unions over the 1998 to 2001 time period was, however, conversions from federal to state charter: 33.9% in 1997, 23.6% in 1998, 11.5% in 1999, 12.5% in 2000 and 12.5% in 2001. This translates into 74 charter conversions in 1997, 40 in 1998, 34 in 1999, 32 in 2000 and 27 in 2001. The aggregate five-year total is $33 billion in assets, representing 12.4% of the total assets of the 2001 federally chartered credit union system.



* State Chartered Credit Union (SCU).
Source: National Credit Union Administration.

While these numbers might suggest that the conversion trend has peaked, this is hardly the case. According to NCUA there are another 14 federal-to-state conversions reportedly pending. In addition, the size of credit unions converting from federal to state charter, and therefore the total assets involved in such conversions, is on the increase; the average assets and median assets are dramatically increasing.

It is perfectly normal, if not expected, for conversions to occur in a healthy dual chartering system, but it is an entirely different matter when the trend is significantly skewed, as it has been over the past five years in the conversion from federal to state charter. We have found after talking to credit unions that the root cause of the current trend is the more rigid field of membership policies and/ or their application at the federal level rather than at the state levels. In this regard,



Conversion to Federally Insured State Charter.
* Federally Chartered Credit Union (FCU).

FEDERAL CREDIT UNIONS CONVERTING TO STATE CHARTERED CREDIT UNIONS*

	TOTAL ASSETS (Billion $)	AVERAGE ASSETS (Million $)	MEDIAN ASSETS (Million $)	NUMBER OF FCUs#
1997	$5.35	$72.2	$28.8	74
1998	$3.52	$88.0	$35.2	40
1999	$6.55	$192.8	$93.7	34
2000	$9.25	$289.1	$92.3	32
2001	$8.69	$211.7	$88.5	41
1997 to 2001 TOTAL	$33.4			221
1997 to 2001 AVERAGE		$150.9	$54.5	

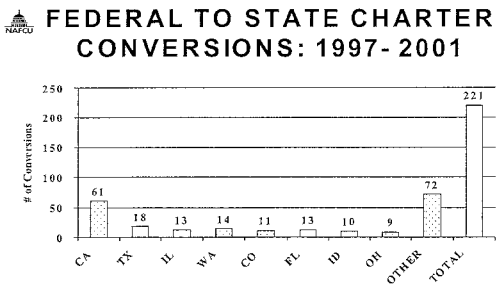
* Federally Insured State Chartered Credit Unions.
# Federally Chartered Credit Union (FCU).
** Includes the 14 cases that are in the process of converting.

NAFCU conducted a predictive analysis of federal credit union conversions based on field of membership, state, asset size, membership penetration rate, prior merger activity, county population and the poverty rate. The analysis, which was based on prior conversions, indicated that:

- Growth-oriented multiple common bond federal credit unions with a relatively large asset size and low current field of membership penetration rate in a state with a more liberal field of membership have a greater probability to seek state charter conversion.

- Federal credit unions in suburban versus rural areas with a relatively low percentage of low-income households are likely to convert as a result of community charter restrictions.

The analysis further shows that the states where the greatest number of conversions have occurred, or are most likely to occur, are California, Texas and Florida.



Source: National Credit Union Administration

As a result of this analysis and the actions that NAFCU has taken to

gather member input, the other reasons for conversions that NAFCU has identified include:

- The desire for regulatory flexibility that is deemed requisite to survive and to grow in the 21st century.
- The need to diversify membership and portfolios.
- The elimination of unnecessary and needless regulations.
- The need to innovate and enable credit unions to meet their future membership needs.
- The ability to offer investment and insurance products that meet membership needs.
- The offering of a more favorable business climate.
- The need for a progressive and pro-business regulatory environment.
- Active solicitation by state regulators to encourage federally chartered credit unions to convert to state charter.

Another trend that emerged in NAFCU's analysis is that when both a state-charted credit union and a federally chartered credit union merge, the resulting credit union more often than not opts to retain a state charter.

A number of these trends are backed up at least anecdotally in news articles from the credit union trade press that cover a number of large conversions and changes in state laws and regulations that allow larger fields of membership

(allowing for greater growth). Some samples of these articles can be found in Appendix A.

NAFCU Meets with Policymakers to Enhance the Federal Charter

Deficiencies in federal chartering policies and/or their application by NCUA cannot be remedied without bringing these matters to the attention of key policy makers in Washington.

Over the past two years, NAFCU has been working with NCUA Board Chairman Dennis Dollar and other NCUA Board members in an attempt to improve the regulatory environment. We are pleased to see that these efforts have been fruitful in several respects:

- A single-sponsor credit union may now retain that status while continuing to serve a spun-off division of the sponsor that was in the federal credit union's field of membership prior to the enactment of the CUMAA.

- A single-sponsor federal credit union may now retain that classification while bringing in groups in which the sponsor has a 10% ownership interest.

- When a group within a credit union's field of membership undergoes a corporate restructuring or reorganization, the credit union may now also serve

any new members of that group without having to go through the SEG addition process.

NAFCU would also note that Chairman Dollar has done a superb job in pursuing regulatory initiatives that are decreasing the regulatory burden on credit unions while maintaining safety and soundness throughout the federal credit union system. This has proven to be a valuable first step in enhancing the federal credit union charter.

On the legislative front NAFCU has spent the past two years meeting with legislators to compile a package of initiatives that would serve to restore the balance between the federal and state chartering systems. NAFCU has, as a "work-in-progress," developed a series of recommendations designed to enhance the federal charter, several of which are contained either in whole or in part within the *Financial Services Regulatory Relief Act of 2002*. Today's credit unions exist in a very dynamic environment, and we realize that the laws and regulations dealing with credit union issues will always be in need of further review and refinement. NAFCU's goal in crafting its recommendations was to ensure the continued viability of the federal charter for credit unions. NAFCU refined its package and released its "guiding principles" for enhancing the federal charter last summer. (See Appendix B: *Enhancing the Federal Charter – Moving Credit Unions into the 21st Century*).

Financial Services Regulatory Relief Act of 2002

NAFCU believes that the *Financial Services Regulatory Relief Act of 2002*, H.R. 3951, is a positive step in addressing some of the regulatory burdens and

restrictions on federal credit unions that have caused a number of federally chartered credit unions to consider converting to state charters.

NAFCU applauds the balanced approach evidenced in the bill and commends Representatives Capito and Sandlin for their leadership in introducing it. We would like to offer the following observations, comments, and feedback on what we believe are positive aspects of the legislation *(listed in order of section number)*.

A. Section 302. NAFCU supports this effort to give credit unions land leases on federal property under the same terms and conditions as credit unions now are provided space allotments under the FCUA. The credit unions that will be impacted by this change are defense (military) credit unions that have tried to expand their service to our men and women in uniform by building (and paying for) their own member service centers on military facilities. Many that have expanded their services by building their own facilities to serve military personnel have had their leases go from a nominal fee (e.g. $1.00 a year) to a "fair market value" rate of over $2000 a month. For non-profit cooperatives like credit unions, this change in leasing costs will inevitably lead to higher fees and/or fewer services for the men and women on that base.

B. Section 303. NAFCU supports this effort to increase investment options for federal credit unions by allowing certain investments in securities.

The current limitations in the FCUA unduly restrict federal credit unions in today's dynamic financial marketplace and have the potential to adversely impact both safety and soundness in the future. We believe that federal credit unions should have the same investment authority that is approved for other federally regulated financial institutions with regulation by the NCUA Board.

C. Section 304. NAFCU supports this provision that would increase the general 12-year limitation of term of federal credit union loans to 15 years or longer as permitted by the NCUA Board. The current 12-year limitation is outdated and does not meet with maturities that are commonly accepted in the market today. We believe that it is important that the NCUA Board should have the rulemaking authority to extend this limitation beyond 15 years in order to address the flexibilities that are necessary in today's market.

D. Section 305. NAFCU supports this provision to increase the one percent investment limit in credit union service organizations (CUSOs). However, we believe that the bill should go further than just raising the limit to three percent and, rather, give the NCUA Board the authority to set the proper investment limit.

E. Section 306. NAFCU supports this effort to exclude loans or loan participations by federal credit unions to non-profit religious organizations

from the member business loan limit and urges the Subcommittee's inclusion of this language on H.R. 3951. We also continue to support this exclusion as a stand-alone provision, as introduced by Representative Ed Royce (R-CA) in the *Faith Based Lending Protection Act*, H.R. 760.

F. Section 307. NAFCU supports efforts to increase credit union services by allowing federal credit unions to offer check-cashing services to anyone in their field of membership. We do, however, urge the Subcommittee to take a further step and amend this section in mark-up to expand this provision to include wire transfers and other money transfer instruments and technologies as approved by the NCUA Board. By Congress' granting this additional authority, we believe that credit unions can play an important role in fighting abuses by some current providers of remittances to many of our nation's immigrants.

G. Section 308. NAFCU supports this clarifying provision. The numerical limitation of 3,000 to consider spinning off and forming a separate credit union should not apply to voluntary mergers of healthy credit unions. In addition, a credit union that converts to (or merges into) a community charter should be allowed to retain all employee groups in its field of membership prior to the conversion. Current law does not allow this, penalizing not only the credit union, but also those in its field of membership. In addition, we believe that

the retroactive effective date of August 7, 1998 (the date of enactment of CUMAA), is an important part of this section and must be maintained.

The one section that we believe needs further examination and scrutiny by the Subcommittee before moving forward is Section 301. NAFCU has reservations regarding the provision that would allow privately insured state-chartered credit unions to become members of a Federal Home Loan Bank. As of December 2001, there were 678 credit union members of various Federal Home Loan Banks. Of that number, about half are state-chartered but *all have federal insurance*. In fact, federal insurance is a pre-condition for all regulated depository institutions -- banks, thrifts and credit unions – seeking membership in the Federal Home Loan Banks. (The sole exception to this requirement under existing law applies to insurance companies for whom there is no federal insurance option.) We have heard from a number of our members with concerns about this provision in light of past failures of some private and/or state insurance funds in the late 1980's and early 1990's.

In addition to our support for the provisions outlined in the above sections, NAFCU is pleased to see that several other provisions included in the bill that, while not directly sought by credit unions, will positively impact credit unions, and/or the regulation and supervision of credit unions. These include:

Section 402. Time for appeals to receivership appointments

Under current law section 207(a)(1)(B) of the FCUA (12 USC 1787(a)(1)(B)) gives federal credit unions placed into receivership or conservatorship only 10

days to appeal liquidation proceedings. NAFCU supports the language found in Section 402(c) extending to 30 days the time to lodge such appeals.

Section 404. Asset limits in *Depository Institutions Management Interlocks Act*

Since the definition of "depository institution" in the *Depository Institution Management Interlocks Act* includes credit unions, we support and assume that the proposed increase in the exemption limit from $20 million to $100 million is also extended to credit unions.

While we believe the bill is a balanced approach in its current form and we understand the sponsor's desire to include only a manageable number of provisions in the legislation, we would like to call the Subcommittee's attention to some additional issues that fall into the scope of the legislation.

A. Exempt credit unions from Hart-Scott-Rodino pre-merger application filings and fees the same as all other regulated financial institutions

We recommend including in the bill language that would exempt credit unions, just as banks and thrifts are already exempt, from the pre-merger notification requirements of the *Hart-Scott-Rodino Act*. Currently, when the merger of two credit unions exceed certain thresholds they are subject to the pre-merger notification requirements

of the Federal Trade Commission (FTC) and, in the absence of a waiver must pay a filing fee of $45,000 or higher. Other financial institutions are exempt from FTC review of their merger transactions and filing (and paying the filing fee) of pre-merger notifications with the FTC. Credit unions already have the same exemption from the FTC's enforcement and investigative authority as other financial institutions, and credit union mergers already undergo NCUA review. We urge the Subcommittee to add language that would address this issue and bring NCUA merger review requirements and credit union pre-merger notification requirements in line with those for other financial institutions.

B. Adjust the Usury Ceiling For Federal Credit Unions

Federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans. We believe, however, that 12 USC 1757(5)(a)(vi) should be amended to adjust the usury ceiling from 15 to 18 percent (the level it has been at or above for nearly 20 years) and to relax, if not eliminate, the cumbersome consultation requirements and other limitations that could hamper NCUA's management of the usury ceiling. Credit unions are often a borrower's best safeguard against going to a predatory lender, and although counterintuitive, failing to adjust the usury ceiling and allowing it to return to 15 percent could under certain economic conditions have the

real potential to drive marginal borrowers to predatory lending institutions.

C. Remove "local" from the definition of "community" for purposes of community charters

Today's dynamic financial marketplace characterized by "cyber-banking" technology rather than bricks and mortar makes the word "local" an extraneous limitation for community-chartered credit unions. In addition, and as previously noted, this provision has accounted for the majority of conversions from federal to state charters. We believe this word should be removed and the NCUA Board should be given the regulatory flexibility to set the definition as it deems fit.

D. Relax the "Reasonable Proximity" Requirement

This requirement is an undue burden on credit unions, requiring them to have a physical presence within a reasonable proximity of the location of a group that the credit union wants to add to its field of membership. In the financial marketplace of the 21st century that has seen an increase in Internet and remote banking, this requirement serves as an unnecessary burden and restriction on credit unions and those who wish to join them.

E. **Eliminate the preference imposed by CUMAA, for the formation of new credit unions over the addition of groups to an existing credit union**

Oftentimes, an existing credit union is better suited to meet the needs of a SEG and offer it better service than a new credit union would or could. Most SEG applicants do not have the time, money, or critical mass to form their own credit union. According to NCUA, since the passage of CUMAA in 1998 there have not been any SEG groups whose applications have been denied that have gone on to form their own credit union. These individuals have, therefore, been left without credit union services.

F. **Relax the current member business loan restriction imposed by CUMAA**

NAFCU supports including language that would restore credit union member business lending authority to the status it enjoyed prior to the enactment of CUMAA. This would be consistent with findings from the Department of Treasury study (*Credit Union Member Business Lending*) on member business lending authorized by CUMAA and released in January of 2001.

Credit unions have a history of serving those who will not otherwise receive services within the financial marketplace and, as we believe a fair reading of the 2001 Treasury study indicates, there is a market niche that is not being served within the business loan market that credit unions could readily fulfill, enhancing small business in America.

G. Flexibility in Credit Union Governance Issues

The FCUA contains many antiquated "governance" provisions that, while appropriate in 1934, are today outdated, unnecessary and inappropriate restrictions on the day-to-day operations and policies of a federal credit union. For example, a member of a federal credit union that has been abusive and/or is deemed to pose a threat to the credit union, its employees, and other members cannot be expelled without a special meeting of the credit union membership – which can be a costly endeavor for the credit union. NAFCU supports including language in the bill that would remove such antiquated governance procedures from the FCUA and give the NCUA Board greater authority in establishing appropriate governance policies and procedures for federal credit unions.

H. Secondary Capital

NAFCU supports allowing all insured credit unions, not just "corporate credit unions" and those designated as "low-income," to include

secondary capital accounts when calculating net worth under regulations promulgated by the NCUA.

We hope that the Subcommittee will consider these issues as the bill moves forward in the legislative process. We have attached proposed legislative language on a number of these issues in Appendix C.

Conclusion

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, we urge the Subcommittee to carefully assess the trend of conversions from federal to state charters. We believe that H.R. 3951 is an excellent first step. We understand that it is a work in progress by the Subcommittee and we urge the Subcommittee to undertake a careful examination of what other measures fall within the scope of this legislation that will address the concerns we have articulated.

NAFCU thanks the Subcommittee for the opportunity to make this statement before you today and commends the House Financial Services Committee for examining these important issues. We look forward to working with you on this important piece of legislation and would welcome your comments or questions.

Appendix A

Selected Articles

Attached are selected articles and summaries, from various news sources concerning the recent trends that are taking place throughout the credit union community. The articles focus on the increasing number of charter conversion, from federal to state.

Articles
(Reprinted with permission of the *Credit Union Journal* and the *Credit Union Times*)

New York's Up State FCU Converts to State Charter
Credit Union Times

ROME, N.Y. - Up State FCU, chartered in 1951 as a state-chartered credit union which converted to a federal charter in 1979, is once again a state-chartered CU. The $280 million CU's charter conversion was approved by the State of New York Banking Department on April 19. As of May 1, the credit union will be known as Up State Credit Union. Roxanne Sopchak, vice president of marketing for the credit union said Up State has continually assessed the benefits of the different types of charters to determine which is in the best interest of the credit union's members.

When Up State converted to a federal charter in 1979, it was so the credit union could take in select employee groups. During the months of uncertainty prior to passage of The Credit Union Membership Access Act, the credit union laid out its options again. Sopchak said the ambiguity in the language in the NCUA Field of Membership and Chartering Manual concerning "close proximity" forced the credit union's decision to convert. Up State includes among its nearly 80,000 members about 500 select employee groups throughout an eight or nine county area in central and northern New York.

California CUs Continue Flight To State Charter
Credit Union Journal

SACRAMENTO, Calif. (05/02/00) - Another four large California-based federal credit unions have applied to the state's Department of Financial Institutions (DFI) to convert to a state charter. That make eight so far this year, on top of 13 last year and 11 the year before. The latest applications for conversion: Rockwell FCU, Downey ($500 million); American First FCU, La Habra ($375 million); Water & Power FCU, Los Angeles ($325 million) and Whittier Area FCU, Whittier ($165 million). The Water & Power FCU application is significant because that credit union converted from state to federal charter just five years ago.

More CUs Show Interest In Banking Charters
Credit Union Journal

WASHINGTON (05/19/00) - Increasing numbers of credit unions are expressing interest in converting to mutual savings banks because of concerns over growth limitations under field of membership (FOM) rules and real estate lending caps. So far 19 credit unions have applied to convert to mutual savings banks (thrifts) with 11 having completed the conversion, three abandoning or having their members reject the switch, and four more in the application stages. Several more are expected to file applications to convert by year-end, sources told The Credit Union Journal.

California CUs Continue To Seek Broad FOMs
Credit Union Journal

SACRAMENTO, Calif. (06/05/00) - State chartered credit unions continue to expand their horizons to take advantage of the state's liberal FOM statutes. Documents obtained by The Credit Union Journal from the state's Department of Financial Institutions under the Public Information Act show three more state charters have applied for broad FOMs encompassing millions of residents. Those include Valley CU, Jan Jose, which has requested approval to serve 2.4 million residents of Alameda and Contra Costa counties; AEA CU, which has asked to serve 1.2 million residents in Santa Barbara and Venture counties and the city of Folsom; and Merriwest CU, which has requested authorization to serve 2.4 million residents in San Mateo, San Francisco and Contra Costa counties.

Resource One FCU Approved to Convert to State Charter
Credit Union Times

DALLAS - Resource One FCU has become the eleventh federal credit union in Texas to convert to a state charter since 1997 and the fourth so far this year. The state Credit Union Division approved the $151 million credit union's charter conversion application on May 31. Resource One initially applied to convert to a state-charter in 1997. It received NCUA approval to proceed with a member vote, but the credit union's board decided to put off the conversion pending the outcome of H.R. 1151.

When The Credit Union Membership Access Act was signed into law in Aug. 1998, Resource One President Jim Brisendine said the credit union decided to proceed with the charter conversion because "H.R. 1151 places too many limitations on federal credit unions, especially concerning field-of-membership." He said the credit union is "considering" applying for a community charter.

Resource One counts 319 select employee groups among its 48,000 members.

Texas CU Commission approves state's largest FCU-to-state charter conversion
Credit Union Times

AUSTIN, Texas - Vought Heritage FCU, Grand Prairie has become the largest federal credit union in the state to receive approval from the Texas Credit Union Department to convert to a state charter. Texas Credit Union Commissioner Harold Feeney approved the $330 million, nearly 53,000 member credit union's application on Friday, Apr. 28. Vought Heritage's President/CEO Jim Gray said the credit union applied for the charter conversion late last year so it would have the ability to expand its field-of-membership in Tarrant and Dallas counties.

CUs Score HR 1151 in Move To State Charters
Credit Union Journal

SACRAMENTO, Calif. (05/08/00) - Increasing numbers of federal credit unions, growing frustrated over the new FOM law HR 1151, the CU Membership Access Act, and are calling passage of the new law a victory for banks, instead of credit unions. "They put so many controls in place and extra hoops that credit unions have to jump through that I think we are kidding ourselves by calling it a clear victory," Kerry Lewis, vice president of American First FCU, told The Credit Union Journal. The $375 million La Habra, California, credit union is one of eight in The Golden State seeking to convert to state charter. "I feel the changes to the Federal Credit Union Act have become more restrictive

instead of more open in order to serve the consumers in this new business economy and is one of the key drivers in all the changes."

New York CU Approved To Convert To State Charter
Credit Union Journal

ALBANY, N.Y. (05/16/00) - The state Department of Banking said it approved an application by Up State FCU in Rome, N.Y., to convert to a state charter, the 13th federal credit union to convert this year. The $320 million credit union said it switched charters to obtain the more liberal FOM allowances. Up State is the sixth New York credit union to convert to state charter since January 1, 1997.

Six more FCUs lost to states in May
Credit Union Times

ALEXANDRIA, Va. - Four federally chartered credit unions were lost to the state charters from merger activity in May and two changed sides as a result of a charter conversion, recently released NCUA regional director activity data indicated. In addition, the May "Regional Directors' Actions Taken Under Delegation of Authority" report showed that a region-wide total of another 8 multiple-SEG FCUs converted to federal community charters in the month for a total potential membership of almost 950,000 people.

Year-to-May 31 there have been 28 multiple-SEG-to-federal community charter conversions approved at the regional level and four at the NCUA Board level for a total potential membership of 3.5 million. The May regional director figures now bring the year-to-May 31 FCU-to-FISCU conversion total to seven and the total federal charter losses from merger activity for the same period to 15. During that period only one FISCU converted to a federal charter.

Oregon Enacts New Community Charter Rules
Credit Union Journal

SALEM, Ore. (05/08/00) - State credit union regulators have finalized and made effective new rules governing community chartered credit unions, allowed for the first time last year under a rewrite of the state's CU statute. The rules, which became effective March 31, will allow credit unions to apply for a community charter that consists of one or more cities, towns, counties or other political subdivisions already recognized by local government. There is no population limit under the rules. State officials said there have been several expressions of interest from state credit unions but no applications yet under the new rules.

California Senate approves cross-border CU services bill
Credit Union Times

SACRAMENTO, Calif. - The state Senate May 24 approved a bill sponsored by the California Credit Union League that would implement a legislative and regulatory framework for state-chartered credit unions to open branches in foreign countries.

S.B. 1472, sponsored by Sen. Deborah Ortiz (D-Sacramento), also includes regulations under which the same credit unions could open branches in other states and under which credit unions in other countries could open branches in California.

The bill passed 39-0.

Florida CU Seeks Huge FOM Grant
Credit Union Journal

MIAMI (11/28/01) - Tropical Financial CU, recently awarded the state's biggest FOM, has its sights set on larger markets still and has applied to state regulators for permission to serve the 2.2 million residents in Dade-Miami County, the state's most populous county. The application was submitted just weeks after the $500 million credit union was granted permission from the Florida Division of Banking to serve more than two million residents in Broward and Sarasota counties, which is believed to be the largest FOM grant in the Sunshine State for any credit union, state or federally chartered. The vast FOM grants come just four months after Tropical Financial converted from federal to state charter. Gregory Blount, president of Tropical Financial CU, told The Credit Union Journal their aim is to expand into those areas of the state where they are already serving one of their 350 select employee groups. The geographic grants, he said, will enable them to sign and serve new employee groups without time-consuming regulatory approval, he said.

California CUs Continue To Gobble Up FOM
Credit Union Journal

SACRAMENTO, Calif. (02/22/01) - Several large state charters, led by the expansive Patelco CU, have applied to state regulators with the Department of Financial Institutions (DFI) for serve huge population swaths. Documents obtained by The Credit Union Journal under the state's Public Information Act show Patelco has requested permission to serve seven million residents in eight California counties: San Francisco, San Mateo, Sonoma, Santa Clara, Napa, Marin, Solano, Alameda and Contra Costra. Over the last two years the $1.8 billion credit union has received approval to serve about one million residents in 13 California cities and more than 100 employee groups. Separately, Priority One CU, Pasadena, has requested permission to serve five million residents in four valleys and metropolitan Los Angeles; Pacific Resource CU, Los Angeles (formerly Arco FCU), has asked permission to serve 1.5 million residents in metropolitan Los Angeles; and Sacramento CU, has requested approval to serve 400,000 residents in two counties.

Federal Convert Gobbles Up New FOM
Credit Union Journal

MIAMI (02/11/02) - Tropical CU continued last week to grab for broader FOM with an application to state regulators to serve the 1.1 million residents of Palm Beach County. The $475 million credit union, which converted from federal charter just six months ago, was granted one of the nation's largest FOMs since then, with permission last month to serve the 2.3 million residents of Miami-Dade County, the state's most populous county. That came after state regulators approved Tropical CU's request to serve the two million people in Broward and Sarasota counties. Credit unions officials told The Credit Union Journal they plan to obtain permission to serve communities surrounding their existing branches.

Tiny CU Gets Big FOM
Credit Union Journal

ROCHESTER, N.Y. (02/07/02) -- Rochester Postal Employees CU has obtained approval from the state Department of Banking to convert to a community charter serving the 750,000 residents of Monroe County, one of the largest community FOMs ever approved in the Empire State. The $18 million, 3,500-member credit union has also changed its name to First Rochester Community CU to reflect its new FOM, which was effective Feb. 1.

Texas CUs Get Broad FOM Grants
Credit Union Journal

AUSTIN, Texas (04/03/02) - The state CU Department said Tuesday it approved several large FOM expansions, including an application from San Antonio Teachers CU to serve more than 1.4 million residents of surrounding Bexar County. The state regulator also approved requests from Texans CU, Richardson, to serve more than one million residents in Travis and Williamson counties and another 200,000 students in Collin County; Members First CU, Corpus Christi, to add 325,000 residents of Cameron County; Telco Plus CU, Longview, to serve 170,000 residents of Smith County; Benchmark CU, Midland, to add 130,000 residents of Midland County. The state regulator also approved a request from Community CU, Plano, to remove its exclusionary clauses protecting FOM overlaps in Dallas, Rockwall, Grayson and Collin counties, opening up new competition by the $1 billion credit union with dozens of credit unions in those four counties.

Appendix B

NAFCU's Guiding Principles

ENHANCING THE FEDERAL CHARTER

MOVING CREDIT UNIONS INTO THE 21ST CENTURY

NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Washington, DC 20007-0269
(703) 522-4770 (800) 336-4644
Fax: (703) 524-1082 email:nafcu.org
Website: www.nafcu.org

NAFCU has spearheaded the effort to enhance the federal charter, seeking both regulatory and legislative changes to preserve the health of federal credit unions and to make the federal charter more attractive. NAFCU's effort comes in the wake of over 180 conversions to state charters since 1997 (involving over $30 billion in assets) and a perception among some in the credit union community that the federal charter is not as valuable as it should be.

Early in 2000, NAFCU convened a task force of credit union leaders to recommend specific regulatory and legislative initiatives that NAFCU could take to improve the federal charter. These specific recommendations were in response to the changing federal-state dynamic, as well as a proactive approach to clarify and improve the Federal Credit Union Act as we enter the 21st century. NAFCU has pressed its case for charter enhancement before Congress, the White House and appropriate federal agencies, including NCUA, the Treasury Department and the Small Business Administration, to name just a few.

NAFCU has also sought feedback in various forums, as well as from its membership, on the issues originally identified by the task force, as well as other matters of concern such as secondary capital, the composition of the NCUA Board, and private insurance.

In some areas, NAFCU has already achieved success on the regulatory front. Following NAFCU's recommendations, NCUA has ruled that:

- A single-sponsor credit union can retain that status while continuing to serve a spun-off division of the sponsor that was in the federal credit union's field of membership prior to the enactment of the CUMAA.
- A single-sponsor federal credit union can retain that classification while bringing in groups in which the sponsor has a 10% ownership interest.
- When a group within a credit union's field of membership undergoes a corporate restructuring or reorganization, the credit union may serve any new members of that group without having to go through the select employee group addition process.

Building on its successes to date, the NAFCU Board believes it is important to continue pursuing regulatory enhancements while also continuing to present its case to Congress.

At the same time, it should be noted that NCUA is expected to soon issue final rules on RegFlex and Incidental Powers. Going forward, NAFCU believes that the NCUA has the authority to take further actions that would serve to substantially enhance the federal charter. Specific examples include a broader interpretation of local community merger authority and the reimbursement of additional types of board of directors' expenses.

Finally, the NAFCU Board believes that it is also important to set forth guiding principles that address not only specific charter enhancements but also the way credit unions are structured and regulated –in other words, what they will look like in the future. The NAFCU Board has, therefore, adopted the following guiding principles:

NAFCU'S GUIDING PRINCIPLES

Preserving credit union uniqueness

NAFCU is a strong proponent of credit union growth and innovation –to ensure that credit unions remain competitive in the financial marketplace of the 21st century. At the same time, the foundations of service, cooperation, self-governance and common purpose that make credit unions unique must be preserved. Federal credit unions are, by definition, institutions that: are organized and operated for mutual purposes without profit; do not issue capital stock; are governed by volunteer boards; and have fields of membership. NAFCU would oppose any initiatives that might significantly alter these fundamental characteristics and thereby jeopardize the non-profit, unique, and tax exempt status of credit unions.

Field of membership changes

NAFCU believes that all Americans should have access to credit union services within the field of membership concept, which remains a defining characteristic of credit unions. The field of membership concept, however, must be flexible to adapt to a changing society and an evolving financial services marketplace. NAFCU believes that changes in this area should include:

- eliminating the term "local" from the definition of "community"
- eliminating the language in the CUMAA that indicates a preference for starting new credit unions, in lieu of permitting employee groups to join an existing credit union.
- allowing community-SEG combinations
- confirming authority for healthy credit unions to merge voluntarily
- easing the ability of FCUs to add low-income groups to their FOMs
- allowing community-based FCUs to serve members in communities merged or spun off into other municipalities – "once a potential member, always a potential member"

Lifting MBL restrictions

NAFCU believes that credit unions have a key role to play in providing needed capital to credit union members who are small business owners, and it has pressed for lifting these restrictions. The recent Treasury Department study on MBL indicates that credit union business loans go primarily to small businesses (many of the loans are for $50,000 or less); these loans fill a niche oftentimes not served by commercial lenders. In addition, the Treasury Department has noted that it does not view these loans as a competitive threat to banks.

Retaining volunteer boards

NAFCU believes that volunteer boards –elected by a credit union's members –are a hallmark of the Federal credit union system. Volunteer boards, along with "one member, one vote" elections, are unique aspects of Federal credit unions that demonstrate their cooperative and democratic foundation. At the same time, NAFCU supports granting discretionary authority

to boards to approve reimbursement of additional types of appropriate out-of-pocket expenses incurred by directors in fulfilling their duties.

Secondary capital

NAFCU is concerned about the challenge some credit unions face in raising adequate capital to facilitate growth in a "PCA" ("prompt corrective action") environment. NAFCU believes that the best minds in the credit union community can come together to develop workable proposals, consistent with the not-for-profit, mutual structure of credit unions, to provide credit unions the capital needed for growth, much as was done 20 years ago when we recapitalized the National Credit Union Share Insurance Fund. Accordingly, NAFCU supports Congressional action to amend the Federal Credit Union Act to authorize NCUA to promulgate rules and regulations regarding secondary capital accounts for all federally insured credit unions.

Maintaining NCUA's independence

NAFCU believes it is imperative that credit unions have an independent regulator, one that recognizes the unique characteristics of credit unions and serves as an advocate for the preservation of credit unions' unique status under the law. Accordingly, NAFCU strongly supports the continued independence of NCUA and would oppose any proposals to fold NCUA into a larger federal agency as that would dilute the direct impact credit unions have on the formulation of NCUA policy. NAFCU also supports the current NCUA Board structure.

Keeping NCUSIF strong

The National Credit Union Share Insurance Fund (NCUSIF) has an unparalleled record of protecting credit union members' shares. NAFCU does not believe it is necessary at this time to change the way the fund is financed, and it does not support separating NCUSIF from NCUA. While NAFCU does not oppose efforts by credit unions to augment NCUSIF insurance with supplemental private insurance, NAFCU continues to believe that NCUSIF insurance should remain mandatory for all federally chartered credit unions.

The federal charter: still valuable

In conclusion, NAFCU believes the federal charter remains an extremely valuable "franchise" for credit unions. At the same time, NAFCU intends to continue its prudent, measured approach to change –from both a regulatory and legislative perspective --adding value to the charter while preserving the core characteristics that make credit unions the unique financial institutions they are.

Appendix C

Proposed Legislative Language

Legislative Language for NAFCU Suggested Additions to the Financial Services Regulatory Relief Act of 2002

I. Usury Ceiling Adjustment

12 U.S.C. Section 1757 (5) (A) (vi) is amended to read as follows:

> *" (vi) the rate of interest may not exceed 18 per centum per annum on the unpaid balance inclusive of all finance charges, except that the Board may establish an interest rate ceiling exceeding such 15 per centum per annum rate if it determines that a higher interest rate ceiling is warranted;"*

II. Eliminate "local" from the definition of community.

Amend 12USC 1759(b)(3) as follows:

> following the word "well-defined" delete the word "local"

III. Eliminate Preference Imposed by CUMAA for the Formation of a new Credit Union

Amend 12USC 1759(f)(1) as follows:

In subparagraph (A) after the words "credit unions" delete "instead of approving an application to include an additional group within the field of membership of an existing credit union"

> In subparagraph (A) at the end delete "; and" and insert "."
>
> Delete subparagraph (B)

IV. Restoration of Pre-CUMAA Member Business Loan Authority

Section 203(a) of Public Law 105-219 is hereby repealed.

V. Expulsion of a Credit Union Member for those who pose a threat to the Credit Union, its members and employees

Amend 12 USC 1764(a) as follows:

in subsection (a) after the words "subsection (b)" insert "and (c)"

change subsection (c) to (d) and insert new subsection (c) which reads:

"(c) The board of directors of a Federal credit union may, by majority vote of a quorum of directors, adopt and enforce a policy with respect to expulsion from membership based on circumstances where the member has been abusive, threatening, and is deemed potentially dangerous to credit union employees and fellow members."

In new subsection (d) after the words "subsection (a)" delete "or" and add ",(b) or (c)"

VI. Exempt Credit Unions from Hart-Scott-Rodino pre-merger application filings and fees the same as all other regulated financial institutions

VI. Exempt Credit Unions from Hart-Scott-Rodino pre-merger application filings and fees the same as all other regulated financial institutions

Section 205(c) of the Federal Credit Union Act (12 U.S.C. Sec. 1785(c)) is amended as follows (new language is underlined; deleted language is ~~struck out~~):

(c) In granting or withholding approval or consent under subsection (b) of this section:

(1) T~~t~~he Board shall consider-

(~~1~~A) the history, financial condition, and management policies of the credit union;
(~~2~~B) the adequacy of the credit union's reserves;
(~~3~~C) the economic advisability of the transaction;
(~~4~~D) the general character and fitness of the credit union's management;
(~~5~~E) the convenience and needs of the members to be served by the credit union; and
(~~6~~F) whether the credit union is a cooperative association organized for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.

(2) For mergers between credit unions that would otherwise be subject to Section 7A(c)(7) of the Clayton Act (15 U.S.C. Sec. 18a(c)(7)), the Board shall not approve -

(A) any proposed credit union merger transaction which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of providing financial services in any part of the United States, or

(B) any other proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

CORRESPONDING PROPOSED AMENDMENT TO THE HART-SCOTT-RODINO ACT:

Section 7A(c)(7) of the Clayton Act (15 U.S.C. Sec. 18a(c)(7)) is amended as follows (new language is underlined):

(7) transactions which require agency approval under section 1467a(e) of title 12, section 1828(c) of title 12, section 1785(b) of title 12 or section 1842 of title 12, except that a portion of a transaction is not exempt under this paragraph if such portion of the transaction (A) is subject to section 1843(k) of title 12; and (B) does not require agency approval under section 1842 of title 12;

Testimony of

PIERCE STONE

CHAIRMAN, PRESIDENT & CEO
VIRGINIA COMMUNITY BANK
LOUISA, VIRGINIA

On behalf of the

INDEPENDENT COMMUNITY BANKERS OF AMERICA

Before the

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE
HOUSE FINANCIAL SERVICES COMMITTEE
Washington, D.C.
April 25, 2002

Good morning Chairman Bachus, Ranking Member Waters, and members of the Committee. My name is Pierce Stone, and I am chairman, president and CEO of Virginia Community Bank, a community bank with $140 million in assets, located in Louisa, Virginia. I also serve as Chairman of the Independent Community Bankers of America on whose behalf I appear before you today. I want to thank you for giving me the opportunity to testify today on H.R. 3951, the Financial Services Regulatory Relief Act of 2002.

We applaud your efforts to reduce many of the unnecessary regulatory and paperwork burdens imposed on community banks without jeopardizing the safety and soundness of our financial system. During the current economic climate, it is especially important for Congress to eliminate the regulatory obstacles that community banks face so that community banks can commit more of their time and resources to serving the people in their communities.

Mr. Chairman, I would like to take this opportunity to thank you and congratulate you for your ongoing efforts on behalf of community banking. You have been an advocate for many of our causes, including protecting and preserving the deposit insurance fund, increasing insurance coverage levels for individual accounts, retirement accounts and municipal deposits, and for recognizing the unique needs and characteristics of community banks and the communities we serve.

ICBA Supports Tiered System

ICBA supports a bank regulatory structure that fosters the safety and soundness of our nation's banking system, and recognizes the fact that community banks pose a very different risk to the banking system than larger banks.

In recognition of these differences, both Congress and the agencies have instituted welcomed regulatory and supervisory policies that lighten the regulatory and paperwork burden for community banks. These policies include less frequent safety and soundness exams for small, healthy banks; streamlined and risk-focused exam procedures for small, noncomplex banks; less frequent CRA exams for small, well-rated banks; and streamlined CRA exams for small banks. Bank regulators are also considering the development of bifurcated capital adequacy rules with simpler rules and calculations for community banks.

The Federal Reserve has also called for enhanced oversight of "large complex banking organizations" whose failure or disruption could have systemic implications for the entire financial services industry and our economy. Community banks present no such systemic risk. Congress and the agencies have instituted policies that recognize the uniqueness of community banks and their need to operate under a lighter regulatory burden. For example, The Federal Home Loan Bank System Modernization Act of 1999 (part of the Gramm-Leach-Bliley Act) provides community banks with enhanced access to membership in the FHLB System and the ability to use advances for small business and agricultural lending.

ICBA strongly supports these efforts and urges Congress and the agencies to continue to adopt policies to build a tiered regulatory and supervisory system that recognizes the differences between community banks and larger, more complex institutions. A tiered regulatory system allocates the cost of regulatory/paperwork burden relative to the risk of the institution and helps restore equity in regulation, leveling the playing field and enhancing customer service.

Deposit Insurance Reform

Another issue that helps to level the playing field for community banks is deposit insurance reform, a critical issue for community banks. Mr. Chairman, you have been a great leader in advancing this issue in Congress, especially your efforts to increase FDIC insurance coverage levels for retirement accounts, individual accounts and municipal deposits. Core deposits are the single most important source of funding and liquidity community banks rely on to make loans. Attracting and retaining core deposits is critical to a community banks' ability to serve their community's credit needs. We thank you for your support and leadership in moving H.R. 3717, the Federal Deposit Insurance Reform Act of 2002, through this committee.

There are many provisions in H.R. 3951 that address a range of supervisory and enforcement issues among the agencies that are technical in nature, which we generally support. There are also several provisions of the bill, which are more substantive in nature, several of which we also support and several that we have some concern with. In addition, there are also several provisions that ICBA urges this committee to include in H.R. 3951, which I will discuss later in my testimony.

Provisions ICBA Supports

Subchapter S

ICBA supports Section 101 of this bill, which removes a restriction in current law that makes it difficult for community banks to qualify as "Subchapter S" corporations. Expanding Subchapter S eligibility is very important for community banks. In 1958, Congress created S corporations to create an effective alternative business structure for private entrepreneurs. A Subchapter S Corporation can escape punitive double taxation by paying income tax only at the shareholder level. Through the Small Business Job Protection Act of 1996, community banks became eligible to elect S Corporation status for the first time. To be eligible for Subchapter S status, a corporation may have no more than 75 shareholders.

Unfortunately, many small banks are having trouble qualifying for Subchapter S status under the current rules and cannot benefit from Congress's intended tax relief. We would like to see additional changes to the tax code to liberalize eligibility requirements for community banks to convert to Subchapter S status, but we understand that this committee's jurisdiction over this issue is limited.

Section 101 expands Subchapter S eligibility for banks by removing one of the barriers community banks face when trying to convert to Subchapter S status. Under the National Bank Act, all directors of national banks must own shares of the bank having an

aggregate value of at least $1000, or an equivalent interest in the bank holding company that controls the bank. This requirement means that all of the directors must be shareholders, thereby making it very difficult and at times impossible for community banks to comply with the 75 Subchapter S shareholder limit. Section 101 removes the director shareholder restriction in the law by delegating authority to the Office of Comptroller of the Currency to permit the directors of banks seeking Subchapter S status to satisfy the shares requirement by holding a debt instrument that is subordinated to depositors. This would avoid having to count a director as a shareholder for purposes of Subchapter S status while still maintaining that directors retain the requisite personal investment in the financial soundness of their bank. Section 101 helps to liberalize the Subchapter S status rules, thereby enabling more community banks to significantly reduce their tax liability.

Management Interlocks

ICBA also supports Section 404, which increases the exemption for the Depository Institutions Management Interlocks Act to $100 million from $20 million in asset size. The Depository Institutions Management Interlocks Act prohibits depository organizations from having interlocking management officials if the depositories are located or have an affiliate in the same metropolitan, primary metropolitan, or consolidated metropolitan statistical, area. Section 404 increases the existing exemption, which helps to ensure that small community banks can obtain qualified and knowledgeable bank directors. Increasing this exemption will expand the pool of talent on which these banks can draw. It also helps community banks with affiliates located in rural areas that may have difficulty obtaining bank directors because of their location.

Reduced Exam Cycles

Another very important aspect of regulatory relief for community banks is reducing the frequency of safety and soundness exams for small healthy banks. Section 601 gives the federal banking agencies the discretion to adjust the exam cycle of insured depository institutions to ensure that examiner resources are used in the most efficient manner. ICBA strongly supports reducing the frequency of examinations on small healthy community banks and supports minimally intrusive examinations.

ICBA Supported Provisions Currently Not Included in H.R. 3951

Extend SIPC Coverage to Banks

ICBA urges the Committee to include a provision in H.R. 3951 that amends the Securities Investor Protection Corporation (SIPC) statute to provide community banks with the same protection afforded other investors and other depository institutions for their brokerage account assets when a broker dealer fails. Under current law, banks that are customers of a broker dealer that subsequently fails are not afforded any protection by the SIPC.

The failure last year of MJK Clearing, a subsidiary of Minneapolis-based Stockwalk Group, Inc., has left more than one hundred banks -- whose brokers used MJK for

clearing and safekeeping their customers' securities -- without proper recourse for their loss of investments.

SIPC is a nonprofit corporation formed under the Securities Investor Protection Act of 1970 and serves as the brokerage industry's safety net for customer accounts. SIPC does not provide any guaranty of principal or protection against market risk or fraud. It allows an investor to get back its stock, bonds, and cash held by a broker-dealer in the event of a brokerage firm collapse.

SIPC coverage extends to customers of brokerage firms, but does not insure assets of a bank acting as an investor for its own account. Thrifts and credit unions are not excluded from SIPC coverage. The change we seek to the SIPC statute creates parity for banks. A legislative amendment to the SIPC statute eliminating the exclusion of banks from SIPC coverage would be an effective means to afford banks the protection they need when a broker dealer safekeeping their investment fails.

In the event of a broker dealer collapse, community banks may find their own securities placed in a pool of assets used to satisfy claims of other SIPC-covered accounts. As a result, the community bank's brokerage account may be illiquid for an extended period, and community banks may suffer significant losses when liquidation of the broker dealer is complete. A simple change in the SIPC statute would remedy this inequity.

Powers of State Member Banks

ICBA also urges the Committee to include in H.R. 3951 repeal of the 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 granted to national banks. This is an unfair restriction on state member banks. State-chartered *nonmember* banks enjoy the opportunity to engage in investment activities within the confines of safety and soundness, and state-charter *member* banks should be afforded the same opportunity. The current law unnecessarily treats state-chartered member banks and state-chartered nonmember banks differently by limiting the activities of state-charter member banks. Many provisions in H.R. 3951 create parity among bank and thrift institutions; repealing this restriction would simply do the same for state-chartered banks. We urge the Committee to include a provision in H.R. 3951 that gives the Federal Reserve more flexibility to allow state member banks to engage in investment activities authorized by their chartering state and approved by the FDIC as not posing a significant risk to the deposit insurance fund.

Provisions in H.R. 3951 ICBA Opposes

Cross-Marketing Restrictions

ICBA opposes several provisions in H.R. 3951. One of these is Section 501, which diminishes the cross-marketing restrictions imposed by the Gramm-Leach-Bliley (GLB) Act on the merchant banking investments of financial holding companies. Currently, a depository institution controlled by a financial holding company, and a nonfinancial company owned under the GLB Act's merchant banking authority by the same financial holding company, are prohibited from engaging in cross-marketing activities. H.R. 3951

would allow depository institutions controlled by a financial holding company to engage in cross-marketing activities with companies owned under the merchant banking authority of the GLB Act. We believe that these cross-marketing activities will undermine the separation between the nonfinancial portfolio company and the financial holding company along with its depository institution subsidiaries, therefore breaching the separation between banking and commerce.

As you know Mr. Chairman, during the debate of the GLB Act, Congress imposed strict cross-marketing prohibitions on transactions between depository institutions and merchant banking portfolio companies controlled by the same financial holding company in order to maintain the separation of banking and commerce when banks engage in merchant banking activities. We are concerned that the cross-marketing provisions in H.R. 3951 breach the banking and commerce line.

Congress has spoken clearly on the important separation of banking and commerce. If there was ever any doubt that this was the right policy choice, the events taking place today in Japan should erase those doubts. The kieritzu concept did not work in Japan, and it will not work in the U.S.

De novo Branching Across State Lines

Section 401 of the bill removes the current prohibition on national and state banks to expand through de novo interstate branching. ICBA opposes this provision. Under federal law, national and state banks are allowed to branch de novo into another state only if that state expressly permits de novo interstate branching.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 involved a series of compromises, including specific protections afforded to state authority. We recognize that federal law allows federally-chartered thrifts to branch across state lines without regard to state law. However, we believe that the state legislature is the appropriate forum in which to decide whether national and state banks are permitted to expand into another state through de novo interstate branching.

States have long played a critical role in setting banking policy and overseeing both local and national financial institutions. In establishing bank structure laws, Congress has generally chosen to establish a basic framework of rules, while allowing states to adopt additional rules and higher standards, particularly with regard to bank competition and operation.

Seventeen states have made the decision to enact legislation that expressly permits entry of a bank into their state by de novo branching. Thirty-three states have yet to establish such a law and instead continue to require interstate entry through the acquisition of an existing bank. States should be free to make this decision because they know best what the banking structure in their state should be. We support leaving the decision regarding de novo interstate branching within the discretion of state authority.

Credit Union Provisions

ICBA opposes several credit union related provisions in H.R. 3951, including Section 301, the provision that permits privately insured credit unions to become members of the Federal Home Loan Bank (FHLB). Under current law, only federally insured credit unions may become members of the FHLB. Allowing privately insured credit unions to become members of FHLB could pose a significant risk to the FHLB system, a system that many community banks rely on as an important source of alternative funding.

Privately insured credit unions do not operate under the federal regulatory oversight that current FHLB members do (including state chartered institutions). Members of the FHLB system are federally insured depository institutions. The strong link to federal insurance should not be diluted by opening the door to non-federally insured entities. In addition, when the FHLBs are reviewing institutions for membership (and monitoring their performance) they have easy access to the regulator's exam reports. There is a question as to whether the information available for privately insured credit unions would be of a similar quality.

I would note also that the National Association of Federal Credit Unions (NAFCU), the largest trade group exclusively representing federal credit unions, opposes this provision.

Several other provisions in H.R. 3951 that we oppose attempt to expand the credit union member limitation and create other advantages strictly for credit unions. These include, allowing federal credit unions to provide check cashing services to anyone eligible to become a member; offering credit unions a minimal charge for real estate leases on federal land; providing additional investment authority for credit unions and exclusion of loans to non-profit religious organizations from the member business loan limit.

ICBA also opposes expansion of member limits in voluntary mergers and conversions involving multiple common bond credit unions, Section 308. In voluntary mergers of multiple bond credit unions, the National Credit Union Association has determined that it must consider requiring employee groups over 3,000 in the merging credit union to spin off and form separate credit unions. Section 308 provides that this numerical limitation would not apply in voluntary mergers.

Section 308 also allows a community charter credit union to retain in its membership field all employee groups from the multiple bond credit union that has merged or converted into it. This is merely another attempt by credit unions to expand their membership beyond what is permitted under current law.

Credit unions were created by Congress, and given certain tax and regulatory advantages, for the purpose of serving individuals of modest means. Credit unions and community banks are similar in many ways. They both serve the community and offer many of the same products. But one big difference remains: credit unions do not pay taxes, giving them a major competitive advantage over taxpaying banks and thrifts. Providing credit unions the ability to expand their membership through voluntary mergers and conversions involving multiple common bond credit unions goes against the spirit of the credit union charter as well as the Credit Union Membership Act of 1998 (H.R. 1151).

Conclusion

Mr. Chairman we appreciate the opportunity to testify before you today on H.R. 3951 and provide our views on this important piece of legislation. We look forward to working with you on this legislation and on other legislation that may have an impact on community banks.

Testimony of

America's Community Bankers

on

H.R. 3951

Financial Services Regulatory Relief Act of 2002

before the

Subcommittee on Financial Institutions
and Consumer Credit

of the

Financial Services Committee

of the

United States House of Representatives

on

April 25, 2002

Curtis L. Hage
Chairman and CEO
Home Federal Bank
Sioux Falls, South Dakota

and

Chairman
America's Community Bankers
Washington, DC

Mr. Chairman and Members of the Committee, I am Curtis Hage, Chairman and CEO of Home Federal Bank in Sioux Falls, South Dakota.

I am here today representing America's Community Bankers (ACB)[1] as its chairman. ACB is pleased to have this opportunity to discuss with the subcommittee legislation to reduce the regulatory burden on financial institutions. We greatly appreciate the subcommittee's work on the Financial Services Regulatory Relief Act (H.R. 3951), particularly the leadership of the bill's sponsor Representative Shelley Moore Capito, and cosponsors Chairmen Mike Oxley and Spencer Bachus, and Representative Max Sandlin. Chairman Bachus, ACB strongly encourages you and the subcommittee to proceed with the effort and hope that the bill can be further improved as it moves through the process.

I would also like to congratulate you, Chairman Bachus, and all the members of the House Financial Services Committee on the passage of deposit insurance reform last week. That legislation is important to my community and my customers. I hope the House and Senate will complete action on it soon and send it to the President for his signature.

Now let me turn to the subject of today's hearing.

Priority Issues

Sec. 401. Branching

ACB strongly supports section 401 which would remove unnecessary restrictions on branching by national and state banks. This will extend to banks many of the benefits of the flexible branching authority now available to savings associations.

Sec. 105. Repeal of intrastate branch capital requirements

We also support section 105 which would eliminate the requirement that a national bank meet the capital requirements imposed by the states on state banks seeking to establish intrastate branches. A national bank's operations are already limited if it is in troubled condition.

Additional Recommendation: Eliminating Unnecessary Branch Applications

A logical counterpart to these proposals to streamline branching and merger procedures would be eliminating 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

[1] ACB represents the nation's community banks of all charter types and sizes. ACB members, whose aggregate assets exceed $1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

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 an inordinate amount of time and effort to determine whether a new branch would serve the "convenience and needs" of the community. Now, these decisions are left to the business judgment of the institution itself. ACB's proposal can be found in our appendix, labeled "Eliminating Unnecessary Branch Applications."

Sec. 201. SEC Parity

ACB vigorously supports section 201, which would provide parity for savings associations under the Investment Advisers Act and the Securities Exchange Act. These provisions 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 already recognized that it is appropriate to treat banks and savings associations the same under these acts by proposing regulations that provide parity for the exemption from broker dealer registration under the Securities Exchange Act. The SEC has included similar, but incomplete, proposals for exemptions from the Investment Advisers Act in its regulatory agenda.

Additional Recommendation: Business and Real Estate Lending

Another high priority for ACB is a modest increase 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 25 percent. 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. ACB's proposal can be found in our appendix, labeled "Expanded Business Lending."

ACB urges the subcommittee to add two additional provisions that would further improve savings associations' ability to lend in their communities. One would eliminate

an outdated per-unit limit on residential development and the other would increase a limit on commercial real estate loans.

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. This ACB proposal can be found in our appendix, labeled "Loans to One Borrower."

ACB also recommends increasing the limit on commercial real estate loans from 400 to 500 percent of capital, and permitting the Office of Thrift Supervision to increase that amount. 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. This ACB proposal can be found in our appendix, labeled "Limit on Commercial Real Estate."

Additional Recommendation: Reimbursement for Record Production

A final ACB priority concerns the cost of producing records for law enforcement purposes. ACB's members have long supported the ability of law enforcement officials to obtain bank records for legitimate law enforcement purposes. The investigation of the September 11 events has highlighted the value of financial records in pursuing terrorists and criminals. 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 the RFPA reimbursement language be broadened 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). Since financial institutions will be providing additional records under the authority of this new act, it is important to clarify this issue. Both of these proposals can be found in our appendix under "Reimbursement for the Production of Records."

* * * * *

The following highlights ACB's positions on other provisions of H.R. 3951 and proposes additional regulatory relief measures.

Title I – National Bank Provisions

Sec. 101. National bank directors and subchapter S qualification

ACB supports this provision that would allow national banks to use subordinated debt instruments to meet the requirement for directors' qualifying shares. This would ensure that directors retain a personal stake in the financial soundness of the bank, while making it easier for the bank to meet the 75-shareholder limit that defines eligibility for subchapter S tax treatment.

Sec. 102. Voting in shareholder elections

ACB supports this provision to allow national banks to choose cumulative voting to elect directors. This is a matter of corporate governance that can be best determined by each institution.

Sec. 103. Simplifying dividend calculations for national banks

ACB supports this provision to increase the flexibility for national banks in paying dividends deemed appropriate by their boards of directors. Again, this is a matter of business judgment best left to each bank's board of directors.

Sec. 106. Clarification of waiver of publication requirements for bank merger notices

ACB supports the ability of the OCC to waive the publication requirement for in-state mergers in emergency situations or by unanimous vote of the shareholders. This will help avoid unnecessary disruption in these instances.

Title II – Savings Association Provisions

Sec. 202. Investments by federal savings associations to promote the public welfare

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. Since 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 strongly supports this amendment to extend CDC investment authority to federal savings associations under the same terms as currently apply to national banks.

Sec. 203. Merger and consolidation of federal savings associations with non-depository institution affiliates

ACB supports this provision to give federal savings associations the authority to merge with one or more of their non-depository subsidiaries or affiliates. This is equivalent to recently enacted authority for national banks.

Sec. 204. Repeal of statutory dividend notice requirement for savings association subsidiaries of savings and loan holding companies & Alternative recommendation

ACB supports this provision to give the OTS the discretion to waive the requirement that state savings association subsidiaries of savings and loan holding companies notify the OTS prior to paying a dividend. ACB suggests an alternative approach that would simply eliminate 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. ACB's proposal can be found in our appendix under "Eliminating Dividend Notice Requirements."

Additional Recommendation: Streamlining subsidiary notifications

ACB recommends the committee eliminate an additional 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. ACB's proposal can be found in our appendix under "Streamlining Subsidiary Notifications."

Sec. 205. Modernizing statutory authority for trust ownership of savings associations

ACB supports this provision that conforms the treatment of trusts that own savings associations to the treatment of trusts that own banks.

Sec. 206. Repeal of overlapping rules governing purchased mortgage servicing rights

ACB supports this provision that would eliminate the 90-percent-of-fair-value cap on valuation of purchased mortgage servicing rights. It 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 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.

Additional Recommendation: Extending divestiture periods

ACB further 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 2-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. ACB's proposal can be found in our appendix under "Extending Divestiture Period."

Sec. 207. Expanded authority for federal savings associations to invest in small business investment companies

ACB supports this provision that restates in the Home Owners' Loan Act recently enacted statutory authority for federal savings associations to invest in small business investment companies (SBICs) and entities established to invest solely in SBICs. This technical provision will make is easier for savings associations to accurately determine their authority to invest in SBICs by consulting HOLA. Under the new provision, savings associations are subject to an aggregate 5 percent of capital limit on such investments.

Title III – Credit Union Provisions

Sec. 301. Privately insured credit unions authorized to become members of a Federal Home Loan Bank

ACB opposes this provision that would permit privately insured credit unions to become members of a Federal Home Loan Bank. Every other depository institution that is a member of a FHLBank must be and is federally insured and federally regulated. This helps ensure that these institutions are operated in a safe and sound manner, providing a substantial layer of security for the FHLBank System. In the recently enacted Gramm-Leach-Bliley Act the Congress struck a careful balance for the System by equalizing membership requirements for all federally insured depository institutions and reforming the System's capital system to reflect these changes. Permitting privately insured credit unions that undergo no federal regulatory scrutiny to borrow from the FHLBank System undermines the carefully balanced decisions made in GLB.

Sec. 304. Increase of general 12-year limitation of term of federal credit union loans to 15 years

ACB opposes increasing from 12 to 15 years the maturity limit for loans made by federal credit unions. This is yet another attempt by tax-exempt credit unions to become more like banks without accepting the responsibilities to pay tax and reinvest in communities. ACB strongly opposes the extension of credit union lending powers without community reinvestment and taxpayer responsibilities.

Sec. 307. Cashing checks for non-members

While this section has a worthy goal, increasing the availability of check cashing services, it would set an unfortunate precedent of allowing credit unions to offer services to non-members. It will also be difficult for credit unions to verify that an individual seeking to cash a check is eligible to become a member. Cashing a check is typically a much more rapid procedure than opening an account, providing inadequate time to accurately determine eligibility. Clearly, this is part of the credit unions' strategy to

expand services beyond members without accepting community reinvestment and taxpayer responsibilities.

Sec. 308. Voluntary mergers and conversions involving multiple common bond credit unions without numerical limitation

This section directly undermines a key provision of the Credit Union Membership Access Act of 1999, which determined the field-of-membership rules for credit unions. In ACB's view, CUMAA was more than generous to the credit unions, especially in light of the fact that they are tax exempt and are not subject to the Community Reinvestment Act. Therefore, we oppose this provision to permit voluntary mergers and conversions involving multiple common-bond credit unions without numerical membership limitations. Permitting the merger of large credit unions without numerical membership limitations promotes the creation of massive tax-exempt conglomerates, and harms both community banks and small, locally focused credit unions that generally adhere to the original scope and mission of the industry.

Title IV – Depository Institution Provisions

Sec. 403. Reporting requirements relating to insider lending

ACB supports the provision that would eliminate unnecessary reporting requirements. In addition, we would like to make the following substantive recommendation to change one limitation:

Additional Recommendation: Loans to executive officers

In addition to the language in section 403, ACB recommends that the bill eliminate 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. ACB's proposal can be found in our appendix under "Loans to Executive Officers."

Sec. 404. Inflation adjustment for small depository institution under the Depository Institution Management Interlocks Act

ACB supports this amendment to increase the exemption from the DIMIA 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.

Additional Recommendation: Interstate acquisitions by savings and loan holding companies

ACB recommends an amendment be added to Title IV to permit a 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. ACB's proposal can be found in our appendix under "Interstate Acquisitions."

Title V – Depository Institution Affiliates Provisions

Sec. 503. Eliminating geographic limits on thrift service companies

ACB supports this section that eliminates the single-state geographic limits on savings association service companies. This limit is out of date and ripe for repeal.

Additional Recommendation: Savings association investments in bank service companies

ACB further recommends that the Bank Service Company Act – which permits national and state banks to establish entities similar to savings association service companies – be updated to allow savings associations to participate. This amendment is a logical counterpart to the provision in section 503. In some cases, savings associations would prefer to invest in bank service companies, rather than establishing savings association-only companies. By the same token, bank service companies would benefit by being able to attract additional investors. ACB's proposal can be found in our appendix under "Bank Service Company Investments."

Title VI – Banking Agency Provisions

Sec. 601. Waiver of examination schedule to allocate examiner resources

ACB supports this provision to permit the federal banking agencies to adjust examination schedules when necessary to maintain safety and soundness. This provision is likely to benefit well-run community banks.

Sec. 602. Credit card accounts for bank examiners on same terms as other consumers

ACB supports this provision to permit bank examiners to obtain credit cards from banks they may examine, so long as the cards carry the same terms and conditions available to the general public. This will allow examiners, who must have credit cards for travel expenses, to obtain them in the same way as any other consumer.

Sec. 603. Interagency data sharing

ACB supports this extension of data-sharing authority from the Federal Reserve to the other federal banking agencies. We note, however, that this would allow the agencies to share information not only with other supervisory authorities, but with officers, directors, or receivers, or other institution-affiliated entities. In view of the breadth of this provision, ACB recommends that the committee direct the agencies to use this new authority only when needed to advance their mission and to protect against undue infringement on personal privacy.

Sec. 607. Repeal of minimum antitrust review period with agreement of the Attorney General

ACB supports this provision to remove the 15-day waiting period when the appropriate federal banking agency and the attorney general agree that a merger or acquisition would not result in a significant adverse effect on competition. This would eliminate an unnecessary waiting period.

Sec. 609. Streamlining depository institution merger application requirements

ACB supports this provision to eliminate the requirement that each federal banking agency request a competitive factors report from the other three banking agencies as well as from the Attorney General. This would eliminate the need for redundant reviews.

Additional Recommendations

In addition to the other recommendations indicated, ACB recommends that the committee include the following provisions in its legislation:

Eliminating Management Report and Attestation on Internal Controls

This recommendation provides that well-capitalized and well-managed institutions do not have to attest to their internal controls for financial management. Congress has already decided that institutions that must have an external audit do not have to prepare a management report regarding their compliance with safety and soundness laws. This report and attestation are similarly redundant and could be eliminated without decreasing in any way management's responsibility to maintain adequate internal control mechanisms. ACB's proposal can be found in our appendix under "Eliminating Management Report and Attestation on Internal Controls."

Reducing Debt-Collection Burdens

Under the Fair Debt Collection Practices Act, a debtor has 30 days in which to dispute a debt. This amendment 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. ACB's proposal can be found in our appendix under "Reducing Debt-Collection Burdens."

Decriminalizing RESPA

This proposal would strike the imprisonment sanction for violations of RESPA. It is highly unusual for consumer protection statutes of this type to carry the possibility of imprisonment. The possibility of a $10,000 fine remains in the law, maintaining adequate deterrence. ACB's proposal can be found in our appendix under "Decriminalizing RESPA."

Home Office Citizenship

ACB recommends an amendment to 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. ACB's proposal can be found in our appendix under "Home Office Citizenship."

Conclusion

ACB appreciates this opportunity to present our view on the regulatory relief bill now before the committee. It contains a number of valuable provisions, such as the increased flexibility for bank branching and parity for savings associations under the Securities Exchange Act and the Investment Advisers Act. Our testimony includes a number of additional suggestions, including the following:

- Eliminating unnecessary branch applications;
- Increase business lending limits for savings associations;
- Increasing flexibility in residential real estate and commercial real estate projects; and
- Providing reimbursement for producing records under the Right to Financial Privacy Act and the USA PATRIOT Act.

Appendix

to

America's Community Bankers'

Testimony

on

Regulatory Relief

Thursday, April 25, 2002

Contents

Eliminating Unnecessary Branch Applications .....

Expanded Business Lending .....

Loans to One Borrower .....

Limit on Commercial Real Estate .....

Reimbursement for the Production of Records .....

Eliminating Dividend Notice Requirements .....

Streamlining Subsidiary Notifications .....

Extending Divestiture Period .....

Loans to Executive Officers .....

Interstate Acquisitions .....

Bank Service Company Investments .....

Eliminating Management Report and Attestation on Internal Controls .....

Reducing Debt-Collection Burdens .....

Decriminalizing RESPA .....

Home Office Citizenship .....

Eliminating Unnecessary Branch Applications

SEC. 1. BRANCH NOTIFICATION BY NATIONAL BANKS— Section 5155(i) of the Revised Statutes (12 U.S.C. 36(i)) is amended to read as follows:

> "(i) A national bank that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Comptroller within 30 calendar days."

SEC. 2. BRANCH NOTIFICATION BY STATE MEMBER BANKS—Section 22 of the Federal Reserve Act is amended by adding the following new subsection:

> "(i) A State member insured bank that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Board within 30 calendar days."

SEC. 3. BRANCH NOTIFICATION BY STATE NONMEMBER BANKS—Section 18(d)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(1)) is amended to read as follows:

> "(1) A State nonmember insured bank that is well-capitalized (as that term is defined in section 38 of this Act) may establish a branch, provided that it notifies the Corporation within 30 calendar days."

SEC. 4. BRANCH NOTIFICATION BY FEDERAL SAVINGS ASSOCIATIONS– Section 4(m)(1) of the Home Owners' Loan Act (12 U.S.C. 1464(m)(1)) is amended to read as follows:

> "(1) IN GENERAL. A Federal savings association that is well-capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) may establish a branch, provided that it notifies the Director within 30 calendar days."

Explanation

Section 1 replaces a requirement that a national bank receive prior approval to open a branch with a provision that permits a national bank to establish a branch so long as it notifies the Comptroller within 30 calendar days.

Section 2 provides that a state member bank may open a branch so long as it notifies the Federal Reserve within 30 calendar days. This overrides the regulatory requirement of Regulation H (12 C.F.R. 208.6).

Section 3 replaces a requirement that a state nonmember bank receive prior approval to open a branch with a provision that permits a state nonmember bank to establish a branch so long as it notifies the FDIC within 30 calendar days.

Section 4 replaces a requirement that savings associations located in the District of Columbia obtain prior approval with a provision that permits any Federal savings association to establish a branch so long as it notifies the Director of OTS within 30 calendar days.

Under current regulatory practice, applications for new branches are routinely granted for strong institutions. Many other application requirements have been replaced with notification procedures. These amendments will expedite the ability of those institutions to open new branches, allowing them to more quickly offer services to additional communities, enhance competition.

Expanded Business Lending

SEC. __. SMALL BUSINESS AND OTHER COMMERCIAL LOANS – Section 5(c) of the Home Owners' Loan Act (12 U.S.C. 1464) is amended by –

(a) adding a new subparagraph (1)(V):

"(V) *Small business loans.* Small business loans, as that term is defined by the Director." and

(b) amending sub-clause (2)(A) by striking "20 percent" and inserting "25 percent" and by striking ", and amounts in excess of 10 percent of such total assets may be used under this subparagraph only for small business loans, as that term is defined by the Director."

Explanation

The amendment eliminates the 10 percent lending limit restriction on small business loans and increases the 20 percent limitation on other business loans from 20 to 25 percent. Expanded authority would enable savings associations to make more loans to small- and medium-sized businesses, enhancing their role as community lenders.

Loans to One Borrower

SEC. ___. LOANS TO ONE BORROWER—Section 5(u)(2)(A) of the Home Owners' Loan Act (12 U.S.C. 1464(u)(2)(A)) is amended by striking subclause (ii)(I).

Explanation

In addition to the loans-to-one borrower authority, savings associations may lend the lesser of $30 million or 30 percent of capital for a residential development. Within that overall limit, there is a $500,000 per-unit limit. This amendment eliminates a $500,000 per unit cap, while retaining the $30 million/30 percent limit. The per-unit cap is an excessive regulatory detail that creates an artificial market limit in high cost areas.

Limit on Commercial Real Estate

SEC. ___. COMMERCIAL REAL ESTATE LOANS—Section 5(c)(2)(B)(i) of the Home Owners' Loan Act (12 U.S.C. 1464(c)(2)(B)(i)) is amended by striking "400 percent of the Federal savings association's capital" and inserting "500 percent of the Federal savings association's capital (or such higher amount that the Director determines)".

Explanation

This section increases the limit on commercial real estate loans from 400 to 500 percent and permits the OTS to increase that amount. 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.

Reimbursement for the Production of Records

SEC. ___. CORPORATE RECORDS—Section 1101(4) of the Right to Financial Privacy Act (12 U.S.C. 3401(4)) is amended by adding ", except that such term shall mean any legal entity for purposes of section 1115 of this Act" after "individuals".

SEC. ___. CLARIFICATION OF SCOPE—Section 1115 of the Right to Financial Privacy Act is amended by adding the following new sentence—

> "This section shall apply to records required to be assembled or provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001."

Explanation

The Right to Financial Privacy Act provides that the government will reimburse banks for the cost of assembling and providing records of individual bank customers that the government is investigating. This amendment extends that to records of corporate bank customers. The amendment also clarifies that RFPA reimbursement requirements apply to records provided under the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001.

Eliminating Dividend Notice Requirements

SEC. ___. DIVIDEND NOTICES-- Section 10(f) of the Home Owners' Loan Act (12 U.S.C. 1467a(f)) is amended by adding the following paragraph and redesignating section 10(f) as section 10(f)(1):

> "(2) this subsection shall not apply to a subsidiary savings association that is well capitalized (as that term is defined in section 38 of the Federal Deposit Insurance Act) and will remain well capitalized after the payment of the dividend."

Explanation

Under this amendment, well-capitalized savings associations will no longer be required to notify the OTS of their intention to pay a dividend, provided that they will remain well capitalized after they pay the dividend. This will allow well-capitalized institutions to conduct routine business without regularly conferring with the OTS.

Streamlining Subsidiary Notifications

SEC. ___. STREAMLINING SUBSIDIARY NOTIFICATIONS—Section 18(m)(1)(A) of the Federal Deposit Insurance Act (12 U.S.C. 1828(m)(1)(A)) is amended by striking "the Corporation and" and by striking "each such agency" and inserting "the Director of the Office of Thrift Supervision".

Explanation

This amendment eliminates the requirement that a savings association notify the FDIC before establishing or acquiring a subsidiary or engaging in a new activity through a subsidiary. A savings association will still be required to notify the OTS, providing sufficient regulatory oversight.

Extending Divestiture Period

SEC. ___. EXTENDING DIVESTITURE PERIOD—Section 10(c)(1)(C) of the Home Owners' Loan Act (12 U.S.C. 1467a(c) (1)(C)) is amended by striking "2-year period" and inserting "10-year period".

Explanation

This section provides unitary savings association holding companies that become multiple savings association holding companies have 10 years to divest non-conforming activities. This is the same period granted to new financial services holding companies under the Gramm-Leach-Bliley Act.

Loans to Executive Officers

SEC. 1. LOANS TO EXECUTIVE OFFICERS -- Section 22(g)(4) of the Federal Reserve Act (12 U.S.C. 375a(4)) is amended by striking "in an amount prescribed in regulation of the member bank's appropriate Federal banking agency" and inserting "up to the Member bank's limit on loans to one borrower".

SEC. 2. REPORTING REQUIREMENTS RELATING TO LOANS TO EXECUTIVE OFFICERS.

(a) REPORTING REQUIREMENTS REGARDING LOANS TO EXECUTIVE OFFICERS OF MEMBER BANKS- Section 22(g) of the Federal Reserve Act (12 U.S.C. 375a) is amended--

(1) by striking paragraphs (6) and (9); and
(2) by redesignating paragraphs (7), (8), and (10) as paragraphs (6), (7), and (8), respectively.

(b) REPORTING REQUIREMENTS REGARDING LOANS FROM CORRESPONDENT BANKS TO EXECUTIVE OFFICERS AND SHAREHOLDERS OF INSURED BANKS- Section 106(b)(2) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1972(2)) is amended--

(1) by striking subparagraph (G); and
(2) by redesignating subparagraphs (H) and (I) as subparagraphs (G) and (H), respectively.

Explanation

Section 1 would eliminate the special regulatory $100,000 lending limit on loans to executive officers. The limit applies only to executive officers for "other purpose" loan, i.e., those other than housing, education, and certain secured loans. This conforms 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.

Section 2 eliminates certain reporting requirements currently imposed on banks and their executive officers and principal shareholders related to lending by banks to insiders. The change in reporting requirements would not alter restrictions on the ability of banks to make insider loans or limit the ability of federal banking agencies to take enforcement action against a bank or its insiders for violation of lending limits.

Interstate Acquisitions

SEC. ___. INTERSTATE ACQUISITIONS-- Section 10(e)(3)of the Home Owners' Loan Act (12 U.S.C. 1467a(e)(3)) is amended by adding the following new subparagraph and redesignating the following subparagraphs accordingly:

"(A) such acquisition would be permissible for a bank holding company under section 3(d) of the Bank Holding Company Act of 1956;"

Explanation

This amendment permits a multiple savings association 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.

Bank Service Company Investments

SEC. ___. INVESTMENTS BY INSURED DEPOSITORY INSTITUTIONS – The Bank Service Company Act (12 U.S.C. 1861, et seq.) is amended –

(a) by striking 1(b)(5) and inserting the following:

"(5) the term "insured depository institution" shall have the meaning provided in section 1812(c) of this title;",

(b) by striking "insured bank" wherever it appears and inserting "insured depository institution,",

(c) by striking "bank's" in paragraph 1(b)(8) and subsection 5(a) and inserting "institution's" and striking "bank or banks" in subsection 5(c) and inserting "institution or institutions", and

(d) by striking "banks" in section 2 and in subsection 4(f) and inserting "depository institutions".

SEC.___. PERMISSIBLE BANK SERVICE COMPANY ACTIVITIES - Section 4 of the Bank Service Company Act is amended –

(a) by adding "or State savings association" after "State bank" each place it appears in subsection (c),

(b) by adding "or Federal savings association" after "national bank" each place it appears in subsection (d),

(c) by striking subsection (e) and inserting the following new subsection in its place—

"(e) A bank service company shall perform only those services that each shareholder or member of the company is otherwise authorized to perform under applicable Federal or State law and shall perform such services only at locations in a State in which each such shareholder or member is authorized to perform such services."

Explanation

The Bank Service Company Act permits national and state banks to invest in companies that may provide clerical, administrative and other services closely related to banking to depository institutions. This amendment permits savings associations to invest in bank service companies on the same terms as permitted for national and state banks.

Eliminating Management Report and Attestation on Internal Controls

SEC. ___. MANAGEMENT RESPONSIBILITY IN WEAK INSTITUTIONS—Section 36(b) of the Federal Deposit Insurance Act (12 U.S.C. 1831m(b)) is amended by

(a) striking "each insured depository institution shall prepare" and insert "each insured depository institution described in subparagraph (C) of this subsection shall prepare", and

(b) inserting the following new subparagraph—

(C) This subsection shall apply with respect to insured depository institutions that exhibit financial, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory, or are not well capitalized, as that term is defined in section 38.

Explanation

Provides that well-capitalized and well-managed institutions do not have to attest to their internal controls for financial management. Congress has already provided that institutions that must have an external audit are no longer required to prepare a management report regarding its compliance with safety and soundness laws.

Reducing Debt-Collection Burdens

SEC. ___. CONTINUING COLLECTION EFFORTS – Section 809 of The Fair Debt Collection Practices Act (12 U.S.C. 1692g) is amended by adding the following new subsection and redesignating the following subsection accordingly:

> "(c) Continuing Collection Efforts. A debt collector may continue to collect the debt until the debt collector receives the notice described in subsection (b) of this section."

Explanation

A debtor has 30 days in which to dispute a debt. This amendment makes clear that a debt collector need not wait for that 30-day period while the debtor decides whether or not to dispute the debt.

Decriminalizing RESPA

SEC. ___. ELIMINATION OF IMPRISONMENT SANCTION – Section 8(d)(1) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2607(d)(1)) is amended by striking "or imprisoned for not more than one year, or both".

Explanation

This strikes the imprisonment sanction for violations of RESPA. The possibility of a $10,000 fine remains, maintaining adequate deterrence.

Home Office Citizenship

SEC. . HOME OFFICE CITIZENSHIP— Section 5 of the Home Owners' Loan Act (12 U.S.C. 1464) is amended by adding the following new subsection:

> "(x) **Citizenship**— For purposes of determining diversity of citizenship under 28 U.S.C. 1332, a Federal savings association shall be deemed a citizen only of the State in which it has its home office."

Explanation

This amendment provides 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.

Question submitted by Chairman Spencer Bachus

For Curtis L. Hage, testifying on behalf of America's Community Bankers
Hearing on H.R. 3951, the Financial Services Regulatory Relief Act of 2002
Thursday, April 25, 2002

Question

What are the policy grounds for your opposition to permitting privately insured credit unions to become members of the Federal Home Loan Bank System?

Reply

Mr. Chairman, we believe that extending Federal Home Loan Bank System (FHLBank System) membership to non-federally regulated depository institutions could increase the risk for the FHLBank System without a commensurate federal regulatory oversight of the non-federally regulated depository institutions.

The FHLBank System was created in 1932 with the enactment of the Federal Home Loan Bank Act. When Congress created the FHLBank System it also created the Federal Home Loan Bank Board to regulate the FHLBanks, as well as the depository institutions that became members of the FHLBank System. In effect Congress created a federal regulator to ensure that the depository institutions eligible to be members of the FHLBank System were subject to full federal regulation.

Morton Bodfish, a member of the first Federal Home Loan Bank Board, recognized Congress' intent that the Federal Home Loan Bank Board have full supervisory authority over the members of the FHLBank System. In a speech titled "An Analysis of the Home Loan Bank System"[1] he said, "..., it (the Bank Board) has the power to examine any member institution as well as the twelve banks."

Further, in the Congressional hearings leading up to passage of the FHLBank Act, John O'Brien (Office of the Legislative Counsel) was called on to explain the legislation[2]. In describing membership he said, it includes "...savings banks, and trust companies and other banks as the board determines have such time deposits and are in such financial condition to warrant their making such home-mortgage loans ..." This explanation coupled with the statutory language giving the Federal Home Loan Bank board supervisory authority over the members of the FHLBanks strongly suggests that Congress intended depository institutions to be subject to some form of federal regulation.

---

[1] Building and Loan Annals1932, United Sates Building and Loan League, Chicago, Illinois
[2] Hearings Before A Subcommittee of the Committee on Banking and Currency, House of Representatives on H.R.7620, March 16, 17, 18, 21, 22, 23, 24, 28, 29, 30, 1932.

Insurance companies were included as eligible members under the original Act in 1932 because many insurance companies at that time made residential mortgages. Insurance companies then and now do not have the option of being federally regulated, and since they are not depository institutions are not eligible for federal deposit insurance. Since it initial passage the FHLBank Act has been amended several times. In 1989, the Federal Home Loan Bank Board was abolished and replaced by the Office of Thrift Supervision as the primary regulator of federally chartered savings associations. The Federal Housing Finance Board was created as the primary regulator of the FHLBanks. The Federal Deposit Insurance Corporation now insures all federally insured savings associations as well as banks and the National Credit Union Administration insures and supervises federally insured credit unions.

Congress has recognized, as it expanded the universe of eligible members in amending the FHLBank Act, the importance of limiting new membership to federally insured depository members. In 1932 the FHLBank Act allowed "a building and loan association" that was not subject to state or federal regulation to be a member of a FHLBank if it subjected itself to Federal Home Loan Bank Board inspection. With the passage of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, Congress extended FHLBank membership only to federally insured commercial banks and credit unions. In the 1999 Gramm-Leach-Bliley Act Congress created a new category of membership called Community Financial Institutions (CFIs). Congress, in addressing FHLBank membership again limited considerations only to federally regulated or insured depositories. CFIs are a subcategory of FDIC insured depository institutions.

Over the years Congress has extended limited access to FHLBank advances to other types of institutions. In each of these instances, non-member borrowers have been subject to separate borrowing rules.

ACB's opposition to this provision is not about credit union access to the FHLB System. Credit unions already have access and we have no contention to that access. It is the access of institutions that do not, or may not, meet the test of adequate supervision and oversight. Experience has taught us that when our economy was stressed, the privately insured credit unions, thrifts and banks were the first to fail and the private insurance was inadequate to cover the losses. These losses were then transferred to the federally insured member thrifts and banks. We should only have to learn that lesson once.

Privately insured credit unions voluntarily choose not to be federally insured or regulated. Any depository institution that would like to avail itself of FHLBank membership should be required to be federally insured and as a result subject to federal supervision. Previous experience with private insurance in several states (e.g., Ohio and Maryland) proved to be costly and ineffective supervision. Privately insured credit unions appear to want access to the federally created FHLBank System, but want to avoid the cost and rigors of federal insurance and supervision.

Opening FHLBank membership to non-federally insured depository institutions creates a disparity in regulation and oversight that could pose a risk to System that is unnecessary and past lessons have taught us need to be avoided. This type of broader membership could create an incentive to use FHLBank membership to grow a business while avoiding federal insurance or regulation. This could lead to unwise business decisions beyond the reach of federal regulators and would be bad public policy.

Question submitted by Representative Melissa Hart

For Curtis L. Hage, testifying on behalf of America's Community Bankers
Hearing on H.R. 3951, the Financial Services Regulatory Relief Act of 2002
Thursday, April 25, 2002

Question on Bank Service Corporations

Section 503 of H.R. 3951 eliminates certain out of date geographic limits on savings association or "thrift" service companies – however, as you have pointed out in your written testimony, savings associations are not permitted to participate in bank service corporations. Would you please give the committee your opinion on how savings associations could benefit from investing in a bank service corporation as authorized under the Bank Service Corporation Act?

Reply

Savings associations would benefit from the added flexibility provided in section 503 in two ways. First, by being able to be an investor in, rather than just a customer of, a bank service company, a savings association would be able to better align its business interests with an important financial and service partner. Second, a savings association would have expanded business choices; it would maintain its ability to invest in savings association service companies but could, for business, geographic or other reasons choose to invest in a bank service company. Bank service companies would enjoy an expanded base of new potential investor/customers, while savings association service companies would have to respond to increased competition. This would improve the competitive climate for all banks and savings associations that seek the services these companies offer.

April 25, 2002

Testimony of

Elizabeth A. Duke

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Of the

Financial Institutions Committee
United States House of Representatives

Testimony of Elizabeth A. Duke
On Behalf of the American Bankers Association
Before the
Subcommittee on Financial Institutions and Consumer Credit
Of the
Financial Institutions Committee
United States House of Representatives

April 25, 2002

Mr. Chairman and members of the Subcommittee, my name is Elizabeth A. Duke, Sr. Vice President, Government Relations, SouthTrust Corporation (a $48 billion bank holding company headquartered in Birmingham, Alabama). I am a member of the Board of Directors of the American Bankers Association (ABA) and I chair ABA's Government Relations Council. The ABA 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 want to express our appreciation to you, Mr. Chairman, for your leadership in reducing unnecessary regulatory costs and for providing this forum to thoroughly discuss these issues. I would also like to acknowledge Congresswoman Roukema for her commitment to regulatory relief over the last several congresses and Congressman Bereuter, who was instrumental in developing and passing legislation to reduce the regulatory burden in previous Congresses.

I am glad to be here today to present the views of ABA's members on the need to reduce the burden of red tape and paperwork. This is an important issue for *all* businesses, including banking. The bi-partisan accomplishments forged in previous Congresses have clearly helped to restore balance in the bank regulatory process. In addition to the statutory changes, Congressional initiatives to roll back unnecessary regulation have created an environment within the bank regulatory community that has encouraged review, streamlining and even elimination of some unnecessary regulations. The result is a more efficient regulatory system and lower costs.

The process of reviewing regulations and their impact on our businesses and communities is an ongoing process, as the marketplace continues to change rapidly. Outdated laws and regulations only serve to squander scarce resources of banks that could otherwise be used to provide financial services demanded by our customers. Today, I would like to talk about the need to reduce unnecessary government regulation and discuss some of the key provisions in H.R. 3951, The Financial Services Regulatory Relief Act of 2002. The bill contains many important improvements that genuinely reduce unnecessary regulatory burdens. It also contains many provisions that should make the regulatory agencies more efficient and will have an ***indirect*** impact on banks. Unfortunately, the bill also contains provisions that are not directed as reducing red tape, but in effect are designed to enhance the competitive position of one financial services industry – credit unions – over taxpaying financial services providers.

I. The Need for Reducing Unnecessary Government Regulation

Mr. Chairman, the cost of regulation is not just a minor nuisance for bankers – it has a significant impact on bank customers and local economies. Compliance costs are a significant drain on bank resources and result in more expensive bank products and lower economic growth – often with very little customer benefit.

Over 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 Reserve[1] in the 1990s indicates that the total cost of compliance today for banks would range from $25 billion to $33 billion per year. And these costs do not include the cost related to preparing and sending 2.5 billion privacy notices under the Gramm-Leach-Bliley Act, which last year was estimated to be in excess of $1 billion.

Regulatory costs are significant for banks of all sizes, but pound for pound, small banks carry the heaviest regulatory load. In 1996, Congress found that "small businesses bear a disproportionate share of regulatory costs and burdens."[2] For the typical small bank, about one out of every four dollars of operating expense goes to pay the costs of government regulation.[3] For large banks as a group, total compliance costs run into the billions of dollars annually.

Certainly, some of this 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 approximately $40 billion to $50 billion. This would clearly have a big impact on our economies. In fact, it represents nearly 10 percent of all consumer loans or 30 percent of all small business and farm loans.

Cost is not the only problem – compliance also puts a big strain on manpower, especially at small banks. SouthTrust Corporation is a large banking firm with $48 billion in assets. We have ***64 full-time employees*** devoted to compliance. Small banks do not have this luxury. I know this intimately as I spent 10 years as CEO of a community bank, Bank of Tidewater, Virginia. My own experience, confirmed by studies done in the 1990s, was that I spent on average about one full day per week on compliance issues. For the industry as a whole, this amounts to 4 million CEO hours per year.

My experience was not unusual. In fact, there are more than ***3,800 banks and thrifts with fewer than 25 employees; almost 1,000 banks and thrifts have fewer than 10 employees.*** These banks simply do not have the human resources to run the bank *and* to read, understand and implement the thousands of pages of new and revised regulations, policy statements, directives, and

---

[1] "Survey of Regulatory Burden", American Bankers Association, June 1992;
Elliehausen, "The Cost of Banking Regulation: A Review of the Evidence," Staff Study, Board of Governors of the Federal Reserve System, April 1998.

[2] Small Business Regulatory Enforcement Fairness Act of 1996.

[3] According to the Small Business Administration's Office of Advocacy, the total cost of regulation is 60 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. (Crain and Hopkins, "Impact of Regulatory Costs for Small Firms," Small Business Administration, Office of Advocacy, 2001)

reporting modifications they receive every year. I'm sure I speak for all bankers when I say that I would much rather be spending my time talking with our customers about their financial needs and how my bank will fulfill them than poring over piles of government regulations.

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. The losers in this scenario are bank customers and the communities banks serve.

II. Key Provisions in H.R. 3951

There are several provisions that I would like to highlight today that take a step forward in reducing the regulatory burden. As I will discuss below, there are several provisions that unfortunately are aimed at changing the competitive structure between credit unions and taxpaying banks, and, we believe, should ***not*** be included as part of this regulatory relief legislation. While I will focus my comments on these areas, there are many other provisions included in H.R. 3951 that, while directed at changes within the regulatory agencies, are sure to make the agencies more efficient and would have some positive indirect impact on banking institutions.

Thrift Parity for Trust Activities

Section 201 would exempt savings associations from both broker-dealer and investment adviser registration under the federal securities laws. The ABA strongly and enthusiastically endorses Section 201. Commercial banks and trust companies have long been exempt from investment adviser registration under the Investment Advisers Act of 1940.[4] This exemption is grounded upon the notion that bank trust departments that provide investment advice to personal trust accounts, charitable foundations, employee benefit plans, and the like are subject to federal and state fiduciary laws and are appropriately regulated and supervised by state and federal banking regulators.

In 1980, the Congress gave savings associations the authority to engage in trust and fiduciary activities on the same basis as national banks. However, no commensurate revisions were made to the Investment Advisers Act of 1940, thereby forcing trust and fiduciary activities engaged in by savings associations to be subject to both regulation and examination by state and federal thrift examiners and the Securities and Exchange Commission ("SEC").

Section 201 would remedy this situation by exempting savings associations from investment adviser registration to the same extent as commercial banks and trust companies. Savings associations, like their commercial bank brethren, are subject to a multitude of state and federal fiduciary laws, including ERISA, rules and regulations issued by their primary regulator, state fiduciary law, and decisional law and are subject to extensive examination and oversight by their

[4] While it is true that the Gramm-Leach-Bliley Act narrowed the bank exemption from investment adviser registration to exclude those banks and trust companies that provide investment advisory services to registered mutual funds, Section 201 makes clear that these same limitations applicable to banks would be equally applicable to savings associations.

federal regulators. ***No need exists for yet another layer of costly and duplicative regulatory oversight.***

With respect to broker-dealer registration, Section 201 also would accomplish what the SEC has endeavored to accomplish through rulemaking. Specifically, the SEC has stated in its interim final rules addressing the bank exemptions to broker-dealer registration under Title II of the Gramm-Leach-Bliley Act of 1999, that extending the broker-dealer exemptions beyond banks and trust companies to savings associations was reasonable, in the public interest and consistent with the protection of investors. We strongly supported the SEC's statement in this regard and applaud the Committee's efforts to provide certainty and to create a level playing field under the federal securities laws between commercial banks and savings associations.

Cross Marketing

H.R. 3951 (Section 501) makes two important changes applicable to the new merchant banking powers authorized under the Gramm-Leach-Bliley Act. The first change is important in that it would allow ***all*** financial holding companies ("FHCs") engaged in merchant banking activities to cross-market products and services offered by both the bank and the portfolio company in which the investment is made so long as the financial holding company has a non-controlling investment stake in the portfolio company. The second change would permit all FHCs, whether or not their investment in the portfolio company was controlling, a limited ability to cross-market bank and portfolio company products and services. This latter change is necessary to ensure that FHCs affiliated with securities underwriting firms are not unfairly disadvantaged vis-à-vis those FHCs affiliated with insurance underwriting firms.

Under the Gramm-Leach-Bliley Act, an FHC is permitted to engage in merchant banking equity investment activities if, among other things, it is affiliated with either a securities firm or an insurance underwriting firm. The theory behind these requirements is that affiliation with either of these firms evidences some degree of sophistication with the financial markets.

The Gramm-Leach-Bliley Act generally imposes cross-marketing restrictions on FHC's engaged in merchant banking activities. The Act prohibits a depository institution controlled by an FHC from marketing any product or service of a company in which the FHC has made a merchant banking investment. The reverse is also true: the company in which the FHC has invested may not market the products and services of the FHC's affiliated depository institution to its customers.

A carve-out from this prohibition is provided, however, for merchant banking investments made by insurance companies owned by an FHC. Thus, insurance underwriting firms that affiliate with depository institutions are able to cross-market, through Internet websites or through statement stuffers, depository institution products to or through the company in which they have made a merchant banking investment. Products and services offered by the company in which the insurance underwriting firm has invested also may be marketed through Internet websites or statement stuffers via the depository institution that is affiliated with the insurance underwriting firm.

The ABA's affiliate, the ABA Securities Association (ABASA), has consistently championed the ability of FHCs affiliated with securities firms to engage in website/statement stuffer cross-

marketing. Nearly all of ABASA's members are FHCs that may make merchant banking investments because of their affiliation with securities firms, while very few own insurance companies that could engage in the type of insurance company merchant banking permitted by Gramm-Leach-Bliley. As a result, our FHC members could not take advantage of the website/statement stuffer exception, while other FHCs with insurance company merchant banking operations would be permitted to do so. The ability to cross-market through Internet websites is important to banks. Current business practices often require an FHC to invest in an Internet firm in order for its banks' products to be posted on or linked to that firm's website.

Taken together, the amendments would allow banks to cross-market bank products and services to customers of a portfolio company and vice versa, so long as the FHCs investment stake was non-controlling, which is defined as owning or controlling 25 percent or more of the total equity or any class of voting securities. No distinction would be made between those FHCs authorized to engage in merchant banking by virtue of their insurance underwriting affiliates versus those that are authorized on the basis of their securities firms. In addition, even where a control situation existed, limited cross-marketing through websites and statement stuffers would be permitted for all FHCs.

Mr. Chairman, these amendments are very, very positive. They have the strong support of both the industry and the Federal Reserve Board. The amendments will not only put ABASA's members on an equal footing with those insurance underwriting firms that engage in merchant banking, they will also allow all FHCs to engage in cross-marketing so long as their merchant banking stake is non-controlling. This latter provision is very important to level the playing field between FHCs and other non-FHC financial firms not similarly constrained by the Gramm-Leach-Bliley Act's bar on cross-marketing.

Control of Shares by Trusts

Section 502 would give the Federal Reserve Board the discretion to grant exceptions to Section 2(g)(2) of the Bank Holding Company Act. Bank holding companies are generally prohibited from owning more than 5 percent of the voting shares of any company. Section 2(g)(2) provides that shares held in trust for the benefit of employees and certain others shall be deemed to be controlled by or attributed to the bank holding company. Consequently, shares held in trust that are attributable to the bank holding company by operation of Section 2(g)(2) must not, ***when aggregated with all other shares held***, cause the bank holding company to own more than 5 percent of the voting shares of any one company.

This attribution provision has raised significant questions among ABA's membership about the continued ability of bank holding companies to offer benefit plans, such as 401(k) plans, to their employees. As the Committee is aware, the ability to offer a retirement plan as part of a benefits package is often the key to hiring and keeping qualified employees. While the ABA would prefer that the bill contain a specific carve-out from Section 2(g)(2) for employee benefit plans in addition to the general exemptive authority provided in H.R. 3951, we are confident that the Board will properly exercise its authority to exempt these plans from the attribution rule.

Exam Cycle

Section 601 provides discretion for Federal regulators to adjust the exam cycle of insured depository institutions. The ABA believes that this provision helps to more effectively allocate examination and supervisory staff. Moreover, under current law, an 18-month, rather than the normal 12-month, examination cycle is required for institutions with assets under $250 million. Many community banks have experienced considerable growth over the last five years, pushing them out of the small bank examination cycle. Yet, their core simplicity in structure has not changed. Thus, greater flexibility to adjust examination schedules to meet the evolving industry – both in size and complexity – is appropriate.

Subchapter S

ABA supports the provision in H.R. 3951, Section 101, allowing the use of a debt instrument to satisfy the qualifying shares ownership requirement by directors of national banks. Passage of this provision would help national banks who find it difficult to elect subchapter S tax status because of the difficulties associated with the director qualifying shares requirements contained in the banking laws.[5] There are many other subchapter S changes that would be helpful to banks interested in making a subchapter S election, including, but not limited to, raising the shareholder limit from 75 to 150, providing passive income relief to banks and allowing IRA shareholders. Many of these changes can be found in the Subchapter S Modernization Act of 2001 (H.R. 2576; S. 1201). While we realize that these provisions are not under the jurisdiction of this subcommittee, we thought it would be appropriate to raise these suggestions as we appreciate the subcommittee's interest in making subchapter S more widely available to community banks.[6]

Expanded Community Development Investment Authority for Thrifts

Section 202 would make the community development investment authority of thrifts parallel to that of banks. Thrifts are currently more restricted than banks in the types of investments they can make. We believe that allowing thrifts the same range of investment opportunities as banks would be beneficial to communities.

We also suggest increasing the investment limit for banks to that of thrifts. Increasing the investment limit would significantly increase the potential resources available for community development, and we urge the Subcommittee to consider such an expansion.

---

[5] Subchapter S is a method of taxation whereby shareholders are taxed in a manner that is similar to the taxation of a partnership. Corporations that meet the strict eligibility standards under subchapter S of the Internal Revenue Code benefit from lower taxes, as the shareholders are taxed directly, rather than the corporation. The Small Business Job Protection Act of 1996 (H.R. 3488) permitted eligible banks, for the first time, to elect subchapter S status beginning in January 1997.

[6] Note that the granting of these changes, while helpful to community banks, would still not put them on a par with tax-exempt credit unions. Significantly, earnings of subchapter S banks are taxed in all instances, whether these earnings are passed on to owners of the bank or not. The same is not true for credit unions, which may retain their earnings tax free. This provides greater growth potential for credit unions vis-à-vis subchapter S or other taxpaying institutions, and further expands the credit union tax subsidy.

Additionally, we propose allowing bank-affiliated Community Development Corporations (CDCs) to become members of the Federal Home Loan Bank System. Often, insured depository institutions, which otherwise might not be members of the Home Loan Bank System, will set up a community development corporation to house their community and economic development efforts. Allowing these bank-affiliated CDCs to join the Home Loan Bank System poses no increased risk to the System because they are supervised by the bank regulators. It does provide these institutions with another source of funds to further their community development activities. This, like increasing the investment authority of thrift institutions, will be beneficial to communities.

Interstate Branching

Section 401 would remove the prohibition on national and state banks from expanding through *de novo* interstate branching. Currently, this may occur only if a state's law expressly permits interstate branching. The current constraint was developed as a compromise when the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 was enacted. Not surprisingly, removing this provision remains controversial even though the market has evolved since that time. The ABA is still discussing this issue with our members and with state bankers' associations.

III. Credit Union Provisions

The ABA has major concerns with provisions in H.R. 3951 that would expand credit union powers, membership, and business lending authority, while also promoting the further consolidation of an already rapidly consolidating tax-exempt credit union industry. These provisions are designed to enhance the competitive position of credit unions vis-à-vis taxpaying financial institutions and should not be a part of any regulatory burden legislation. The distinction between these credit union-related provisions and the provisions previously mentioned rests with the tax-exempt status of credit unions and the limitations on their powers that result from their tax status. Each of the provisions discussed below have the real effect of expanding the credit union charter and its powers – and would likewise expand the credit union tax subsidy and competitive advantages over taxed financial competitors. The same cannot be said about other provisions in this bill.

However, there are two provisions related to credit unions that could reasonably be considered to eliminate burdens without expanding their powers or enhancing their competitive positions. The first provision authorizes a fifteen-year maturity limit for loans and grants rulemaking authority for the National Credit Union Administration (NCUA) to establish longer maturity limits. Under current law, there is a twelve-year maturity limit for loans (with certain exceptions such as mortgage for primary residence). ABA does not oppose this provision as long as it is consistent with safe and sound practices. Second, the bill would provide NCUA with the authority to approve by regulation additional investment authority for credit unions. Current law limits credit unions investment authority to loans, government securities and certain other limited investments; with the diminishing size of the Treasury market, this limitation has become a real issue for credit unions. These two legislative changes have the effect of eliminating a practical barrier in activities already authorized. They do not, like the provisions discussed below and opposed by the ABA, expand the competitive benefits of tax-subsidization already granted to credit unions.

Expansion of Credit Union Powers

Section 305 greatly expands the authority of credit unions to invest in credit union service organizations (CUSOs), thus allowing such entities – which can engage in a wide variety of powers beyond those authorized for credit unions themselves – to vastly broaden their market reach. The provision would triple the amount that credit unions can invest in service organizations, which are not regulated by NCUA. This represents a significant increase in risk, where half of an adequately capitalized credit union's net worth would be at risk. ABA steadfastly opposes this initiative.

Since the beginning of 1999, almost all CUSOs have been formed as limited liability corporations which ***allows the earnings of the CUSO to be taxed at the credit union's marginal tax rate of zero percent***. Thus, any expansion in a credit union's authority to invest in a CUSO would represent a further expansion of the credit union tax subsidy. This expansion of the subsidy would widen the competitive disadvantage between taxpaying banks and tax-exempt credit unions. This provision would expand the tax subsidy provided to credit unions well beyond the current ten-year ***$16 billion*** cost estimated by the U.S. Treasury Department.

Moreover, the ability of CUSOs to provide services to non-credit union members represents a further erosion of the common bond. Thus, this provision is an attempt to circumvent the mission of the credit union charter and an unnecessary expansion of the tax subsidy provided to these institutions.

Expanded Membership

Section 308 would permit credit unions that seek to convert their charters, e.g., from a occupation-based institution to a community charter serving a wide geographic area and/or large population base, to gain the new charter's expanded field of membership while maintaining its prior membership categories. For example, if Lockheed FCU was to add Orange County, it could continue to serve A&H Machine in Oklahoma or Access Graphics in Colorado, or Metrix Group in New Jersey. Moreover, Lockheed FCU has branch locations in New Hampshire and Texas along with California.

Such a provision violates the "reasonable proximity" requirement established by Congress for credit unions just a few years ago. Congress made it quite clear in the Credit Union Membership Access Act of 1998 that if a multiple group credit union was to add a new group to its field of membership, the credit union needed to be "within reasonable proximity to the location of the group."[7] This provision was meant to continue the credit unions' focus on the uniquely "local" aspect of their business operations. The provision in H.R. 3951 would undermine the unique nature of credit unions as volunteer-run, democratic organizations. If members are not within physical proximity of the credit union, they are less likely to participate in the governance of the credit union and to volunteer. If credit unions desire to be full-service financial institutions, they should be required to play by the same rules.

---

[7] 12 USC 1759(f)(1)(B).

Voluntary Mergers of Credit Unions

Another, perhaps less obvious, aspect of the bill would greatly encourage further consolidation in the credit union industry beyond what is already occurring. During the last decade, the number of credit unions has fallen 19 percent from 12,860 credit unions as of year-end 1990 to 10,365 as of June 2001. Since the beginning of 1991, credit union mergers have averaged 306 per year. Importantly, much of the consolidation has been a result of large credit unions aggressively absorbing small credit unions. ***In 1998, Congress sought to promote small credit unions by maintaining limitations on the ability of larger credit unions to voluntarily merge together.*** It did so by specifically directing the NCUA to promote the creation of independent credit unions and limiting the merger of credit unions with over 3000 members to situations involving a troubled credit union.

The new proposal would permit such mergers any time credit unions want to merge. The effect of this provision would be to eliminate any restriction on the merger of healthy credit unions, leading to even more rapid consolidation of credit unions into ever-larger tax-exempt institutions. We think small, traditional credit unions would share our concerns in this area. Regardless, such an eventuality would further destroy the "myth" that credit unions represent small, niche players in the financial services marketplace. The very consideration of this change in policy should raise the significant question to policymakers as to why such credit unions are deserving of federal and state tax subsidies.

Credit Union Business Lending Expansion

H.R. 3951, Section 306, would also expand the business lending powers of credit unions and represents another attempt to emasculate the business lending restrictions enacted by Congress in the 1998 credit union legislation. That law, which prohibited credit unions from lending amounts greater than 12.25 percent of their capital to businesses, contains limited exemptions which result in loans that are not counted toward the cap. In general, under existing law, the types of loans which are excluded from the definition are those which are secured, guaranteed, insured or in an amount of less that $50,000. ***This proposal to exclude business loans to nonprofit religious organizations would add a significant new unsecured, non-guaranteed, non-insured*** category of loans to the exemptions.

Simply put, these expansions are an attempt to circumvent the restrictions created by Congress and do so in a way that may add significantly to the riskiness of the credit unions' portfolio. We understand the intent of the provision's author. However, consequent to the broad nature of the provision, very large religious-affiliated organizations or even businesspersons remotely affiliated with religious organizations could be construed to qualify. Many religious organizations operate significant business enterprises, such as television networks, bookstores, universities, production houses, web sites, retirement homes, and the like. Therefore, a credit union would be able to make unlimited business loans so long as the borrower was determined to be a nonprofit religious organization. We do not believe that the government should extend its subsidies to support these types of loans.

Our nation's banks provide a wide range of financial assistance to a multitude of religious organizations, facilitating the building of churches and synagogues, the provision of literacy programs, the creation of job training assistance efforts, and the development of a panoply of community development activities. We applaud efforts of all those in the financial community, including credit unions, who engage in such activity. However, the ***ABA does not believe that the government should subsidize such activities for one segment of financial institutions and not others.*** Such would be the case if Congress adopted this provision.

IV. Conclusion

Mr. Chairman, 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 subcommittee to achieve this goal.

THE FINANCIAL SERVICES ROUNDTABLE

Testimony of

The Financial Services Roundtable

Submitted for the Record

For the

United States House of Representatives
Financial Services Subcommittee on
Financial Institutions and Consumer Credit

Hearing

on

H.R. 3951
The "Financial Services Regulatory Relief Act of 2002"

April 25, 2002

I. Introduction

The Financial Services Roundtable appreciates the opportunity to submit testimony on H.R. 3951, the "Financial Services Regulatory Relief Act of 2002." The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

Roundtable member companies provide fuel for America's economic engine, accounting directly for $12.4 trillion in managed assets, $561 billion in revenue, and 1.8 million jobs.

II. H.R. 3951, the "Financial Services Regulatory Relief Act of 2002"

The Roundtable strongly supports H.R. 3951. We believe it is important for Congress to periodically review the laws applicable to the financial services industry and to revise those laws when they become outdated or impose unwarranted costs on consumers. Such adjustments to our laws also establish clearer guidelines for firms engaged in financial services activities.

The Roundtable wishes to express special thanks to Congresswoman Shelly Moore Capito (R-WV) for her introduction of this bill, and to Chairmen Mike Oxley (R-OH) and Spencer Bachus (R-AL) for their efforts to generate momentum for enactment of regulatory burden relief legislation this year.

While the Roundtable supports the bill as a whole, there are several provisions that deserve special comment.

A. Elimination of Barriers to *De Novo* Interstate Branching

The Roundtable strongly supports section 401 of the bill, which would remove certain existing restrictions on interstate branching and mergers. We believe that section 401 is a natural extension of the Riegle-Neal Interstate Banking and Branching Efficiency

Act of 1994, which expanded the interstate branching authority of banks. The passage of time has demonstrated that the benefits that were expected from that Act have in fact developed. The creation of new branches has helped to maintain the competitiveness and dynamism of the American financial services industry and has improved access to financial services in otherwise under-served markets. Branch entry into new markets has enhanced competition in many markets, and this, in turn, has resulted in a better array of financial services for households and small businesses and more competitive pricing of products. Furthermore, interstate branching has enabled banks to continue to serve the needs of consumers as they move, live, and work across state borders.

Currently, however, banks may not establish new offices (so-called "*de novo* branches") outside their home state unless the host state specially authorizes *de novo* branching. Only 17 states have enacted legislation to allow *de novo* entry. Both large and small financial institutions have found this limitation on *de novo* branching to be costly and burdensome and, in some cases, an absolute barrier to entry.

H.R. 3951 would permit *de novo* interstate branching for state and national banks without an affirmative opt-in from the host state. As the Office of the Comptroller of the Currency ("OCC") and the Federal Reserve Board ("Board") have testified, this change will bring benefits to financial institutions and their customers by permitting an institution to select which form of interstate expansion is best suited for its market. It also will provide to all financial institutions and their customers the benefits that thrifts and their customers have long experienced.

B. Reduction of Cross-Marketing Restrictions

The Roundtable strongly supports section 501 of the bill, which would make two modifications to the cross-marketing restrictions imposed by the Gramm-Leach-Bliley Act of 1999 ("GLBA"). First, section 501 would permit depository institutions controlled by a financial holding company to engage in cross-marketing activities with companies in which a merchant banking affiliate has made an investment to the same extent, and subject to the same restrictions, as companies in which an insurance affiliate has made an investment. 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. Section 501 would establish parity of treatment between financial holding companies that own insurance affiliates and those that own merchant banking affiliates. The Roundtable agrees with the Board that such parity of treatment is appropriate and is not a violation of the separation of banking and commerce.

Second, section 501 would 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. We agree with the bill's premise that, 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. As the Board has testified, in these non-control situations, the separation of banking and commerce is maintained by the other restrictions contained in GLBA 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.

C. Parity for Banks and Thrifts Under Federal Securities Laws

The Roundtable strongly supports section 201 of the bill, which would extend to thrifts the exemptions that banks have from investment adviser and broker-dealer registration requirements. Under current law, banks are exempt from registration under the Investment Advisors Act of 1940, and have, in the past, enjoyed a blanket exemption from broker-dealer registration requirements under the Securities Exchange Act of 1934. Thrifts have had neither exemption. While the Securities and Exchange Commission ("SEC") has

the authority to correct this disparity, and has taken some regulatory steps to do so, there is no certainty that it will do so.

The Office of Thrift Supervision ("OTS") and the SEC have recognized that this differential treatment is no longer logical. The trust powers of banks and thrifts are essentially the same. Additionally, banks and thrifts provide investment advice, trust and custody, third party brokerage, and other related services in relatively the same manner.

D. Removal of Post-Approval Waiting Period

The Roundtable strongly supports section 609 of the bill, which would permit the consummation of a merger transaction immediately upon approval of the merger by the appropriate federal financial services agency. Under current law, there is a 30-day waiting period between the approval of a merger by a federal financial regulator and the consummation of the merger. If the appropriate federal financial regulator and the Attorney General agree, this waiting period can be shortened, but only to 15 days. Section 609, which is supported by the Federal Reserve and the OCC, would permit the waiting period to be eliminated if the agency and the Attorney General agree. This would eliminate the costly and often unnecessary delay imposed under current law.

E. Other Provisions in H.R. 3951

The Roundtable believes that several other provisions of the bill are noteworthy. These provisions include section 103, which would simplify dividend calculations for national banks; section 202, which would provide authority for thrifts to make investments for public welfare similar to those which banks are now permitted to make; section 403, which would eliminate certain reports from insiders that the Board has found do not contribute significantly to the effective monitoring of insider lending or the prevention of insider abuse; section 502, which would provide discretion to the Board to make exceptions under the rule that attributes to a bank holding company ownership of shares held in trust by that company; and section 601, which would permit the federal banking agencies to adjust examination schedules in order to more efficiently allocate resources among the institutions most in need of examination.

III. Additional Recommendations

As H.R. 3951 moves through the Financial Services Committee, the Roundtable recommends that the bill be expanded to address some other existing laws that impose unnecessary burdens on financial services firms and their customers.

A. Investment Authority for State Member Banks

An early draft of H.R. 3951 would have given the Federal Reserve Board the authority to allow state member banks to engage in investment activities authorized by their chartering state and the Federal Deposit Insurance Corporation ("FDIC"). The Roundtable believes that the Board should have this authority. Under current law, state member banks are limited to activities permitted for national banks. State nonmember banks, however, may engage in a potentially wider range of activities, including those not authorized for national banks, if the FDIC finds that such activities present no risk to the deposit insurance fund. There is no reason to discriminate between state-chartered banks, simply because of their membership in the Federal Reserve System. An empowered state banking system is essential to the evolution of the financial services industry and the preservation of the dual banking system. The addition of this provision would help advance those goals. We encourage the Committee to reincorporate it in the bill.

B. Removal of Price Variance Part of Anti-Tying Rules

The Roundtable encourages the Committee to repeal the price variance feature of the existing anti-tying rule so a financial institution can give a price break to a customer if that customer decides to purchase other products and services from the institution. Financial institutions should have the ability to offer a customer a price break on a product or service if the 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. We encourage the Committee to adopt this consumer friendly amendment.

C. Consumer Loans by Thrifts

The Home Owners' Loan Act ("HOLA") limits the amount of loans a federal thrift can make for "personal, family and household purposes." Currently, a federal thrift cannot commit more than 35 percent of its assets to loans that will be used for personal, family, and household purposes. At the same time, HOLA places no limit on the amount of credit card and educational loans by a federal thrift. We believe all consumer loans, regardless of their purpose, should be treated like credit card loans and educational loans. There is an obvious consumer advantage in expanding the competitive market for consumer lending. HOLA should be modified to reflect this goal. Therefore, we ask the Committee to amend the bill to remove the limitations on loans for personal, family or household purposes.

D. Diversity Jurisdiction for Federal Thrifts

Under current law, a federal thrift that has interstate operations is not deemed to be a citizen of any state, and, therefore, cannot bring a legal action in federal court based upon diversity jurisdiction. We ask the Committee to address this anomaly in the law. A federal thrift that is not engaged in interstate operations is deemed to be a citizen of the state in which it is located and can bring a suit in federal court based on diversity of citizenship. Furthermore, a national bank, whether engaged in local or interstate activities, is deemed to be a citizen of the state in which it is chartered and may bring an action in federal court based upon diversity. Federal thrifts with interstate operations should have the same recourse to federal courts as thrifts without interstate operations and national banks.

E. QTL Test for Multi-State Thrifts

Under current law, a thrift with operations in multiple states must meet the qualified thrift lender ("QTL") test not only on a multi-state basis, but also in every state in which it has branches. The net result of this rule is to restrict the free flow of commerce between and among the states, and to misallocate resources to meet the arbitrary demands of the statute. With the barriers to interstate operations rapidly falling away, continuation of the individual state test for multi-state thrifts is anachronistic. Permitting multi-state thrifts to

meet the QTL test on a multi-state basis would be a good example of regulatory relief that would encourage the free flow of goods across state borders.

F. National Deposit Ceiling

Under current law, a depository institution may hold no more than 10 percent of all deposits in the country. This 10 percent deposit ceiling is based upon the total number of deposits held by all commercial banks and thrifts. With the successful growth of credit unions and the expansion of foreign bank branches in the U.S., the deposit options for consumers extend beyond just commercial banks and thrifts. Therefore, we ask the Committee to adjust the base for purposes of calculating the 10 percent ceiling to include deposits held by credit unions and U.S. branches of foreign banks. We are not recommending any change in the percentage limitation, only that the base be revised. This provision was included in an earlier version of the bill, and we ask that it be reincorporated.

G. Treatment of CDs Issued by Federal Thrifts

Currently, FDIC-insured certificates of deposit ("CDs") issued by federal thrifts and national banks are not classified as securities under federal securities and banking laws. As such, CDs issued by federal thrifts and national banks do not need to be registered with the SEC. Many states, however, treat CDs as securities. While all of the states that do so have exempted banks and federal thrifts from applicable registration requirements, some have required registration of exclusive agents of federal thrifts. This requires the federal thrift to pay a registration fee to the state and requires the agents to pass one or more NASD examinations. We ask the Committee to preempt states from requiring persons who represent a federal thrift in selling deposit products to register as a state securities law agent.

H. Treatment of Thrift Agents

Another recommended amendment that is similar to the previous one relates to the treatment of mortgage loan agents of federal thrifts. Currently, federal thrifts and their employees are exempt from state mortgage broker or mortgage lender licensing statutes. On the other hand, exclusive agents of federal thrifts are not exempt from these state

statutes. We ask the Committee to amend HOLA to exempt exclusive agents from these state laws.

I. CRA for CEBA Banks

We recommend that the Committee permit banks subject to the terms of the Competitive Equality Banking Acting (so-called "CEBA" banks) to meet their Community Reinvestment Act ("CRA") obligations through community development lending as well as other forms of lending. CEBA banks, by their nature, often offer only a limited line of products. In many communities, there simply are not sufficient customers available for a CEBA bank to meet its CRA obligation unless the bank can count community development lending.

J. Usury Limit on Finance Companies

Federal law allows state-chartered banks to charge the same rates as nationally chartered banks, therefore eliminating the interest rate disparity between state and national banks in states such as Arkansas. Unfortunately, finance companies are treated as state-chartered banks for purposes of this law and, therefore, they continue to be subject to the usury rate cap in Arkansas. In today's rate environment, this means that finance companies are limited to five percent over the federal discount rate (which is around two percent) while banks can charge almost any rate necessary to secure a loan. The Roundtable recommends that the Committee amend the bill to eliminate this inequity and allow more competition.

K. Treatment of Collateralized Deposits In Bankruptcy

The Roundtable recommends that the Committee modernize the system by which banks collateralize deposits of bankrupt companies. Currently, banks may be required to pledge collateral to the United States government if they hold deposits of companies that are in bankruptcy. Yet, only surety bonds or U.S. government debt, which is unconditionally guaranteed by the U.S. government, are acceptable collateral for this requirement. Because of the decline in outstanding public debt and advances in capital markets, there are other obligations that should be considered by the U.S. Treasury as acceptable collateral.

Similarly, the value of collateral has been limited to par value, rather than market value. We ask the Committee to update the law governing the form and value of collateral to reflect current market practices and standards.

L. Regulation of Broker-Dealer Activities of Banks

GLBA gave the SEC the authority to regulate the broker-dealer activities of banks. Consistent with the Committee's desire to foster cooperation between the regulators of financial services firms, the Roundtable urges the Committee to amend GLBA to direct the SEC to consult with the federal banking agencies prior to the issuance of any regulations governing the broker-dealer activities of banks. This requirement would not limit the SEC's power over bank broker-dealers, but it would ensure that the SEC fully consider the views of the primary regulators of banks prior to the adoption of any regulation.

M. Interstate Trust Operations

Just as Congress has fostered the development of interstate branching and banking through the passage of the Riegle-Neal Act, the Roundtable urges the Committee to amend the bill to facilitate interstate trust activities. Today, the trust activities of financial institutions remain subject to a variety of state laws. These laws have inhibited the ability of institutions to provide trust services. Consumers today are more mobile than ever. A change to "interstate" trust laws to facilitate the providing of trust services to a greater number of people is long overdue.

N. Uniform Privacy Standard

With the enactment of GLBA, Congress acknowledged the need to protect the privacy of the individuals who seek or use financial services. Unfortunately, since GLBA was passed, we have seen a proliferation of proposed privacy laws by state and local governments that, if enacted, would create a patchwork of privacy requirements around the country. Such a balkanization of privacy laws would not only impose significant compliance costs on financial institutions, but would inevitably lead to customer confusion. Accordingly, we urge the Committee to adopt a uniform, national standard on financial privacy.

In the alternative, we urge the Committee to consider H.R. 3068, the "Financial Privacy and National Security Enhancement Act," sponsored by Congressman Bob Ney (R-OH). This legislation would set a four-year temporary "time-out" from the unintended harmful effects that state privacy laws could have on consumers, law enforcement, financial firms, and the U.S. economy. In addition, it would create a four-year Presidential Privacy Study Commission to assess the privacy protections provided by financial firms and to report on ways to improve consumer financial privacy, while preserving both the ability of institutions to service their customers and the effective information flow for national security purposes.

O. Anti-Fraud Network

Finally, the Roundtable recommends that the Committee incorporate H.R. 1408, "the Financial Services Anti-Fraud Network Act of 2001," into this bill. With our system of functional financial regulation, it is imperative that all financial regulators, state and federal, cooperate. H.R. 1408 fosters such cooperation by providing for the development of an anti-fraud network. The bill already has passed the House by a vote of 392 to 4, and, we believe, it would be an excellent addition to this measure.

IV. Conclusion

In conclusion, the Roundtable appreciates the opportunity to submit testimony on this important bill, and expresses its appreciation to all Members of the Committee, but particularly Chairman Bachus and Congresswoman Capito, for their effort on this legislation.

O