Testimony of

Albert C. Kelly, Jr.

On behalf of the

American Bankers Association

before the

Subcommittee on Capital Markets and Government Sponsored Enterprises

of the

Committee on Financial Services

United States House of Representatives

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Chairman Garrett, Ranking Member Waters, and members of the Subcommittee, my name is Albert C. Kelly, Jr., Chairman and Chief Executive Officer, SpiritBank, Bristow, Oklahoma. I am also the chairman of the American Bankers Association. ABA represents banks of all sizes and charters and is the voice of the nation's $14 trillion banking industry and its two million employees.

I appreciate the subcommittee taking the time to review an important new rule that may soon be issued by the Securities and Exchange Commission (SEC) requiring registration of companies that provide advisory services to municipalities.

ABA strongly believes that Section 975 of the Dodd-Frank Act (Dodd-Frank) was not intended to cover banks. Instead, it established a regulatory scheme for ***unregulated entities*** providing advice to municipalities with respect to the municipal financial products defined by Congress, e.g., municipal derivatives, guaranteed investment contracts, or investment strategies which include plans or programs for the investment of the proceeds of municipal securities.

However, the SEC has proposed rules that interpret the scope of the "municipal financial products" in Section 975 far beyond the securities activities of state and local governments to reach all "funds held by or on behalf of a municipal entity." This would mean that giving advice about traditional bank products such as deposits and loans could trigger registration as municipal advisors by most banks and each of their employees who may give "advice" to local governmental bodies such as schools, libraries, hospitals, etc.

Let me give a simple example of the unintended consequences that the proposed rule, if finalized, would bring about. The term "advice" is not defined in the SEC's proposal. Thus, we do not know whether a suggestion by a teller that the local librarian may wish to consider an interest-bearing account, rather than a checking account, would mean that the teller would have to be registered as a municipal advisor.

Registration would overlay onto the existing comprehensive bank regulatory scheme an entirely new securities-based regulatory scheme with enforcement by the SEC. The consequences would be severe. In addition to subjecting banks to wholly unwarranted and duplicative regulation and examination, which would cause banks to incur significant costs, local community banks might simply stop taking municipal deposits.

This means that local governments may have to go outside their communities—particularly in small towns, such as in my state of Oklahoma—for something as simple as a bank account. Thus, rather than protecting municipalities, such a rule would raise costs and make it more difficult to find basic financial services from their local banks.

ABA's members provide a full range of products and services to state and local governmental bodies including deposit accounts, cash management, loans, credit facilities, employee benefit, trust, advisory services, custody, securities lending, liquidity facilities for debt programs, servicing municipal debt programs, securities processing and agency services, and other capital market services. In addition, many bank employees serve their communities through appointments to or volunteering for local boards and commissions in capacities which may include providing advice with respect to municipal financial products. ***Under the SEC's proposal, these employees would be rewarded for their voluntary services to their communities by being required to register as municipal advisors in their individual capacity.***

ABA fully supports legislation (H.R. 2827) introduced by Representative Robert Dold (R-IL) that would clarify what constitutes a municipal advisor and would remove financial institutions from the proposed ill-defined definition. In the absence of this legislation we would strongly urge this Committee, as you are doing today, to conduct oversight of the SEC as it goes through the process of issuing a final rule. Such oversight would assure the results do not impose unnecessary costs and unintended consequences.

In my testimony today, I would like to focus on three key issues:

- The proposed rule goes beyond statutory intent.
- The final rule should avoid unnecessary regulatory duplication.
- Small communities would have reduced access to basic banking services under the current proposed rule.

I will discuss these items in detail below.

I. The Proposed Rule Goes Beyond Statutory Intent

ABA strongly believes banks were not intended to be covered by the provisions in Section 975. This sentiment is shared by members of Congress, including Congressman Kenny Marchant, former Vice-Chair of the Financial Institutions Subcommittee, who wrote to the SEC stating that the proposed rule goes beyond statutory intent. It seemed from the outset that the SEC agreed the focus would be narrow, as well. Martha Haines (the former head of the SEC's Office of Municipal Securities) had stated in a 2009 hearing before the rulemaking began that the focus would be on the 260 non-broker-dealer advisors. Congressman Bachus, Chairman of the full Financial Services Committee, reminded the SEC of that statement in a letter he wrote in 2009.

Aside from the letters and the hearing record, there are several points that illustrate that the focus of municipal advisor regulation should not be on regulated banks. First, Section 975 is an amendment to the Securities Exchange Act of 1934, which is intended to regulate transactions in the U.S. securities markets and the conduct of participants in those markets. In the Gramm-Leach-Bliley Act, Congress determined that banks should be able to continue to engage in traditional bank activities, already comprehensively regulated under the federal banking laws, without registering with the SEC as broker-dealers and subjecting themselves to the supervisory, examination and recordkeeping regime applicable to securities brokers and dealers. Indeed, Congress codified that determination in Section 3(a)(4)(B)(i)–(x) of the Exchange Act[1] by providing an express exemption from broker-dealer registration for a bank that effects transactions in identified banking products or other enumerated activities, including deposit-taking and lending, sweep accounts, trust and

[1] 15 U.S.C. §78c(a)(4)(i)-(x).

fiduciary, investment adviser, safekeeping and custody, municipal securities, and transfer agency activities. This exemption was later implemented in Regulation R.[2]

The SEC proposal would impose a wholly duplicative securities-based regulatory regime on the very activities that Congress determined were sufficiently regulated under banking law as to ***not*** to warrant SEC regulation. Such a regime serves no public purpose and would impose substantial costs on banks that will necessarily be passed on to municipal clients. The bottom line is that unless the final rule exempts bank activities, it is the municipalities—the very entities intended to be protected by Section 975—that will be harmed.

ABA's view is also supported by the statute itself. We believe that Congress did not include an exemption for banks because Congress was not thinking of banks' provision of advice to municipalities when it considered Section 975. This view is borne out by the fact that Section 975 amends a statute that provides for examination and enforcement by the bank regulators for those banks that act ***as municipal dealers***. Had Congress been thinking of banks ***as municipal advisors***, it surely would have provided for similar examination by the bank regulators. The fact that it did not is, we believe, because Congress did not intend banks—which are already comprehensively regulated—to be covered by a duplicative securities-based regulatory regime. Nor did Congress provide for a "separately identifiable department" or SID of a bank for municipal advisor activities as it did with respect to municipal dealer activities. A SID permits banks to segregate municipal dealer activities from the rest of the bank.

Another illustration of the fact that Congress was not thinking of banks when considering Section 975 is that the statute provides an exemption from registration for advisers who are required to register under the Investment Advisers Act. Banks that provide investment advice to any person—including municipalities—are exempt from registration under the Investment Advisers Act, because that activity is already sufficiently regulated under banking law. The fact that Section 975 exempts registered advisers because they are already regulated is strong evidence that the same was intended for banks.

We believe Congress' goal was to regulate entities whose municipal advisory activities were ***not*** subject to regulation and to do so by imposing only a single regulatory program on such activities. Heretofore unregulated financial advisors would be regulated by the SEC and the MSRB. The SEC's proposal, by contrast, would impose on bank municipal advisory activities a second and

[2] 17 C.F.R. Part 247.

different layer of regulation on top of federal bank regulation of those advisory activities, unlike the path followed for registered investment advisers.

II. The Final Rule Should Avoid Unnecessary Duplication

Banks provide depository services for municipalities or municipally owned entities, such as our local towns, schools, municipal hospital, airport, fire department, conservancy districts, water districts and others. In addition to providing depository and check services to these entities, banks also provide payroll ACH origination, ACH billing, municipal bond support, and more. It is not unusual for many different employees to assist these entities with CD renewals, payroll origination, payment of warrants and other activities that seem to be the target of their registration as proposed.

Subjecting large numbers of community bank employees to SEC registration, supervision and examination in order to continue to provide basic banking is nothing short of ridiculous. We are not providing these entities with "securities" advice, nor are we conducting any other activities that fall under the traditional registration guidelines of the SEC. And, these same employees would be required to take continuing education to remain registered and would be subject to a fiduciary duty.

Moreover, it is very common for bank employees to serve on one or more unpaid volunteer boards for these entities, including city council, city hospital board, city hospital foundation board, school board and city zoning board among others. Under the proposed rules, these employees would also be subject to registration as individuals and would have to comply with the full regulatory scheme described above. If this regulation is made final, it is likely that bank employees will have to stop some of these activities. This makes no sense and makes our communities poorer.

Let me make this very clear. All of the products and services described above—and more that my bank is too small to provide—***are already regulated and have no connection to municipal securities or "municipal financial products"*** as defined in Section 975 or intended by Congress to be reached by the provision. All of the above bank products are regulated extensively already, and the institutions providing them are supervised and regularly examined by the federal bank regulators.

Some of these products are offered within a bank trust department. For example, banks may serve as advisors to municipal pension plans. Individual municipal employees contribute their own funds to such plans—they are not related to the municipality's securities activities; nor do such funds contain the proceeds of municipal securities issuances. The trust departments of banks that

provide advice to municipal pension plans must adhere to the highest standards of fiduciary common law. Moreover, bank trust departments are regularly examined in accordance with such requirements. Indeed, they are examined far more frequently than are investment advisers regulated by the SEC. In addition, many bank products and services offered to municipalities are overseen by state treasurers. ***To impose on these traditional bank products and services an overlay of securities law regulation when offered to municipalities serves no public purpose.***

In addition, the MSRB has proposed guidance on the fiduciary duty of municipal advisors (now withdrawn until the SEC finalizes its registration rule) that would prohibit, as a conflict of interest, a bank that provides a service to a municipality from offering any other service as principal to the municipality. This would lead to absurd results. For example, under the proposed rule, a bank that provided advisory services to a municipal pension plan would be unable to offer deposit accounts to that municipality.

Recordkeeping reporting requirements present another enormous problem should the rule be adopted. The current reporting requirements for banks have long been in place and are tailored to bank structure, capital requirements, and banking activities. The municipal advisor regulatory scheme, by contrast, is a securities-based regime based on traditional investment adviser structures. The cost of complying with a markedly different recordkeeping and reporting system would be substantial and would necessarily be passed on to customers. Further, because of the dispersion throughout a bank of business with municipalities, the entirety of a bank's recordkeeping would become subject to SEC oversight, a result so unnecessarily duplicative of the banking agencies' functions that it begs the question as to what public purpose can be served by such excessive reach.

We believe that the SEC, in its final rule, must state clearly that banks are not covered by Section 975, thus avoiding duplicative oversight by yet another regulatory agency.

III. Small Municipalities Would Have Reduced Access to Basic Banking Services

Let me use another illustration to help you understand just how onerous this new rule could be, if it is implemented in its current form. It is quite common for someone from a public entity to come into a bank branch asking how to set up a simple service, such as a deposit or sweep account. Tellers in that office could give them the basic information about these accounts, although often a branch manager would fill them in on the details.

If this proposal is made final as is, these two activities—both the basic explanation of a deposit account and the detailed one—could require both the teller and the branch manager to be registered as municipal advisors. Not only would they both have to be registered, along with the bank, but the bank itself would then have to undergo scrutiny by yet another regulator—with its own unique set of regulatory standards.

Moreover, if the final rule does not exempt banks and, further, does not provide a definition of advice, banks could be required to register thousands of employees, each of whom would be subject to continuing education requirements established by the MSRB and each of whom would be subject to a fiduciary duty to municipal customers.

Our compliance office is already facing an uphill battle to implement the plans needed to ensure we are compliant with all of the new rules coming from Dodd-Frank. If a new registration, reporting and compliance obligation were to be added, many banks would have to seriously consider whether to continue to provide services—even simple depository services—to the government entities in our community.

It makes no sense whatsoever to create a duplicative system that will end up raising the cost of services to municipal entities, reducing the services available, or forcing some banks to exit the market completely to avoid registration. Such outcomes are unnecessary and benefit neither the bank nor its community.

Conclusion

Section 975 is the result of Congress' intent to impose a regulatory regime on municipal advisory activities that were not previously regulated. To overlay onto traditional bank activities an additional, markedly different securities law regulatory regime and an additional regulator is not in the public interest. It will not provide additional protections for municipal governments, but rather will increase the cost and impair the availability of bank products and services to those bodies. An exemption from registration as municipal advisors must be provided to banks.

We strongly support H.R. 2827 which would clarify what constitutes a municipal advisor and would remove financial institutions from the proposed, ill-defined and inappropriate definition. We urge Congress to enact this important piece of legislation.

Thank you for considering our comments. I am happy to answer any questions.