

Testimony of
America's Community Bankers
on
Financial Services Regulatory Relief Act of 2002
before the
Subcommittee on Financial Institutions and Consumer Credit
of the
Committee on Financial Services
of the
U.S. House of Representatives
on
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and
Chairman
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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

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.

associations are each required to apply and await regulatory approval before opening new branches. This process unnecessarily delays institutions' plans to increase competitive options and increase services to consumers, while serving no important public policy goal. In fact, these requirements are an outdated holdover from the times when regulatory agencies spent 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."

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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 it 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.