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Regulation Comments
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Washington, DC 20552
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Re: **FDIC** 12 CRF Chap. III; **FRB** Docket No. R–1151; **OCC** Docket No. 03–10: **OTS** Docket No. 2003–20; Agency Compliance with Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996; 68 Federal Register 35589; June 16, 2003

Ladies and Gentlemen:

Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) requires the federal banking agencies (the "Agencies") to review their regulations at least once every 10 years in an effort to find more streamlined and less burdensome ways to regulate. The Agencies intend to conduct their first EGRPRA review in a three-year joint effort under the umbrella of the Federal Financial Institutions Examination Council (FFIEC). The Agencies have now published the first request for comment from the industry and the public, seeking comment not only on specific regulatory categories but also on their procedures for EGRPRA review. Regulatory burden adversely affects all members of the American Bankers Association. The American Bankers Association 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 bank holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest bank trade association in the country.

Part I: Comments on the Agencies' Plan for Compliance with EGRPRA

EGRPRA requires the agencies to categorize the regulations; publish the categories for comment; report to Congress on any significant issues raised by the comments, including recommendations for legislative changes; and eliminate unnecessary regulations. The Agencies have identified regulations in over 100 subjects, and they have divided these into 12 categories. The Agencies intend to seek public comment on the regulations in these12 categories between now and 2006. The categories, in alphabetical order, are Applications and Reporting; Banking Operations; Capital; Community Reinvestment Act; Consumer Protection; Directors, Officers and Employees; International Operations; Money Laundering; Powers and Activities; Rules of Procedure; Safety and Soundness; and Securities.

In fact, the Agencies have held several regional banker outreach meetings to solicit input to this process. ABA staff have participated in these meetings, and we make two observations from them. First, most bankers have seen previous efforts at regulatory relief come and go without noticeable effect, while the overall level of regulatory burden has kept rising. Thus most bankers participating in these outreach meetings have little expectation that there will be any significant reduction in the overall regulatory burden. Nonetheless, bankers and regulators are somewhat more optimistic about this effort, since the Congressional mandate encompasses more than just regulatory action: it calls for the Agencies to advise the Congress on unnecessary burden imposed by statute, which the Agencies cannot change but the Congress can.

Second, it is clear from the comments of bankers at these meetings so far that the overwhelming amount of burden is in the statutes and regulations classified by the Agencies as Consumer Protection and Money Laundering. This corresponds with the most recent increases in regulatory burden: recent additions to the burden include massive new HMDA reporting requirements, annual privacy notices, and massive new U. S. Patriot Act requirements, including customer identification programs, mandated responses to urgent law enforcement information requests, etc. In fact, it appears that the great bulk of comment and suggestions for reduction in regulatory burden will fall into these two categories. Rather than overconcentrate the review process in just one 90-day comment period, ABA instead recommends that the scheduled plan for the EGRPRA review be changed to further divide the Consumer Protection and Money Laundering categories into several smaller categories, which would provide more time for review of by our members.

Overall the ABA supports the approach taken by the Agencies in meeting the requirements of Section 222 of EGRPRA and intends to work with its member bankers to provide the Agencies with further suggestions for improvement in their regulations. Recommendations on the first three categories of regulations follow.

Part II: Comments on the First Three Categories of Regulations

As part of the June 16 publication, the Agencies are requesting comments on three categories of regulations: Applications and Reporting, Powers and Activities, and International Operations. Although ABA consulted with a number of its banker committees and used every one of its communications avenues to solicit comment, bankers offered relatively few suggestions for regulatory burden relief in these categories. ABA believes that this is due in large measure to the efforts of the Agencies over the last several years to put their regulations into plain English and to reduce burden. In fact, the Agencies have made considerable progress in the last five years in improving some of their regulations. Examples of regulatory review and rewriting that have made significant improvement in clarity, consistency and burden reduction include the Federal Reserve Board's revisions to their applications regulations, the revisions to Regulation Y on bank holding company and financial holding company regulation, and the addition of Regulation W as a guide to the provisions of Sections 23A and 23B of the Federal Reserve Act on restrictions on transactions with affiliates. The FDIC has made significant improvements in its applications procedures and its deposit insurance coverage regulations. The OCC has made considerable improvements in its applications procedures and in its provisions on Public Welfare Investments. And the OTS has made significant improvement in its applications procedures. We believe that the Agencies should be commended for these efforts to reduce regulatory burden. Nonetheless, not all of the Agencies' regulations have been so revised, and so ABA does offer some recommendations for regulatory burden relief under this request for comments.

1. Applications and Reporting

Interagency Regulations

<u>The Bank Merger Act:</u>

First, there continue to be differences between the application of bank merger standards by the Agencies on the one hand and the Department of Justice on the other. Bankers and merger attorneys have told us that at times this almost creates two separate application processes. While the Department of Justice is not covered under the EGRPRA review, we urge the Agencies and the Department of Justice to make more consistent their standards for merger review. If they cannot, we would urge the Agencies to request that the Congress give the Agencies sole authority to conduct bank and savings association merger reviews.

Second, ABA has requested several times that the Federal Reserve Board include credit union deposits in its analysis of mergers using the HHI screen. The FRB continues to only consider credit union deposits as a mitigating factor in the much more rigorous review of a merger application after it has failed the HHI screen. The Board has stated that it would continue to include credit unions in merger analysis only on a case-by-case basis since credit unions were not yet a significant factor in business lending to merit automatic inclusion into the competitive analysis of bank mergers. However, a case-by-case analysis requires considerably more effort on the part of the merger applicant in preparing the application and responding to the competitiveness questions of the FRB before such an analysis will fully consider the impact of credit union competition in the financial services market.

Since that last correspondence, credit union business lending and services have continued to grow. According to the Credit Union National Association's <u>2001 Credit Union Services Profile</u>, 30% of credit unions, comprising 45% of total credit union members, now offer business services for members. Of these, 85% offer business checking (on which credit unions may pay interest and banks may not -- a significant competitive advantage) and over one-third make business loans. Additionally, business lending is the fastest growing line of business for credit unions in 2001, and this is likely to accelerate, given recent changes in the credit union profile. First, due to a relaxation in the rules, a number of credit unions are adopting a "community charter" that will allow them to offer services to more businesses in their communities. Second, the Small Business Administration has recently amended its Section 7a regulations to allow credit unions to make these popular SBA business loans. All of this leads ABA to conclude that it is time that the FRB recognize that credit unions are full competitors with banks in the financial services marketplace and change the FRB's merger analysis to fully include credit unions.

FDIC Regulations

Call Reports and Other Forms, Instructions and Reports

At every banker outreach meeting so far, the burdens of the Call Report (properly the Consolidated Reports of Condition and Income) have been cited as an area for regulatory relief. Bankers at these meetings recall when the Call Report was only 10 pages, or six pages, or one banker recalls that when he started banking the entire Call Report was only two pages. Today's Call Report for a small community bank, as posted on-line, is 41 pages, containing hundreds of items and the Instructions are 415 pages. It is a widely held belief of bankers that much of the Call Report is not necessary for supervision but rather is useful for economists and statisticians, who have never met a datum that they did not like and want to keep getting reported, no matter the burden. Therefore, first our bankers request the Agencies to conduct a thorough review of the Call Report to cull items not necessary for supervision.

However, since Call Reports are largely automated today, the removal of some small amount of unnecessary burden may be more burdensome that leaving the Call Report alone. The real concern about unnecessary burden lies in the addition of more items for reporting. One example of this problem concerns the reporting of insurance revenue. In 2001 the Agencies added to the Call Reports certain items for the reporting of insurance revenue. In October 2002, a group of bankers from ABA's affiliate, the American Bankers Insurance Association, wrote to the FFIEC's Call Report Task Force with requests for changes in the reporting items and instructions, to reduce the reporting burden and confusion of these new items. (A copy of the letter is attached.) The bankers pointed out that the Call Report appeared to mix statutory reporting for insurance purposes with GAAP reporting for bank purposes, resulting in a fundamentally incompatible reporting item. Further, the bankers recommended that the FFIEC actually add items to the Call Report, in order to make the items reported correspond better to banks' own internal reporting and monitoring. We note that the FFIEC Call Report Task Force was extremely cooperative and made some of the suggested changes for the 2003 Call Reports. However, the ABIA bankers believe that further improvements can be made in line with their 2002 letter, and they urge the FFIEC to adopt the other recommended changes. ABA believes that this example illustrates the real burden of the Call Report today: the expense and effort of adding items and the need for the Agencies to ensure that any new items added to the Call Report correspond as closely as possible to banks' own reporting.

Bankers also suggest that the number of signatures for the Call Report, including three directors, is excessive and unduly burdensome. Finally, bankers believe that penalties for errors in the Call Report are excessive, particularly with respect to items not necessary for supervision, and cause undue apprehension in bank directors and executive officers.

Mutual-to-Stock Conversion

See listing under OTS.

OTS Regulations

<u>Mutual-to-Stock Conversion</u>

ABA's Committee on Mutual Savings Associations has developed a number of ideas for reducing the burden in these conversions. A brief summary of these follows and we will provide more detail upon request:

The OTS currently permits the formation of an intermediate stock MHC, but only a federally chartered one. The OTS should permit such intermediate MHCs to be state chartered. We believe that there is no compelling legal or supervisory reason to require federal chartering. This would permit MHCs to take full advantage of state limited liability and indemnification laws available to fully converting institutions and also would facilitate state MHCs converting to federal charter without the cost and expense of shareholder approval to change from state to federal stock MHC.

While the OTS has indicated that it is acceptable for mutuals to set up phantom stock type plans, the OTS provides no "road map" to address and surmount the regulatory implications of such plans, i.e., how is the "stock" valued, what are the permissible amounts that can be granted to officers and directors individually or as a group, what are appropriate vesting periods, etc. and so on. We urge the OTS to provide a comprehensive "road map" that addresses tax, ERISA and accounting issues, as well as regulatory issues.

OTS should provide a streamlined regulatory process for small thrifts to be able to undertake MHC and full conversions. The regulatory burden of conversion requirements falls heaviest on the smaller institutions, and we believe special consideration should be given to them.

Finally, the OTS and FDIC should articulate a fully synchronized and consistent policy regarding merger conversion of small institutions. Recent transactions pointed out the business uncertainty and potential regulatory arbitrage created by unclear government polices regarding such transactions, and when permitted, permissible features of such transactions such as depositor payouts. Also, the OTS' policy of carefully reviewing transactions of greater than $25 million in assets is being perceived by many as a *de facto* moratorium on all such merger conversions. Requiring mutual institutions with less than $50 million in assets to undertake a costly mutual to stock conversion under circumstances where the company's stock will in all likelihood be illiquid and unable to maintain listing on the NASDAQ for three years, as the OTS requires "best efforts" to do, does not seem practical.

<u>II. Powers and Activities</u>

<u>OCC</u>

<u>Debt Cancellation Contracts and Debt Suspension Agreements</u>

Earlier this year the OCC's new rules on DCC and DSA became effective. Just before that, the OCC temporarily suspended certain portions of the rule as they related to the requirement that the bank offer a periodic payment option and associated disclosures to DCCs and DSAs sold by unaffiliated, non-exclusive third parties in connection with closed-end consumer loans. The reason for the delay was that these requirements would have had the unintended consequence of reducing automobile loans by national banks, and would, in turn, limit financing alternatives for consumers, since national banks were being told by third parties that they would not offer DCC or DSA in connection with their loans, if these requirements were in effect.

ABA and its affiliate the American Bankers Insurance Association filed comments urging the OCC to make permanent this temporary suspension. We further recommended that the OCC extend the scope of its exception to the requirements of the regulation to eliminate the periodic payment option and related disclosures for all closed-end consumer loans, other than real estate loans, regardless how such loans are sold. These requirements were not part of the originally proposed regulation, go farther in their scope than similar credit-related insurance requirements (which typically only require periodic payment coverage for real-estate secured loans), and have the practical effect of eliminating single-fee DCCs and DSAs on consumer loans. We believe that this result places an enormous regulatory burden on national banks by effectively barring them from providing these contracts in many circumstances. The final decision on this interim suspension is still pending, and so we reiterate our recommendations from our comment letter of July 14, 2003.

FRB

Holding Companies (Regulation Y):

The American Bankers Association has requested several times that the Board increase the existing limit of less than $150 million in assets set in the Board's Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors. Among other things, this policy allows holding companies below $150 million in banking assets significantly higher levels of debt leverage than is allowed for larger holding companies. The Board adopted the Policy Statement originally in 1972, largely to assist in the formation of small bank holding companies and to assist, as it states in the policy, "existing small bank holding companies that wish to acquire an additional bank or company and [in] transactions involving changes in control, stock redemptions, or other shareholder transactions." While the Board has updated the Policy Statement in several areas, most importantly in the 1997 revision of Regulation Y, the $150 million limitation has remained constant. ABA believes that in the 30 years since the adoption of the Policy Statement the world in which community banks operate has markedly changed. For one, $150 million in 1972 is over $659 million today. ABA believes that inflation and changes in the financial services industry require that the Policy be updated to allow larger community bank holding companies to avail themselves of the advantages offered by the Policy.

The majority of ABA's members are community banks. Over the last few years, ABA has increasingly heard from these members that they believe that the Board's Policy needs to be updated if they are to have any ability to survive in this era of bank consolidation. They have suggested not only that the limit needs to be increased but also that the debt-to-equity ratio for small BHCs should also be increased. If the policy is to be meet its stated goal of providing meaningful assistance to community banks in making acquisitions and other shareholder transactions, then it must be updated to the realities of today's market. The retention of this unreasonably low and outdated threshold of $150 million greatly burdens community banks over that threshold. ABA recommends that the threshold be raised to at least $500 million in assets.

State Member Banks (Regulation H):

With respect to state member banks, ABA has long objected to the Board's refusal to recognize the application of Citicorp v. Board of Governors of the Federal Reserve System[1] outside of the territorial ambit of the 2nd Circuit Court of Appeals. Citicorp held that a subsidiary of a bank was not a subsidiary of the bank holding company for purposes of regulations of the Board restricting activities of that holding company. However, because state member banks must apply under Regulation H to conduct additional activities in a subsidiary but state nonmember banks do not have to so apply, the Board's policy creates disparate treatment between subsidiaries of state member banks in holding companies and subsidiaries of state nonmember banks. ABA believes that this flies in the face of clear case law rejecting the legal theory of the FRB. Worse, it has the FRB, as regulator of state member banks, denying the conduct of an activity that has already been approved by the FDIC for state nonmember banks. This is inconsistent and unnecessary, especially when it prevents agency activities authorized by state law and recognized by the FDIC as not posing any safety and soundness concerns to the deposit insurance funds.

As a result of the Board's refusal to accept Citicorp outside of the 2nd Circuit, the Federal Reserve Bank of Richmond recently has refused to allow a subsidiary of a state member bank to conduct an activity that is not authorized for a bank holding company to conduct but is authorized for a subsidiary of a Virginia state bank to conduct.[2] ABA believes that that Board's position on this is simply incorrect and unduly burdensome on state member banks in states outside of the 2nd Circuit. ABA urges that the Board finally accept the ruling in the Citicorp case and instruct its District Banks outside of the 2nd Circuit to follow the law as it is observed by the FRB in the states of the 2nd Circuit.

Sincerely,

Paul Alan Smith

Paul Smith
Senior Counsel

[1] Citicorp v. Board of Governors, 936 F. 2d 66 (2d Cir. 1991), *cert. denied sub. nom.* Independent Insurance Agents of America v. Citicorp, 502 U.S. 1031 (1992).
[2] The activity is real estate brokerage, a newly authorized state bank activity for Virginia. See the text of the letter from the Virginia Bankers Association dated July 16, 2003, to the Federal Reserve Bank of Richmond, attached.