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September 16, 2005

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: **FDIC RIN 3064-AC91**; Proposed Revision of Part 363 - Annual Independent Audits and Reporting Requirements; 70 Federal Register 44293; August 2, 2005

Dear Mr. Feldman:

The Federal Deposit Insurance Corporation (FDIC) proposes to amend its regulations on annual independent audits and reporting requirements (12 CFR Part 363) to increase the asset size above which banks and savings associations are required to have internal control assessments by bank management and attestation by the external auditors of those assessments from \$500 million to \$1 billion. The FDIC also proposes to make the same increase in the asset threshold for the requirement that banks have only independent directors serve on their audit committees. The proposal will reduce the regulatory burden and audit expenses of approximately 580 institutions and lower the total regulatory burden hours associated with these requirements by approximately 45%.

The American Bankers Association (ABA) strongly supports the proposal. ABA, on behalf of the more than two million men and women who work in the nation's banks, 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.

Analysis

The FDIC adopted the current provisions of Part 363 in 1993, as a result of the FDICIA of 1991 enacting the audit requirements of Section 36 of the FDI Act. Section 36 set the asset threshold for these audit requirements at \$150 million, but authorized the FDIC to adopt a higher threshold, if appropriate. In 1993, the FDIC determined that it was appropriate for the industry at that time to adopt an audit threshold of \$500 million. This resulted in about 1000 larger institutions holding some 75% of industry assets being subject to the new audit requirements.

There have been significant changes in the industry and the law since 1993. Today, due to industry consolidation and inflation, the more than 1100 institutions with assets in excess of \$500 million hold approximately 90+ percent of the industry assets.

The second significant change has been the enactment of the Sarbanes-Oxley Act (SOX) in 2002 to strengthen corporate governance and accountability for all publicly-held corporations. The concepts underlying Section 404 of SOX on attestations as to internal controls and accounting in fact came from the corporate governance and accountability provisions applied to banks and savings associations by FDICIA. As a result, banks and savings institutions with assets over \$500 million that were publicly held are subject to both the FDIC Part 363 requirements and to the SOX requirements, which, while similar, are not identical. For those institutions, this has resulted in a costly and burdensome duplicative reporting and auditing system.¹ By raising the asset threshold to \$1 billion, the FDIC states that it believes that this would lower burden on these smaller institutions while still retaining these requirements on approximately 86% of industry assets, more assets than were originally covered by the FDIC's \$500 million threshold when adopted.²

Many banks and savings associations over \$500 million but under \$1 billion that are not publicly held report that their auditors have applied SOX-like requirements to them even though SOX does not apply. They also report that auditors have required them to greatly increase their documentation before the auditor will provide the required attestations. These banks and savings associations have also had their audit costs double, triple, and in some cases quintuple, according to what ABA has been told by bankers at numerous banker meetings. Further, a number of them report that the experience level of their audit teams has declined while charges have risen. Some have even had to get new auditors, as their current auditors resigned in order to meet the higher demand for services at larger clients.

Community financial institutions also report increasing difficulties in staffing audit committees with independent, outside directors. Guideline 28 of Appendix A to part 363 provides that a determination of whether a director is independent of management requires consideration of whether the director:

- a) Is or has been an officer or employee of the institution or its affiliates;
- b) Serves or served as a consultant, advisor, promoter, underwriter, legal counsel, or trustee of or to the institution or its affiliates;
- c) Is a relative of an officer or other employee of the institution or its affiliates;
- d) Holds or controls, or has held or controlled, a direct or indirect financial interest in the institution or its affiliates; and
- e) Has outstanding extensions of credit from the institution or its affiliates.

Further, Guideline 29 provides that an outside director would not be independent if the director was, or had been within the preceding year, an officer or employee of the institution. In smaller communities, these restrictions greatly reduce the number and quality of potential directors and audit committee members. For some of these institutions, finding persons who have the financial

¹ The SEC implementation of Section 404 does allow banks and savings institutions subject to both FDIC audit and reporting requirements and to Section 404 to file a combined report that satisfies both requirements; nonetheless, this requires considerably more work and planning to achieve. We note that some auditors have taken the position that the SEC could not speak for the FDIC on this, and so have been unwilling to prepare a combined report. With this proposal, the FDIC has confirmed that a combined report satisfies its requirements as well. ABA appreciates this confirmation by the FDIC.

² Institutions over \$500 million would still be subject to the other requirements of Part 363, including the requirement for an annual independent audit.

knowledge necessary to serve as an audit committee member and who are also “independent of management” as required by Part 363 has become difficult and, in some cases, almost impossible.

Conclusion

After hearing of bankers’ difficulties with Part 363’s requirements, the American Bankers Association began urging the FDIC to raise the threshold to \$1 billion for these requirements. ABA specifically requested this last in our May 4, 2005, comment letter on Round Three of the banking agencies’ regulatory review under Section 226 of the Economic letter to the agencies on EGRPRA (May 4, 2005). ABA is very pleased that the FDIC has carefully considered this issue and proposed to make these changes. We concur with the FDIC that these changes will greatly reduce the regulatory burden on these institutions arising from the requirements of Part 363 without sacrificing safety and soundness. ABA strongly supports the FDIC’s proposal and urges the FDIC to adopt and implement it before year-end.

If there are any questions about these comments, please call the undersigned.

Sincerely,

A handwritten signature in black ink that reads "Paul Alan Smith". The signature is written in a cursive, flowing style.

Paul Smith
Senior Counsel