Statement
of
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Federal Deposit Insurance Corporation
On
Consideration of Regulatory Reform Proposals
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Housing and Urban Affairs
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Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee, I very much appreciate this opportunity to testify on our efforts to reduce unnecessary regulatory burden on the nation's banks and the regulatory review process mandated by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). As a former community banker with 23 years of experience in the industry, and as the current leader of the inter-agency effort to reduce regulatory burden, I have a strong personal commitment to eliminate all unnecessary burden while maintaining the safety and soundness of the industry and protecting important consumer rights.

My testimony will discuss the accumulation of regulations over the years and their impact on the nation's financial institutions. Next, I will outline our efforts to review our regulations and address, on an inter-agency basis, some of the existing regulatory burden, as mandated by EGRPRA. I will describe some actions the Federal Deposit Insurance Corporation (FDIC) is taking internally to reduce burdens imposed by our own regulations and operating procedures. Finally, I will review the need for legislative action to reduce burden and outline some legislative proposals we are discussing with the other agencies.

The Accumulation of Regulations and their Impact on the Nation's Banks
Regulatory burden is clearly an issue for all FDIC-insured institutions. Since enactment of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) in 1989, the bank and thrift regulatory agencies have promulgated a total of 801 final rules. There were good and sufficient reasons for many of these rules and, in fact, some were actually sought by the industry. However, 801 regulatory changes over a 15 year period is certainly a lot for banks to digest, particularly smaller community banks with very limited staff. Rule changes can be quite costly since implementation often requires computers to be reprogrammed, staff retrained, manuals updated and new forms produced. Even if some of the rules do not apply to a particular institution, someone has to at least read the rules and make that determination.

While there are no definitive studies of the total cost of regulation, a survey of the evidence by a Federal Reserve Board economist in 1998 found that total regulatory costs account for 12 to 13 percent of banks' noninterest expense, or about $36 billion in

2003 ("The Cost of Bank Regulation: A Review of the Evidence," Gregory Elliehausen, Federal Reserve Bulletin, April 1998). For the banking industry, every change in reporting requirements or modification of business practices involves new capital expenditures and increased human resources, computer programming costs and vendor expenses. The same research indicates that start up costs for new or changing regulations may be very expensive and insensitive to the size of the changes. In other words, the process of learning about and adopting regulatory changes is expensive for banks, whatever the magnitude of the change. Frequent small, incremental changes may be much more expensive than large, one time changes.

While my strong personal view is that regulatory burden has a disproportionate impact on community banks, which I discuss below, we are committed to addressing the problem of regulatory burden for every insured financial institution. Banks, large and small, labor under the cumulative impact of regulations that divert resources and capital away from economic development, credit extension and job creation. Most of the proposals we are examining would provide significant relief to all financial institutions and I commend the Committee for its attention to this pressing issue.

The Impact of Regulatory Burden on Community Banks

New regulations have a greater impact on some community banks, especially small community banks (under $100 million in assets), than on larger institutions due to their inability to spread start up and implementation costs over a large number of transactions. Economies of scale associated with regulatory compliance have been confirmed in implementation cost studies of the Truth in Savings Act, the Equal Credit Opportunity Act and the Electronic Funds Transfer Act, where the incremental cost of regulation declines as the number of transactions or accounts rise. Jim Hance, Vice Chairman of Bank of America, summed the situation up at a recent conference at the Federal Reserve Bank of Chicago: "[A]ll banks are being mandated to install more and more compliance-related technology—for issues ranging from anti-money laundering to Basel II. Scale allows us to do so far more efficiently than smaller competitors."

The magnified impact of regulatory burden on small banks is a significant concern to me. As a former community banker, I know the importance of community banks in our economy. Community banks play a vital role in the economic wellbeing of countless individuals, neighborhoods, businesses and organizations throughout our country, often serving as the lifeblood of their communities.

These banks are found in all communities—urban, suburban, rural and small towns. Whether a minority-owned urban neighborhood institution or an agricultural bank, community banks have several things in common. They are a major source of local credit. Data from the June 2003 Call Reports shows that the overwhelming share of commercial loans at small community banks were made to small businesses. In addition, the data indicate that commercial banks with assets between $100 million and $1 billion account for a large share of all small business and small farm loans.

Community banks are the bankers for municipalities and school districts. Community bankers generally know personally many small business owners and establish lending relationships with these individuals and their businesses. These small businesses, in turn, provide the majority of new jobs in our economy. Small businesses with fewer than 500 employees account for approximately three-quarters of all new jobs created every year in this country. The loss of community institutions can result in losses of civic leadership, charitable contributions, and local investment in school and other municipal debt.

My concern is that the volume and complexity of existing banking regulations, coupled with new laws and regulations, may ultimately threaten the survival of our community banks. This concern is not new. The conclusion of the 1998 Federal Reserve study states:

- Average compliance costs for regulations are substantially greater for banks at low levels of output than for banks at high levels of output. This conclusion has important implications. Higher average regulatory costs at low levels of output may inhibit the entry of new firms into banking or may stimulate consolidation of the industry into fewer, larger banks.

Over the last 20 years, there has been substantial consolidation in the banking industry. This can be seen most dramatically in small community banks. At the beginning of 1985, there were 11,780 small community banks with assets of less than $100 million in today's dollars. At year end 2003, their number had dropped by 63 percent to just 4,390 (see Chart 1). Even more dramatically, the total market share of those institutions decreased from nine percent at the beginning of 1985 to two percent at yearend 2003 (see Charts 2 and 3). The decline had three main components: mergers, growth out of the community bank category, and failures. The decrease was offset somewhat by the creation of more than 2,400 new banks. In the above calculations, bank asset size was adjusted for inflation. Thus, a bank with $100 million in assets today is compared with one having about $64 million in assets in 1985.

A number of other market forces, such as interstate banking and changes to state branching laws have affected the consolidation of the banking industry. The bank and thrift crisis of the 1980s and the resulting large number of failures and mergers among small institutions serving neighboring communities also contributed to the decline in the smallest financial institutions. It is probable that together those factors were the greatest factors in reducing small bank numbers. However, I believe that in looking to the future, regulatory burden will play an increasingly significant role in shaping the industry and the number and viability of community banks. While many new banks have been created in the past two decades, I fear that, left unchecked, regulatory burden may eventually pose a barrier to the creation of new banks. Keeping barriers to the entry of new banks low is critical to ensuring that small business and consumer wants and needs are met, especially as bank mergers continue to reduce options in some local markets.

It may seem a paradox to discuss profitability concerns at a time when the banking industry is reporting record earnings. Last year the industry as a whole earned a record $120.6 billion, surpassing the previous annual record of $105 billion set in 2002. When you look behind the numbers, however, you see a considerable disparity in the earnings picture between the largest and smallest banks in the country. The 110 largest banks in the country (those with assets over $10 billion), which represent 1.2 percent of the total number of insured institutions, earned $87.7 billion or about 73 percent of total industry earnings, while the 4,390 banks with assets under $100 million, which represent 48 percent of the total number of insured institutions, earned about $2.1 billion, which represents only 1.7 percent of total industry earnings (see Chart 4). Moreover, when you further examine the data, you find that banks with assets over $100 million had an average return on assets (ROA) of 1.39 percent, while those with assets under $100 million had an average ROA of 0.95 percent (see Chart 5).

While the banks under $100 million had the highest yield on earning assets (5.86 percent) they also had the lowest non-interest income (1.43 percent), and the highest noninterest expense to asset ratio (3.71 percent). This combination resulted in about one in ten banks under $100 million in assets being unprofitable in 2003. This is almost five times the ratio for banks between $100 million and $10 billion and almost ten times greater than the largest banks. These numbers make it clear that community banks, while healthy in terms of their supervisory ratings, are operating at a lower level of profitability than the largest banks in the country. At least part of this disparity in earnings stems from the disproportionate impact that regulations and other fixed noninterest costs have on community banks (see Chart 6).

Bankers are becoming increasingly worried that their institutions—and all that they mean to their communities—may not be able to operate at an acceptable level of profitability for their investors for too many more years under what they describe as a "never-ending avalanche" of regulations. In some cases, the cost of complying with that burden is pushing some smaller banks out of the market. As reported in the American Banker (May 25, 2004), regulatory burden was an important factor in the decision by two community banks to sell their institutions. One bank CEO of a consistently high performing community bank confided that at a recent meeting of his bank's board, the institution's directors remarked that the bank's return on assets had been slipping in recent years, in part attributable to the increasing costs of compliance, and asked how much longer the bank can afford to remain independent without giving consideration to maximizing current shareholder value through a merger or sale. These conversations are likely occurring in community bank boardrooms all over the United States today.

An additional challenge bankers face is maintaining the capacity to respond to the steady stream of new regulations while continuing to comply with existing regulations. Some of the new regulations and reporting requirements facing the industry include those required by the FACT Act legislation enacted by Congress last year, USA PATRIOT Act, the Sarbanes-Oxley Act, and the Check 21 Act. These laws reflect important public policy choices concerning, for example, the quality of the credit reporting system, identity theft, national security and changes in technology. However, it

is incumbent upon the regulators who write implementing regulations, as well as the Congress, to be mindful of the need to avoid unnecessarily increasing regulatory burdens on the industry as we implement new reporting requirements and regulations required by legislation.

It is not just the total volume of regulatory requirements that pose problems for banks, but also the relative distribution of regulatory burden across various industries that could hit community banks hard in the future. For example, community bankers are increasingly subject to more intense competition from credit unions, which have, in many cases, evolved from small niche players to full-service retail depository institutions. In the past ten years, the number of credit unions with assets exceeding $1 billion has increased four-fold, from 20 institutions in 1994 to 87 institutions today and the credit union industry continues to grow nationwide. With ever-expanding fields of membership and banking products, credit unions are now competing head-to-head with banks and thrifts in many communities, yet the conditions under which this competition exists enable credit unions to operate with a number of advantages over banks and thrifts. These advantages include exemption from taxation, not being subject to the Community Reinvestment Act, and operation under a regulatory framework that has supported and encouraged the growth of the credit union movement, including broadening the "field of membership." These advantages make for an uneven playing field, a condition that Congress should reexamine and seek to resolve.

I am a strong proponent of market forces determining economic outcomes. If community banks lose out in a fair and square competition with competing institutions, so be it - let the market speak and the chips fall where they may. But if smaller banks are weakened in the market not by competition or technology, but inadvertently or unintentionally by the disproportionate effect of regulatory burden, that outcome seems to be inequitable and unfortunate. We need to be vigilant and careful to assure the appropriate public policy response to prevent this outcome.

As you can tell, I have some serious concerns about the future of community banking, and I see regulatory burden as an important factor in the equation for their future success. I personally believe the stakes are high for community bankers in this fight to reduce regulatory burden, and the very future of community banking may well depend on the success of our efforts.

Inter-Agency Effort to Reduce Regulatory Burden

In 1996, Congress passed the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). Section 2222 of EGRPRA requires the Federal Financial Institutions Examination Council (FFIEC) and each of its member agencies to review their regulations at least once every ten years, in an effort to eliminate any regulatory requirements that are outdated, unnecessary or unduly burdensome. Last year, FDIC Chairman Don Powell, as Chairman of the FFIEC, asked me to oversee this inter-agency effort. I accepted with enthusiasm.

From the beginning of this process, each of the agency principals- Chairman Powell, Comptroller Hawke, Director Gilleran, Governor Bies and former Chairman Dollar-have given their full support. We also have received enthusiastic cooperation and support from the Conference of State Bank Supervisors (CSBS) and the national and state trade associations in working towards regulatory burden relief. We established an inter-agency EGRPRA task force consisting of senior level staff from the Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), National Credit Union Administration (NCUA), and the FDIC. Under the EGRPRA statute, the agencies are required to categorize their regulations by type (such as "safety and soundness" or "consumer protection" rules) and then publish each category for public comment. The inter-agency task force divided the agencies' regulations into the following 12 categories (listed alphabetically):

- 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

The agencies agreed to put one or more categories out for public comment every six months, with 90-day comment periods, for the remainder of the review period (which ends in September, 2006). Spreading out comments over three years will provide sufficient time for the industry, consumer groups, the public and other interested parties to provide meaningful comments on our regulations, and for the agencies to carefully consider all recommendations.

The agencies published their first joint EGRPRA Federal Register notice on June 16, 2003, for a 90-day comment period, seeking comment on our overall regulatory review plan, including the way in which we categorized the regulations. The first notice also requested burden reduction recommendations on the initial three categories of regulations: Applications and Reporting; Powers and Activities; and International Operations. These three categories of regulations contained 48 separate regulations for comment. In response, the agencies received 19 written comments that included more than 150 recommendations for changes to our regulations. Each of the recommendations has been carefully reviewed and analyzed by the agency staffs. Based on the recommendations, staff will bring forward proposals to change specific regulations, as appropriate, which will be put out for public comment.

On January 20, 2004, the agencies issued their second joint request for comment under the EGRPRA program. This notice sought public comment on the lending-related consumer protection regulations, which include Truth-in-Lending (Regulation Z), Equal Credit Opportunity Act (ECOA), Home Mortgage Disclosure Act (HMDA), Fair Housing, Consumer Leasing, Flood Insurance and Unfair and Deceptive Acts and Practices. The comment period for that notice closed on April 20, 2004 and staff is currently analyzing the comment letters received to determine which recommendations to pursue. Even though the second Federal Register notice contained far fewer regulations for comment than the initial notice, the agencies received over 570 comment letters.

Banker, consumer and public insight into these issues is critical to the success of our effort. The regulatory agencies have tried to make it as easy as possible for all interested parties to get information about the EGRPRA project and to let us know what they think are the most critical regulatory burden issues. The EGRPRA website, which can be found at www.egrpra.gov, provides an overview of the EGRPRA review process, a description of the agencies' action plan, information about our banker and consumer outreach sessions and a summary of the top regulatory burden issues cited by bankers and consumer groups. There also are direct links to the actual text of each regulation and comments can be sent to the EGRPRA website. Comments submitted through the website are automatically transmitted to all of the financial institution regulatory agencies. Comments are then posted on the EGRPRA website for everyone to see. The website has proven to be a popular source for information about the project, with thousands of hits being reported every month.

While written comments are important to the agencies' efforts to reduce regulatory burden, we believe it is also important to have face-to-face meetings with bankers and consumer group representatives so that they have an opportunity to directly communicate their views on the issues of most concern to them.

Last year, the agencies sponsored five banker outreach meetings in different cities to heighten industry awareness of the EGRPRA project. The meetings provided an opportunity for the agencies to listen to bankers' regulatory burden concerns, hear comments and suggestions, and identify possible solutions. The outreach meetings were held over a six-month period in Orlando, St. Louis, Denver, San Francisco and New York. More than 250 bankers (mostly CEOs) as well as representatives from the national trade groups and a variety of state trade associations participated in the meetings with representatives from FDIC, FRB, OCC, OTS, CSBS and state regulatory agencies.

The banker outreach meetings were extremely useful and productive. Following panel discussions and a question and answer period, the meeting participants were broken into small discussion groups. Senior-level regulators served as moderators of the discussion groups and regulatory staff recorded bankers' concerns and their recommendations to reduce regulatory burden. Summaries of the issues raised were then posted on the EGRPRA website. Since the banker outreach meetings were so successful last year, we decided to hold at least three more meetings this year. The first

one was on April 22 in Nashville, Tennessee and the second on June 9 in Seattle, Washington. Our third will be held on September 23 in Chicago, Illinois.

We held an outreach meeting for consumer and community groups on February 20, 2004, in Arlington, Virginia. About 24 representatives from various consumer and community groups participated in the meeting along with representatives from the FDIC, FRB, OCC, OTS, NCUA and CSBS. The meeting provided a useful perspective on the effectiveness of many existing regulations. We plan to hold at least two more consumer and community group outreach meetings later this year, with one scheduled for June 24 in San Francisco and another tentatively planned for September 23 in Chicago.

The "Top 10" List of Banker Concerns

Based on the concerns expressed at our banker outreach meetings, we have identified a "Top 10" list of regulations bankers cite as being the most costly, burdensome or otherwise competitively detrimental. The FDIC and most bankers believe that the objectives of these laws are worthy. However, bankers have told us that these important goals can be achieved in a less burdensome manner. While this is not a scientifically selected survey of all bankers or issues, the most frequently mentioned regulations and the nature of their concerns are as follows:

Bank Secrecy Act (Currency Transaction Reports (CTRs), Suspicious Activity Reports (SARs)): Bankers are more than willing to do their part in the war on terrorism and recognize the importance of CTRs and SARs in the process. However, they would like the reporting process to be more effective and efficient. In addition, bankers say they receive no feedback on their efforts.

USA Patriot Act and Customer Identification Systems: Similarly, bankers recognize the importance of verifying the identities of their customers. However, bankers would like the CIP requirement of the USA PATRIOT Act to be more effective and efficient. Again, bankers have commented regarding lack of feedback on their efforts.

Limitations on Transfers and Withdrawals from Money Market Deposit Accounts (Regulation D): Bankers believe the statutory and regulatory limits on transfers and withdrawals from money market accounts are outdated and suggest easing or repealing the limits. They also suggest eliminating existing restrictions which prohibit the payment of interest on demand deposits.

Home Mortgage Disclosure Act (HMDA) and Regulation C: Some bankers assert that the costs of complying with data collection and reporting requirements is too high in relationship to the usefulness of the data. It also was suggested that the reporting thresholds for banks be raised so that banks with less than $50 or $100 million in assets would be exempt from the reporting requirements.

Community Reinvestment Act (CRA) Regulations: Some bankers would like to see the asset size threshold (currently $250 million) for the small bank CRA test raised to as much as $1 or $2 billion.

Privacy Act Notices: Bankers, particularly those that do not share customer information with third parties, stated that sending annual privacy notices to all customers is costly and often confusing to the consumer.

Truth in Lending (Regulation Z) and Real Estate Settlement Procedures Act (RESPA): A number of bankers complained about the volume and complexity of documents required for closing loans and asked the agencies to reconsider the required disclosures. They also suggested simplifying Annual Percentage Rate calculations.

Truth-in Lending and the Right of Rescission: Bankers reported that few, if any customers had ever exercised their right of rescission and thus customers should be permitted to waive their right. Alternatively, some suggested creating additional exemptions to this requirement.

Extensions of Credit to Insiders and Regulation O: Bankers reported that these lending restrictions often make it difficult to find directors willing to serve on bank boards.

Flood Insurance and the Flood Disaster Protection Act: Bankers strongly suggested that flood maps be kept up to date. Others felt that much of the cost of enforcing flood insurance requirements has shifted from the federal government to banks.
The list above includes some of the most frequently mentioned regulatory burden concerns expressed by bankers to us over the last year. The regulators are examining these concerns to determine whether suggested changes to our regulations and/or current laws may be appropriate at this time. This process will continue until the end of the EGRPRA review process in 2006.

Response by Regulatory Agencies
The EGRPRA regulatory review project is still in its early stages, with approximately two years until completion. However, I am pleased to report that the banking and thrift regulatory agencies have been working together closely and harmoniously on a number of projects to address unnecessary burdens. In addition to eliminating outdated and unnecessary regulations, the agencies have begun to identify more efficient ways of achieving important public policy goals of existing statutes. I think it is fair to say that although we have much work ahead of us, there has been significant progress to date. Here are some notable examples:

Privacy Notices
On December 30, 2003, the Federal bank, thrift and credit union regulatory agencies, in conjunction with the Federal Trade Commission, Securities and Exchange Commission, and the Commodity Futures Trading Commission, issued an Advanced Notice of Proposed Rulemaking (ANPR), seeking public comment on ways to improve the privacy notices required by the Gramm-Leach-Bliley Act. Although there are many issues raised in the ANPR, the heart of the document solicits comments on how the privacy notices could be improved to be more readable and useful to consumers, while reducing the

burden on banks and other service providers required to distribute the notices. In response to the comments received, the agencies are planning consumer research and testing that will be used to develop privacy notices that meet these goals. As they do so, the agencies will continue to be mindful of the burden implications of changing the privacy notices and the requirements for their distribution.

Community Reinvestment Act Regulations

On February 6, 2004, the Federal bank and thrift regulatory agencies jointly issued a proposal to amend the Community Reinvestment Act (CRA) regulations. The joint proposal would, among other things, reduce regulatory burden by changing the definition of "small institution" to mean an institution with total assets of less than $500 million, without regard to holding company assets. This represents a significant increase in the small bank threshold from the current level of $250 million which was established in the 1995. Under the proposal, just over 1,100 additional banks (those with assets between $250 and $500 million) would be subject to the streamlined CRA examination process for small banks. This streamlined examination focuses primarily on local lending, which is the mainstay of community banks.

This proposal would not exempt these institutions from complying with CRA-all banks, regardless of size, will be required to be thoroughly evaluated within the business context in which they operate. As I indicated at the FDIC Board meeting when this proposal was approved for publication, I think this is a good first step for the agencies. Personally, I would have liked to see the agencies propose a higher threshold, perhaps $1 billion, since I do not think any bank under $1 billion in assets should be judged by the same standards as a bank with $100 billion or $1 trillion in assets. I recognize that there are many competing interests and that community groups, in particular, as well as many members of Congress generally oppose any increase at all in the threshold level. However, I think that this change to the regulation, if adopted as proposed, would result in significant regulatory burden reduction for a number of institutions without weakening the objectives of the Community Reinvestment Act. The comment period for this proposal closed on April 6, and the agencies received approximately 1,000 comment letters that currently are being analyzed by staff. It is my hope the agencies will consider carefully all comments and agree on a final rule before the end of this year.

RESPA

In July, 2002, the Department of Housing and Urban Development (HUD) proposed a rule intended to improve the process for obtaining mortgages. Given the high level of concern expressed by the banking industry about the closing process, and the tremendous volume of paperwork that consumers have to deal with at real estate closings, I think it is incumbent upon the regulators to continue to play a role in the mortgage reform efforts. I agree with the basic goals of HUD's initiative, which are to: (1) enable people to know their options so they can shop intelligently; (2) clarify and simplify the required disclosures; and (3) provide some certainty that costs won't change before closing. The FDIC has provided some input into HUD's rulemaking process and will continue to provide whatever additional input may be necessary. I think it is

important to assist in this effort to simplify and improve the closing process for consumers, while reducing unnecessary burden on the banking industry.

Bank Secrecy Act

There is no question that financial institutions and their regulators must be extremely vigilant in their efforts to implement the Bank Secrecy Act in order to thwart terrorist financing efforts and money-laundering. Last year, bankers filed over 12 million CTRs and SARs with the Financial Crimes Enforcement Network (FinCEN). Bankers reported that they believe they are filing millions of reports that are not utilized for any law enforcement purpose and consequently a costly burden is being carried which is providing little benefit to anyone. In an effort to address this concern and enhance the effectiveness of these programs, the financial institution regulatory agencies are working together with FinCEN and various law enforcement agencies, through task forces of the Bank Secrecy Act Advisory Group, to find ways to streamline reporting requirements for CTRs and SARs and make the reports that are filed more useful for law enforcement.

I am convinced that we can find ways to make this system more effective for law enforcement, while at the same time making it more cost efficient and less burdensome for bankers. I recently met with FinCEN's new Director, William Fox, and pledged to work with him to make bank reporting under the Bank Secrecy Act more effective and efficient while still meeting the important crime-fighting objectives of anti-terrorism and anti-money-laundering laws.

USA PATRIOT Act and Customer Identification Requirements

Most bankers understand the vital importance of knowing their customers and thus generally do not object to taking the additional steps necessary to verify the identity of their customers. However, bankers wanted guidance from the regulators on how they could comply with this important law. In response, the federal financial institution regulators, the Treasury Department and FinCEN issued interpretive guidance to all financial institutions to assist them in developing a Customer Identification Program (CIP), which was mandated by the USA PATRIOT Act. The inter-agency guidance answered the most frequently asked questions about the requirements of the CIP rule.

FDIC Efforts to Relieve Regulatory Burden

In addition to the above-noted inter-agency efforts to reduce regulatory burden, the FDIC, under the leadership of Chairman Powell, is constantly looking for ways to improve our operations and reduce regulatory burden, without compromising safety and soundness or undermining important consumer protections. Over the last several years, we streamlined our examination processes and procedures with an eye toward better allocating FDIC resources to areas that could ultimately pose greater risks to the insurance funds - such as problem banks, large financial institutions, high-risk lending, internal controls and fraud. Some of our recent initiatives to reduce regulatory burden can be summarized as follows:

1) Raised the threshold for well-rated, well-capitalized banks to qualify for streamlined safety and soundness examinations from $250 million to $1 billion so that the FDIC's resources are better focused on managing risk to the insurance funds;

2) Implemented more risk-focused compliance and trust examinations, placing greater emphasis on an institution's administration of its compliance and fiduciary responsibilities and less on transaction testing;

3) Increased the efficiency of the Information Technology (IT) examination procedures and streamlined IT examinations for institutions that pose the least technology risk;

4) Worked with CSBS and the Federal Reserve to develop, through a Nationwide State/Federal Supervisory Agreement, a closely coordinated supervisory system for banks that operate across state lines;

5) Initiated electronic filing of branch applications and began exploring alternatives for further streamlining the deposit insurance application process in connection with new charters and mergers;

6) Simplified the deposit insurance coverage rules for living trust accounts so that the rules are easier to understand and administer;

7) Reviewed existing Financial Institution Letters and other directives to eliminate outdated or unnecessary documents (also developing a more user-friendly, web-based system for finding communications from the Corporation);

8) Provided greater resources to bank directors, including the establishment of a "Director's Corner" on the FDIC website, as a one-stop site for Directors to obtain useful and practical information to in fulfilling their responsibilities, and the sponsorship of many "Director's Colleges" around the country;

9) Made it easier for banks to assist low and moderate income individuals, and obtain CRA credit for doing so, by developing Money Smart, a financial literacy curriculum and providing the Money SmartProgram free-of-charge to all insured institutions;

10) Implemented an interagency charter and federal deposit insurance application that eliminates duplicative information requests by consolidating into one uniform document, the different reporting requirements of the three regulatory agencies (FDIC, OCC and OTS);

11) Revised our internal delegations of authority to push more decision making out to the field level to expedite decision making and provide institutions with their final Reports of Examination on an expedited basis; and

12) Provided bankers with a customized version of the FDIC Electronic Deposit Insurance Estimator (EDIE), a CD-Rom and downloadable version of the web-based

EDIE, which allows bankers easier access to information to help determine the extent to which a customer's funds are insured by the FDIC.
The FDIC is aware that regulatory burden does not emanate only from statutes and regulations, but often comes from internal processes and procedures. Therefore, we continually strive to improve the way we conduct our affairs, always looking for more efficient and effective ways to meet our responsibilities.

Legislation to Reduce Regulatory Burden
Mr. Chairman, I wish to commend you and your colleagues on your efforts to develop legislation removing unnecessary regulatory burden on the banking industry. Since most of our regulations are, in fact, mandated by statute, I believe that it is critical that the agencies work hard not only on the regulatory front, but also on the legislative front, to alert Congress to unnecessary regulatory burden. For that reason, I was gratified to see the House address some of the burden issues and pass H.R. 1375, the Financial Services Regulatory Relief Act. H.R. 1375 contains a number of significant regulatory relief provisions that could reduce regulatory burden. The bill also includes several provisions requested by the regulators, including the FDIC, to help us do our job better. As my testimony indicates, the FDIC staff has been working closely with their colleagues at the FRB, OCC and the OTS over the last several months, in an effort to identify additional legislative proposals to reduce regulatory burden on the industry. As you know, EGRPRA requires the agencies to collect comments from the public on ways to reduce regulatory burden and report their suggestions to the Congress. While we will submit a more formal report as required by EGRPRA, I would like to report to you some of the suggestions we have heard so far. I personally believe these proposals deserve careful review and ultimately consideration by Congress. Some of the bankers' key suggestions are discussed in detail below.

Eliminating Unnecessary Reports From Directors and Officers with Respect to Extensions of Credit (Regulation O)
The Federal bank and thrift regulatory agencies believe that it is no longer necessary for directors and officers to file the following three reports that are currently required to be filed under section 22(g) of the Federal Reserve Act (12 USC 375a) and section 106(b)(2) of the Bank Holding Company Amendments of 1970 (12 USC 1972(2)):

1) a report filed by a bank executive officer 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;
2) a report required from banks regarding any loans the bank has made to its executive officers since its previous call report; and
3) an annual report from a bank's executive officers and principal shareholders to the board of directors of any outstanding loans from a correspondent bank.

The information contained in these reports is already collected through the normal examination and supervision programs of the regulatory agencies and through quarterly Call Reports. Therefore, the regulatory agencies believe that the preparation and

submission of these reports is not necessary and imposes costs and unnecessary burden on the banks and the individuals required to prepare and file the reports.

Streamlining the Application Process

The Federal bank and thrift regulatory agencies believe that the application process and procedures for certain types of bank mergers can be significantly streamlined, without jeopardizing safety and soundness or weakening important consumer rights, by making the following legislative changes:

1. Amend section 18(c) of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. § 1828(c)), also known as the Bank Merger Act (BMA), to exempt applications for merger transactions between depository institutions and their wholly owned subsidiaries, or with wholly owned subsidiaries of the depository institution's holding company, from a competitive factors review by the Department of Justice and other agency review processes as well as from post-approval waiting periods.

Presently, the BMA requires, among other things, the prior written approval of the appropriate federal banking agency whenever an insured depository institution proposes a merger transaction with any other insured depository institution, or with any noninsured institution, whether or not the institutions are affiliated. Before acting on any merger transaction application (other than one involving a probable failure or an emergency case), the agency must request a competitive factors report from the Attorney General and from each of the other three federal banking agencies and allow 30 days for them to respond. In the case of an emergency, the time period for response is 10 days. In the case of a probable failure, no such request is necessary.

Finally, the BMA provides that the merger transaction (other than a probable failure or emergency case), may not be consummated before the 30th day after approval or, if the Attorney General concurs, the 15th day after approval. In the case of a probable failure, the merger transaction may be consummated upon approval. In the case of an emergency, the merger transaction may be consummated on the 5th day after approval. The post-approval waiting period is generally designed to give the Attorney General an opportunity to file suit to block the merger transaction, if the Attorney General determines that the merger transaction is anticompetitive.

The proposed change would only apply to mergers between an insured depository institution and one or more of its affiliates. It is generally accepted that such mergers do not present any competitive issues. This legislative proposal would shorten the timeframe for the approval and consummation of corporate reorganizations and by doing so create savings for the applicant without raising safety and soundness issues.

2. Shorten the post-approval waiting time on mergers where there are no adverse effects on competition - This proposal would amend section 11(b) of the BHCA (12 U.S.C. § 1849(b)) and section 18(c)(6) of the FDIA (12 U.S.C. § 1828(c)(6)) to shorten the current 15-day minimum post-approval waiting period for certain bank acquisitions and mergers when the appropriate federal banking agency and the U.S. Attorney

General agree that merging with or acquiring another bank or bank holding company would not result in significantly adverse effects on competition to a 5-day period.

Under current law, the post-approval waiting period is generally 30 days. This 30-day period may be shortened to 15 days upon agreement of the appropriate banking agency and the Attorney General. This proposal would give the banking agency and the Attorney General the flexibility to further shorten the post-approval waiting period. The Attorney General would continue to be required to consider the competitive factors involved in each merger transaction. The institutions involved in mergers or acquisitions would benefit from the streamlining of the application review process that reduces bank waiting time and associated costs by allowing faster consummation of a merger where there are no adverse affects on competition or consumers.

3. Eliminate competitive factors report from the other three federal banking agencies - This proposal would amend paragraph (4) of section 18(c) of the FDIA (12 U.S.C. § 1828(c)) to streamline application requirements by eliminating the requirement that each federal banking agency must request a competitive factors report from the other three federal banking agencies as well as from the Attorney General.

The Attorney General would continue to be required to consider the competitive factors involved in each merger transaction. The FDIC, as insurer, would receive a copy of the responsible agency's request to the Attorney General when the FDIC is not the responsible agency for the particular merger, thereby giving the FDIC notice of the transaction. The proposal shortens the timeframe for approval and consummation of transactions and so would decrease regulatory burden associated with the application process.

4. Eliminate the requirement for prior written consent to establish branches by well-managed, well-capitalized, highly-rated institutions - While the regulators have not reached agreement, one additional proposal that we are looking at would amend section 18(d)(1) of the FDIA (12 U.S.C. § 1828(d)(1)) to eliminate the requirement for prior written consent to establish branches by well-managed, well-capitalized, highly-rated institutions. The institutions would need to have at least a satisfactory CRA rating and the agencies are exploring ways to preserve consumers' ability to raise any CRA concerns in connection with these transactions.

Instead of the requirement for prior written consent, this proposal would require after-the-fact notice. Such a notice procedure should permit well-run banks to establish branches more efficiently without the delay and substantial paperwork associated with an application. This amendment would not affect the requirement for prior approval for the establishment of interstate de novo branches under section 18(d)(4) of the FDIA (12 U.S.C. § 1824(d)(4).

I should note also that the Office of Thrift Supervision has recommended adding a new section 5(d)(3)(B) to the Home Owners' Loan Act (12 U.S.C. 1464(d)(3)) (HOLA) to give federal thrifts authority to merge with one or more of their nondepository institution

affiliates. This authority would be equivalent to the authority national banks have pursuant to 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). Section 18(c) of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. § 1828(c)), also known as the Bank Merger Act, will continue to apply and the new authority does not give thrifts the power to engage in new activities.

Under current law, a federal thrift may only merge with another depository institution. This proposal reduces regulatory burdens on thrifts by permitting mergers with nondepository affiliates, where appropriate for sound business reasons and if otherwise permitted by law. This amendment reduces regulatory burden by permitting a thrift that wishes to acquire the business of an affiliate to do so without undertaking a costly series of transactions, such as merging the affiliate into a subsidiary and liquidating the subsidiary into the thrift.

Elimination of Annual Privacy Notice Requirement for Institutions That Do Not Share Personal Information

As noted above, an ANPR was issued at the end of last year seeking public comment on ways to improve the privacy notices required by the Gramm-Leach-Bliley Act (GLBA). In addition to our efforts to improve the content of the notice, the banks have urged that the law be changed to relax the requirement for banks to send annual privacy notices to all of their customers if, in fact, they do not share information with third parties or their affiliates subject to the "opt-out" right under either the GLBA or the Fair Credit Reporting Act. For example, after providing the initial privacy notice, an institution would only provide subsequent notices when its privacy policy actually changes in some material way, rather than requiring that notices be provided on an annual basis.

Waiver of the Three-Day Right of Rescission

The Truth in Lending Act provides consumers with a significant right that gives them three days to re-think the consequences of pledging their home as collateral on certain loans. There is no question that this is a valuable right that must be preserved.

However, bankers note that consumers are often perplexed and sometimes disturbed by the fact that the Federal government limits their access to borrowed funds for three days following loan closing. Bankers have described that consumer dissatisfaction is particularly acute when they are paying interest on their new loan without access to the funds. Although banks can allow consumers to waive their right of rescission, bankers believe the waiver criteria are very restrictive and narrow.

This is a sensitive area. There is no question about that. There need to be ways to address the issues we have heard about while still protecting consumer rights. There are several possibilities to explore and we are open to exploring them with consumers and the industry. For example, perhaps we should look at expanding the waiver criteria to allow a consumer to voluntarily choose not to be protected by the right of rescission. Another possibility is to provide the closing documents three days prior to closing and

incorporate the right of rescission into this three-day period, much like the Federal Reserve Board and Department of Housing and Urban Development proposed to Congress in 1998.

Increased Flexibility of the Flood Insurance Law
Bankers have suggested several changes in the law to increase the flexibility of regulators and lenders to implement flood insurance program requirements and provide the federal financial regulatory agencies with discretion to impose civil money penalties in findings of patterns or practices of violations of flood insurance requirements. Specifically, the suggestions would address the situation where the official flood maps are more than ten years old; increase the "small loan" exception (currently $5,000) and allow adjustments for inflation on a regular basis; and amend the forced-placement rules to allow lenders to force-place flood insurance within 30 days (instead of the current 45 days) of notifying the borrower.

Other banker suggestions include removing the requirement of mandatory Civil Monetary Penalties (CMPs) when federal regulators discover a pattern and practice of certain violations of the National Flood Insurance Program (NFIP). In accordance with each agency's authority to impose CMPs pursuant to its own implementing act, the regulators can tailor their actions more closely to individual cases. The bankers' argue these proposals would reduce burden by increasing the speed with which flood map information may be obtained when maps are out of date, lowering risk when forced placement of insurance is necessary, adjusting for inflation periodically the threshold for loans covered by the NFIP, and replacing mandatory penalties with penalties crafted to match the violation.

Repeal of the CRA Sunshine Law
The agencies have heard from both bankers and consumer groups that paperwork requirements of the CRA Sunshine law are burdensome. The sunshine provisions are found in section 48 of the FDIA (12 U.S.C. § 1831y), enacted by section 711 of the Gramm-Leach-Bliley Act. One way to address these burdens would be to recommend repealing the law. However, the ramifications would need to be carefully studied before advocating repeal. Under current law, depository institutions, nongovernmental entities, and other parties to agreements providing for cash payments, grants, or other consideration with a value in excess of $10,000 or for loans exceeding $50,000 annually made pursuant to or in connection with, the fulfillment of the Community Reinvestment Act of 1977 must make a report of all such covered agreements annually to the appropriate Federal banking agency. Removing the annual reporting requirement would reduce regulatory burden on depository institutions, nongovernmental entities (i.e., consumer groups) and other parties to covered agreements, as well as the Federal banking agencies. There are no safety and soundness concerns about the repeal of this law.

The above-noted legislative proposals are just some of the ideas I am pursuing on an inter-agency basis to reduce unnecessary burdens on the banking industry without diluting important consumer protections and I hope to pursue many others over the

course of the EGRPRA regulatory review process. I very much look forward to working with the Committee on developing a comprehensive legislative package that provides real regulatory relief for the industry. I am certain that this hearing will provide valuable input for the comprehensive package.

Conclusion

Mr. Chairman, as I mentioned at the outset, the EGRPRA effort is committed to addressing the problem of regulatory burden for every insured financial institution. Bankers, large and small, labor under the cumulative impact of regulations. However, I believe that if we do not do something to stem the tide of ever increasing regulation, a vital part of the banking system will disappear from many of the communities that need them the most. That is why I think it is incumbent upon all of us - Congress, regulators, industry and consumer groups - to work together to eliminate any outdated, unnecessary or unduly burdensome regulations. I am personally committed to accomplishing that objective.

I am confident that, if we all work together, we can find ways to regulate that are both more effective and less burdensome, without jeopardizing the safety and soundness of the industry or weakening important consumer protections.

Thank you for providing me with this opportunity to testify.

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