TESTIMONY OF

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ON

H.R. 1362, THE FINANCIAL INSTITUTIONS REGULATORY RELIEF ACT OF 1995

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON BANKING AND FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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2129 RAYBURN HOUSE OFFICE BUILDING

INTRODUCTION

Madam Chairman and members of the Subcommittee, I am pleased to present the views of the Federal Deposit Insurance Corporation on H.R. 1362, the Financial Institutions Regulatory Relief Act of 1995, and related issues. I enthusiastically support the purposes of the bill and, with a few exceptions, am pleased to endorse the specific changes in the law.

Over the past 25 years, a variety of new laws and regulations affecting banks in the areas of safety and soundness, crime detection, and consumer protection have been imposed on financial institutions. While these laws were enacted to protect consumers and the deposit insurance funds, the cumulative effect has imposed significant additional costs on the financial transactions that are essential to sustain a vital and competitive economy. At times, the burden falls disproportionately on insured banks and thrifts, as compared with other types of financial institutions, resulting in significant competitive disadvantages. In addition, regulatory burden generally has a disproportionate effect on smaller institutions. One-quarter of the banks supervised by the FDIC have fewer than 13 employees on a full-time basis, a small number to deal with the complexity and sheer volume of regulatory and legislative requirements.

To begin my testimony today I will share with you the results of an informal survey of banks conducted by the FDIC on the potential savings that might be associated with the repeal or modification of specific legislative or regulatory requirements. Second, I will comment on the legislation introduced by Representative Bereuter, H.R. 1362, the Financial Institutions Regulatory Relief Act of 1995. Next, I will review current efforts of the FDIC to alleviate regulatory burden in the safety and soundness and consumer compliance areas -- some commenced at our own initiative, others with the impetus of legislation. Finally, I will propose additional statutory changes to further reduce regulatory burden on insured institutions.

FDIC SURVEY OF THE COSTS OF SPECIFIC REGULATORY BURDENS

Regulatory burden came into being through accretion. Each law and related regulation may be only marginally burdensome, but taken together their cumulative effect has become greatly burdensome.

In accordance with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, I have initiated a complete review of the agency's regulations and policy statements in an effort to identify those that have become obsolete or those for which the cost to comply substantially outweighs the intended benefits. I want to commend Congress for examining the level of burden imposed by statute. Working through laws and regulations developed over many years will require time, effort, and considerable attention, but it can and should be done. The challenge for Congress and the regulators is to identify those laws and regulations that may be modified, streamlined or eliminated without adversely affecting the safety and soundness of the banking industry or necessary protections for consumers. To accomplish this task, we must test regulations against specific criteria: 1) whether the regulations are necessary to ensure a safe and sound banking system, 2) whether the regulations enhance the functioning of the marketplace, or 3) whether the regulations can be justified on strong public policy grounds related to consumer protection.

We recently conducted an informal survey of just over 60 institutions that the FDIC supervises in order to gauge the potential cost savings from the elimination of specific legislative requirements and regulations currently on the books. The items included in the survey were based on provisions of H.R. 1362 that we support and believe would result in identifiable savings. The regulatory and legislative requirements surveyed included: Truth in Lending and Truth in Savings disclosures, loan data collection and reporting, auditor attestation requirements for bank compliance with laws and regulations, as well as the costs of various applications and notifications.

A broad cross-section of institutions by size and location provided dollar estimates of their costs in meeting 15 very specific regulatory requirements.

While the survey was informal -- and, therefore, cannot be used to make industry-wide estimates -- we believe the results support two general conclusions. First, smaller institutions bear higher proportionate costs than larger ones. When measured in relation to net income, the estimated costs incurred from the 15 requirements surveyed ranged from over 16 percent at very small institutions to just over one percent at the largest.

Second, the responses clearly suggest that positive cost savings could be achieved if the surveyed requirements were eliminated. For all recurring requirements included in the questionnaire, the median cost of compliance per bank was reported to be approximately $40,000 per year. In addition, respondents reported that the median cost estimate of submitting various non-recurring applications and notifications ranged from $500 to $20,000 per action.

Taken together, we estimate that the savings from completely eliminating all requirements covered in the survey could increase the annual rate of return on assets from 5 to 10 basis points on a pre-tax basis for institutions the FDIC supervises. The results of this survey are discussed in greater detail in

Appendix A to this testimony. The FDIC also is pursuing other specific efforts to reduce regulatory burden, which are discussed at the conclusion of the testimony.

H.R. 1362 -- FINANCIAL INSTITUTIONS REGULATORY RELIEF ACT OF 1995

The bank and thrift regulatory agencies can and should pursue efforts to reduce regulatory burden within their existing authority, but we must recognize that a substantial share of the burden on depository institutions derives directly from statutes that are beyond the jurisdiction of the agencies to change. In this regard, it is incumbent on the agencies to monitor the effectiveness and impact of applicable statutes and to make appropriate recommendations to Congress for changes in those statutes to reduce unnecessary burden and improve effectiveness. Included in this testimony, and set out in detail in Appendix B, are the FDIC's suggestions on provisions of law that can and should be amended or eliminated because they do not conform to any of the three criteria set out at the beginning of this testimony.

I also want to commend you Madam Chairman, Representative Bereuter and this Subcommittee for your considerable efforts at dealing with regulatory burden. H.R. 1362, the Financial

Institutions Regulatory Relief Act of 1995 is a strong attempt to address these issues.

In reviewing H.R. 1362, as you have requested, we have identified provisions that we support as drafted, those we support but with some modification, and those few that we do not favor. FDIC staff recently provided the Subcommittee staff with technical suggestions on the bill.

Title I -- Reductions in Government Overregulation

Subtitle A -- The Home Mortgage Process

Truth in Lending The Truth in Lending Act ("TILA") was enacted 27 years ago to enable consumers to shop comparatively for credit by requiring lenders to disclose interest rates and other information about credit terms and costs in a uniform way. TILA, as implemented by Regulation Z, has been largely successful in providing bank customers with comparable information on interest rates applicable to credit that enhances the effective functioning of the marketplace. It also has been successful at remedying many of the deceptive and misleading lending practices it was enacted to correct. Unfortunately, Regulation Z, has become substantially more complicated, as it has been adapted to fit the variety of loan products introduced since 1968. Hence, the real value of TILA to the efficient functioning of the marketplace and to consumers has been obscured because of the complexity of the required disclosures.

The complexity of TILA can be demonstrated in a variety of ways. First, the Federal Reserve Board's Official Staff Commentary on Regulation Z, which provides official interpretations, is longer than the regulation itself.

Second, the complexity of Regulation Z is such that the FDIC cited more than 2,700 of the 3,500 institutions we examined in 1994 for at least one violation. The majority of these violations were technical rather than substantive in nature, however, and were most often the result of recording errors rather than material misrepresentations to consumers that would require reimbursement. For example, in 1994 only 279 institutions made reimbursements to consumers representing a total of $2.8 million as a result of violations cited under Regulation Z.

Third, the banks that responded to our survey indicated that TILA is a relatively costly law to comply with on an annual basis. Specifically, the median reported dollar cost of $10,000 to comply with TILA was almost twice as high as for any other survey item. Clearly, Regulation Z is overdue for major revision.

The FDIC is generally supportive of the revisions to TILA prescribed by subtitle A of H.R. 1362. I will highlight a few of the FDIC's views related to these provisions.

First, the FDIC supports the changes to the Real Estate Settlement Procedures Act ("RESPA") and TILA prescribed by sections 101, 102 and 104 of H.R. 1362. We believe that granting the Federal Reserve Board the authority to conform TILA with RESPA, where possible, will reduce regulatory burden for financial institutions and avoid confusion and complexity for consumers.

We believe that the Federal Reserve Board should have the flexibility to streamline or eliminate any TILA disclosures that do not provide appreciable benefits to consumers. We also believe that the Federal Reserve Board should have the authority to exempt certain transactions from these requirements. In addition, the Federal Reserve Board should review the application of the right of rescission and consider exempting certain transactions from these provisions where appropriate. Finally, we support those provisions which would modify TILA as a result of the Rodash decision.

Consumers today rarely rescind credit transactions with insured financial institutions. In fact, many consumers complain that the inability to waive their right of rescission is inconvenient and costly since it delays the disbursement of funds. Therefore, the FDIC supports exempting certain refinancing and consolidations of credit secured by first liens from the right of rescission as contained in section 107 of H.R. 1362. These transactions would continue to be subject to early "good faith estimate" disclosures required by RESPA, so consumers would continue to have the opportunity to evaluate the implications of their actions.

The FDIC has no objection to section 108 of H.R. 1362. This provision would establish a statutory tolerance level for finance charge errors for closed-end credits secured by real property equal to one-half of the current one-eighth of one percent tolerance associated with the disclosure of the annual percentage rate. This would result in the same proportional tolerance for finance charge errors for small loans as it does for large loans, and would provide greater flexibility to institutions without substantially changing the practical level of protection afforded to the consumer.

Home Mortgage Disclosure Act Section 116 of H.R. 1362 amends the Home Mortgage Disclosure Act ("HMDA") by increasing from $10 million to $50 million in assets the size of institutions that are exempt from reporting. This threshold would be adjusted annually to reflect the impact of increases in the Consumer Price Index. This section also provides the Federal

Reserve Board with the authority to exempt institutions if it determines that the compliance burden outweighs the usefulness of the data required to be disclosed. This exemption would not be available to an institution where the Federal Reserve Board, by order, has found a reasonable basis to believe it is not fulfilling its obligations to serve the housing needs of its community.

The FDIC supports section 116 of the bill, as it would substantially reduce regulatory burden on small banks, without significantly reducing the level of data reported on residential lending. Currently, 3,187 FDIC-supervised banks are required to report under HMDA. Raising the reporting threshold to $50 million would exempt 33 percent of these reporters, but would result in a total reduction in the level of data reported by FDIC-supervised institutions of only six percent. The resulting cost savings to smaller individual institutions, however, would be material. As indicated in Table II of Appendix A, the median cost for surveyed institutions with assets less than $50 million is about $119 per application compared to a median cost of nearly $18 for institutions with total assets greater than $50 million.

We also support the provision that relieves the burden associated with having HMDA data available at each branch location. The public will still have the ability to access the data. Institutions would be required to provide notice at their branch locations that the information is available for review at the institution's home office, or the data will be provided directly to members of the public requesting it either in paper or electronic format no later than 15 days after receipt of a written request.

Subtitle B -- Community Reinvestment Act Amendments

In July of 1993, President Clinton asked the federal bank regulatory agencies to undertake sweeping reform of the Community Reinvestment Act ("CRA") regulations to reduce unnecessary regulatory burden and focus the CRA examination program on more objective, performance-based assessment standards. For the past 22 months, the agencies have worked jointly to produce comprehensive reform of the CRA regulations. To initiate the process, the agencies held hearings in seven locations across the country during 1993, and heard from hundreds of witnesses including representatives from financial institutions, the business community, consumer and community groups, and state and local government officials. Proposed regulations were circulated twice for public comment, which together produced almost 14,000 letters. From this outpouring of public comment, the agencies developed a final CRA rule, which was approved by each agency in April.

The FDIC believes the new CRA rule accomplishes the goals established at the outset, particularly in the area of reducing regulatory burden. The new CRA rule provides for an effective and meaningful evaluation of the performance of an institution without burdensome paperwork and recordkeeping requirements and without undue reliance on ratios and formulas. In keeping with the original intent of the CRA, the new rule encourages institutions to meet the credit needs of their communities, consistent with safety and soundness.

The new rule accomplishes these goals in several ways. First, the new CRA rule emphasizes performance in lending, investment and service, rather than process and paperwork, and provides institutions with considerable flexibility in meeting the credit needs of their communities. The new rule eliminates the requirement that institutions prepare CRA statements, review them annually and document them in the minutes of the board of directors' meetings. Institutions are no longer required to justify the basis for community delineations or to document efforts in marketing or ascertaining community credit needs. Resources formerly devoted to such procedural requirements -- time, money and personnel -- are now available for making loans and investments and providing services in the community.

Second, the new CRA rule distinguishes between large and small institutions by providing a streamlined examination process and an exemption from data collection on loans to small business and small farms for independent banks and thrifts with assets under $250 million, or banks and thrifts with assets under $250 million that are members of a holding company with total assets under $1 billion. Under the new streamlined examination procedure, regulators will determine whether an institution's loan-to-deposit ratio and lending record are reasonable relative to its size, financial condition and management expertise, and the credit needs of its community. The streamlined examination will provide meaningful regulatory relief to over 80 percent of the banking industry.

In addition, all institutions, regardless of size, have the option of being evaluated on the basis of a strategic plan. A strategic plan must specify measurable goals and be aired for public comment in advance of adoption. After any comments received have been addressed, the institution must submit the plan for agency review. Thereafter, the institution will be evaluated based upon how well it meets or exceeds the goals it has established for itself in the strategic plan. This approach encourages greater management involvement in an institution's effort to meet the credit needs of its community and reduces the CRA compliance burden on the institution.

The FDIC believes the new CRA regulation provides meaningful relief in the area of regulatory burden, particularly for small institutions. The streamlined examination and the focus on lending rather than creating a paper trail, as well as the reduced reporting requirements when compared with the previously proposed regulations, will reduce substantially the burden the CRA previously placed on small and large institutions alike.

The FDIC is concerned that several provisions of H.R. 1362 would preempt many of the most positive changes effected by the new CRA rule. First, we urge the Subcommittee to reconsider the need to include the "small town, small bank exemption" provision in section 122 of the bill. This provision would exempt from CRA examination financial institutions in which the main office and each branch is located in a town, political subdivision or other government unit with a population of less than 30,000 and is not part of a metropolitan statistical area, and the institution and its parent holding company have aggregate assets of not more that $100,000. The FDIC firmly believes that the new CRA rule substantially reduces the compliance burden for small banks. The new streamlined examination methods are designed specifically to provide maximum flexibility for institutions and to ensure consistency in evaluation criteria, while substantially reducing the burden of compliance on small institutions. Periodic examination of all institutions, regardless of size or rating, is an effective way to ensure that insured institutions are providing credit and service in their communities consistently over time.

Second, we do not favor the creation of the self-certification process prescribed by section 123 of H.R. 1362. This section would apply to institutions currently rated "satisfactory" or "outstanding" with less than $250 million in assets that have not been found to have engaged in a pattern or practice of illegal discrimination under the Fair Housing Act or the Equal Credit Opportunity Act during the previous five years. A self-certification process would preempt the implementation of the new streamlined examination for small banks contained in the new CRA regulation. The new streamlined assessment method specifically focuses examination criteria for small banks on the goal of the CRA, and promotes consistent, meaningful ratings. However, with self-certification, there would be no way to ensure consistency in ratings across banks, as each institution could base its self-certification on different criteria and there would not be an opportunity for sufficient regulatory review of the CRA performance of an institution. For example, a self-certification process raises numerous practical questions, such as: (1) what criteria would an institution use to base its self-certification on; (2) how long would the self-certification remain valid; and, (3) how would the regulatory agencies verify the rating the institution has given itself.

The streamlined examination provided for in the final regulation is the result of the deliberative process undertaken by the agencies to promote consistency in ratings and to alleviate the compliance burden CRA examinations have imposed on small institutions. It is clear from the extensive positive feedback the agencies have received on this particular aspect of the new CRA rule that the streamlined examination is directly responsive to the concerns of small institutions. Therefore, the FDIC strongly urges the Subcommittee to reconsider any type of self-certification provision, and to allow the new CRA rule to demonstrate its effectiveness in reducing burden.

Section 124 of H.R. 1362 provides for a public comment period at the time of the examination of an institution, and permits both banks and members of the community to seek reconsideration of a CRA rating before it becomes "conclusive" for purposes of applications for deposit facilities. The FDIC believes that the potential for heated public debate at the time of the examination could undermine the process which has been specifically designed to render an objective, balanced assessment of the CRA performance of an institution. Under the new CRA regulation, the agencies will determine a rating on the basis of objective, performance-based standards. Institutions have the opportunity to seek reconsideration of their ratings informally and through the formal appeals process established by their primary regulator.

In addition, the FDIC believes that section 124 of H.R. 1362 would impose requirements that could effectively increase burden on banks. Since many institutions are involved in the examination process on a more frequent and regular basis than they are involved in the applications process, creating an opportunity for public appeal of examination ratings as prescribed by section 124 could increase the burden on all institutions. The FDIC believes that because the new examination procedures focus on results rather than process there will be much greater confidence in the CRA rating of an institution, and less reason for protests.

In addition, from the FDIC's perspective, the safe harbor created by section 124 of H.R. 1362 is not necessary at this time. The FDIC rarely receives CRA protests. Of the 2,749 applications subject to CRA on which the FDIC took action in 1994, only eight were protested on CRA grounds.

In addition, when the FDIC considers an application from a state-chartered institution, we must consider a variety of factors prescribed by the Federal Deposit Insurance Act. These statutory factors include, but are not limited to, the financial history and condition of the institution and the convenience and needs of the community to be served. Although the CRA rating of an institution is important in this process, particularly in assessing the degree to which the institution is serving the convenience and needs of the community, it is not conclusive.

In summary, the FDIC believes that it is appropriate to provide incentives so that institutions will strive to excel in meeting the credit needs of their communities. However, we urge the Subcommittee to allow the agencies to implement the new rule and to evaluate its effectiveness in improving CRA performance and reducing regulatory burden before instituting any statutory changes to the CRA, such as a small town, small bank exemption, self-certification or safe harbor. After the new CRA rule has been fully implemented and its impact assessed, the agencies may consider then whether additional incentives are appropriate.

The FDIC also is concerned with sections 121 and 127 of H.R. 1362. These sections of the bill would prohibit the agencies from imposing additional recordkeeping and/or reporting requirements when examining institutions or in implementing the CRA. First, the FDIC is concerned that section 121 could be interpreted as limiting our ability to have access to loan data in the course of an examination. Such limitations would critically impair our ability to conduct meaningful examinations, and would establish a precedent that could in general undermine the examination process whether for compliance or safety and soundness examinations. We recommend clarifying these provisions in a way that ensures that the agencies' access to relevant lending data during the examination process is not called into question.

Second, section 127 would prohibit the agencies from requiring institutions to collect and report loan data required under the new CRA regulation. The new CRA regulation imposes some additional data collection and reporting requirements on large banks. This is balanced, however, by the usefulness of the information collected. The data, which will be collected on small business and small farm loans, will give a more comprehensive view of how the reporting institutions are meeting the credit needs of their communities. Only 2,000 banks out of 10,600 would be required to collect and report the data.

HMDA data alone presents an incomplete view of the lending of a bank, since it only focuses on mortgage lending. The small business and small farm loan data will help to complete the picture of how an institution meets the credit needs of its community. This will benefit many institutions that are not given full credit today in their CRA ratings for the entire scope of their lending efforts. To limit burden, the data collection requirements for large banks are streamlined, and do not require loan-by-loan reporting. Instead, information will be collected and reported by census tract but will be publicly disclosed in the aggregate by the agencies, not by the banks. Overall, the data collection and reporting requirements of the new CRA rule were designed to minimize the burden on the reporting institutions, and are less burdensome than the requirements contained in the two prior proposed regulations.

Once again, we urge the Subcommittee to reconsider the aspects of H.R. 1362 that would affect efforts to implement the new CRA regulation. The final regulation is greatly improved over the current regulation, as well as the two prior CRA proposals, in terms of the level of burden on financial institutions. The FDIC believes everyone will benefit from the full implementation of the CRA reforms.

Subtitle C -- Consumer Banking Reforms

Truth in Savings The Truth in Savings Act ("TISA") requires institutions to provide accurate and uniform disclosures and terms of advertising to enable consumers to shop comparatively for financial savings products. While TISA provides the consumer with some valuable information, Regulation DD is overly complicated. Section 131 of H.R. 1362 would substantially streamline TISA. Institutions would only be required to disclose the method they use to calculate the interest rate.

While the FDIC supports reducing the complexity and regulatory burden imposed by TISA, we caution the Subcommittee that such a sweeping amendment would eliminate some of the initial disclosures that provide meaningful assistance to bank customers in their effort to comparison shop for deposit products. For example, institutions would not be compelled to disclose minimum balance requirements, service charges or penalties for early withdrawal of funds. While it would seem logical for banks to disclose this information to their customers as a matter of good business, it was the lack of such disclosures that in large part prompted the enactment of TISA. We recommend that the Subcommittee consider legislation that directs the Federal Reserve Board to review Regulation DD and revise those specific sections that do not enhance the ability of consumers to make informed decisions about deposit accounts and products.

Unauthorized Electronic Funds Transfers Section 132 of H.R. 1362 addresses unauthorized electronic funds transfers and the liability of consumers in these instances. The FDIC has no objection to this section, but would recommend that language be included to clarify what actions on the part of the consumer would be deemed to contribute substantially to unauthorized use.

Subtitle D -- Equal Credit Opportunity Act Amendments

Self-testing The goal of fair lending laws is to ensure that the free flow of credit is not impaired by market distortions created by illegal discrimination on repugnant grounds, such as race, national origin, sex or age. The best way to ensure that this goal is met is by enlisting the help of all financial institutions in identifying and correcting illegal discriminatory behavior. Hence, the FDIC strongly supports the use of self-analysis, including self-testing, by financial institutions as the most comprehensive approach to assuring compliance with fair lending laws and to effecting corrective action that resolves any problems. The FDIC also supports the recent decision of the Federal Reserve Board to propose amendments to Regulation B to permit, but not require, financial institutions to request information on race, color, gender, religion and national origin from all applicants. We believe this information will assist institutions in reviewing their overall lending patterns to ensure that they are treating all customers in a fair, nondiscriminatory manner.

The FDIC supports the provisions of section 145 that would shelter an institution's self-testing results from discovery by an applicant in any proceeding or civil action as this will further encourage institutions to monitor their lending practices. However, we note that under the normal rules of discovery, if an institution elects to use the result of its self-testing in its defense, this protection should be waived.

There are, however, other aspects of section 145 that we ask the Subcommittee to reconsider. Section 145 amends sections 706(g) and 706(k) of ECOA to prevent the regulators from referring any evidence of substantive fair lending violations to the Department of Justice or to the Department of Housing and Urban Development if the institution discovered the violation through self-testing. We believe this language, as drafted, is too broad. This provision would prohibit an agency from making a referral even if the institution had not taken or initiated corrective action to remedy the problems discovered through self-testing. We recommend amending section 145 of H.R. 1362 to provide the agencies with discretion to refer those cases where the institution has not initiated or effected corrective action. The FDIC would welcome the opportunity to work with the Subcommittee staff to develop language to accomplish this.

Credit Scoring Section 146 of H.R. 1362 provides that a creditor is in compliance with ECOA with respect to any credit decisions made that are based solely on a statistically sound credit scoring system as defined by the Federal Reserve Board. The FDIC has no objection to this section, as long as it is understood to refer to a credit scoring system that does not disproportionately impact a protected class of persons without a clear business justification and there is no evidence of illegal discrimination.

Subtitle E -- Consumer Leasing Act Amendments

According to section 152 of H.R. 1362, the purpose of this subtitle is to assure simple, meaningful disclosure of leasing terms to enable a consumer to comparison shop for leasing arrangements and to be protected from inaccurate and unfair leasing practices. Section 153 amends chapter 5 of the Consumer

Credit Protection Act which covers consumer leasing by directing the Federal Reserve to draft regulations or staff commentary to update and clarify the current disclosures to carry out the purposes established in section 152. The Federal Reserve currently implements these consumer leasing provisions in Regulation M.

The FDIC supports the expressed purposes of this subtitle, but believes that the Subcommittee should reconsider the methods prescribed in sections 153 through 155 to achieve these goals. For example, section 154 would provide consumers with a streamlined, tabular presentation of certain disclosures, and importantly would add "capitalized cost" to the list of required disclosures. However, this tabular presentation of disclosures would be in addition to, not in place of, the disclosures currently required by Regulation M. This would be duplicative for the lessor and potentially more confusing for consumers who would receive two sets of similar, but not identical, disclosures. We recommend that the Subcommittee reconsider the approach taken in this subtitle to simplify and enhance these important disclosures to consumers. The FDIC will work with the other regulatory agencies and the Subcommittee staff to accomplish this.

Title II -- Streamlining Government Regulations

Subtitle A -- Regulatory Approval Issues

Regulatory Issues The FDIC supports sections 201 and 202 of H.R. 1362. Section 201 provides an exception to the notice requirements for proposals by a well-capitalized and well-managed bank holding company to engage in a nonbank activity or to acquire the shares or assets of a nonbanking company. Section 202 provides a streamlined process for bank acquisitions by well-capitalized and well-managed bank holding companies. Such acquisitions would be deemed approved within 15 business days, or fewer if the Federal Reserve Board approves. Both sections are consistent with the regulatory philosophy of the FDIC of encouraging institutions to become and remain well-capitalized and well-managed.

Applications With respect to section 207 of the bill, the FDIC supports the elimination of prior approval for the establishment of a domestic branch by institutions that operate safely and soundly. Today, the establishment or relocation of a branch is not the major business decision it once was. The bank regulatory agencies have sufficient other enforcement tools to stop unsafe or unsound expansion.

In 1994, the FDIC approved over 1,350 applications to establish or relocate a branch, including three that were protested on CRA grounds. None of the three were denied. Given this record, there is simply no justification on either safety and soundness or community service grounds for continuing to require institutions to endure the costs and delays, however short, that are associated with the preparation and processing of applications for prior approval to establish a branch.

In addition, we suggest that the scope of section 207 be broadened to include applications to relocate a branch as well as to establish a branch. As a corollary, we suggest that institutions only be required to give the FDIC or their primary federal regulator a simple notice of the location of the new or relocated branch. It is necessary for the regulators to know the location of all branches in order to schedule examinations and to prepare for emergencies.

Eliminate Branch Applications for ATMs The FDIC also supports section 208 of the bill, which would exclude automated teller machines from the definition of "domestic branch." We do not see a compelling reason for an agency to approve these facilities in advance or even to have prior notice of their establishment. It is time for the statutes to catch-up to changed technology. The FDIC approved over 700 applications for these facilities in 1994 and volume will likely pick up in the future. Eliminating the prior approval requirement will significantly reduce burden for the industry and the agency.

Reporting Requirements and Certain Exemptions The FDIC supports section 210 of the bill, which would revise section 32 of the Federal Deposit Insurance Act ("FDI Act") to eliminate notice requirements in certain cases involving a new member of a bank's board of directors or senior executive officer. The FDIC regards the existing requirements as unnecessary impediments to the routine management of depository institutions. It is entirely appropriate that, as revised, the prior notice requirement is confined to institutions that are either undercapitalized or otherwise in a troubled condition.

Subtitle B -- Streamlining of Government Regulations

Branch Closures We fully support the branch closure provisions of section 222 of the bill. These provisions substantially mirror the federal regulators' interagency policy statement on branch closings and would reduce regulatory burden by eliminating the need to give prior notice of decisions to close automated teller machines, to relocate branches within the same neighborhood, and to close certain branches acquired through mergers.

Amendments to the Depository Institutions Management Interlocks Act The FDIC does not object to section 223 which would provide a small market share exemption for management interlocks where the affected institutions or their holding companies, together with their affiliates, hold in the aggregate no more than 20 percent of the deposits in each relevant geographic banking market, as defined by the Board of Governors of the Federal Reserve System. We suggest, however, that the appropriate federal regulator, rather than the Federal Reserve Board, define the relevant geographic markets. Each agency already makes independent determinations in merger cases and should be able to do so for this purpose.

Elimination of Appraisal Subcommittee Section 224 of the bill would abolish the Appraisal Subcommittee and transfer certain of its functions to the Federal Financial Institutions Examination Council ("FFIEC"). We fully support this approach. There is no justification for a separate semi-autonomous Appraisal Subcommittee to perform functions that can be performed just as well by the FFIEC. We suggest that the language make clear that the Subcommittee would be obligated to return funds to the Treasury after it has wound-up its affairs in an orderly manner and has satisfied its obligations and commitments to creditors and others, including the current grant to the Appraisal Foundation. We fully expect that the FFIEC will work cooperatively with the Appraisal Foundation to help it develop alternative funding sources and to help maintain appraisal standards and appraiser qualifications at current high levels to ensure the safety of loans secured by real property.

__Insider Lending__ Section 225 of the proposal would liberalize the requirements governing insider lending. We support the creation of an exemption for extensions of credit available to a wide group of employees. Similarly, we support eliminating reporting requirements related to loans that executive officers receive from other banks that exceed limits available at their own bank, as well as the requirement that corporate quarterly reports include information on loans to officers. We would go further, however, by amending section 22(g) of the Federal Reserve Act to allow home equity loans of up to $100,000 and loans secured by readily marketable assets. In addition, we suggest amending section 22(g)(4) of the Federal Reserve Act, which requires each agency to promulgate separate regulations to provide for additional exceptions to the "other loans" category. A uniform Federal Reserve regulation would suffice.

__Examinations__ Section 226 would extend the maximum permissible examination cycle for certain small institutions from 12 or 18 months to 24 months. We believe extending the examination cycle in this manner would tend to establish 24 months as the norm for the time between examinations, which we believe would not be prudent. It was the FDIC's experience in the mid-1980s, that examination cycles were lengthened for smaller institutions on the theory that they did not present systemic risk problems. In fact, serious problems developed in the interim and those problems went undetected for some time. In some cases, they ultimately caused significant losses to the deposit insurance funds. Although we are in a relatively stable period at the moment, it also has been our experience that conditions in the industry can deteriorate rather quickly, especially in the highly competitive and rapidly changing environment of today. Moreover, the regulators are most effective when the examination process is used to encourage sound banking practices and strong management and to observe the philosophy and practices of management and the changes that occur over time between examinations. We believe examinations every two years may not be frequent enough for those purposes.

At the same time, we are mindful of the need to reduce supervisory regulatory burden, especially on smaller, well-capitalized and well-managed institutions. We believe this is best accomplished, however, by streamlining the process, increasing offsite monitoring to reduce onsite examination time, and staffing the examination with no more examiners than needed in order to keep to the necessary minimum demands on the resources of the institution and its management.

We know that bankers are concerned about the burden of examinations. The FDIC recently began surveying bankers for suggestions on ways to improve the quality and effectiveness of safety and soundness examinations. The effort, which is expected to run for one year, is aimed at detecting and changing aspects of the examination process that are ineffective or inefficient. Over the next year, approximately 3,500 FDIC-supervised commercial banks and savings banks are expected to undergo safety and soundness examinations. At the end of these examinations, the institutions will be given a three-page survey that asks questions about the appropriateness and thoroughness of examination procedures; the quality and professionalism of the FDIC team that conducted the review; and the usefulness of the written and oral reports from the FDIC regarding examination findings. Respondents will have the option to remain anonymous or to give their names so that the FDIC can seek follow-up information or clarifications. Participants also will be able to speak with a senior management official of the FDIC to discuss any additional problems or issues.

We also are asking our banks if they prefer having safety and soundness examinations conducted concurrent with or at different times than compliance examinations. Concurrent examinations may not be practical for all institutions, as space constraints and personnel resources may be insufficient to facilitate simultaneous examinations. The FDIC recognizes that an examination can be disruptive to the normal business of a bank, particularly for smaller institutions, and we are making an effort to develop examination schedules that will accommodate the preferences expressed by banks with respect to concurrent or separate examinations whenever practical.

While it is too early in the survey process to provide even preliminary results, we expect that the program will provide a valuable source of information on how the FDIC can minimize the regulatory burden on banks while, at the same time, improve the effectiveness and quality of our safety and soundness examination program.

As a result of these efforts, we urge the Subcommittee to reconsider the need and justification for extending the examination cycle beyond 18 months. We also note parenthetically that many states follow a 12- or 18-month examination cycle so that FDIC coordination with state examinations can more readily be maintained if an 18-month examination cycle is retained.

Repeal of Unnecessary Reporting Requirements The FDIC has no objection to section 230 of H.R. 1362, which would repeal requirements for reporting small business and small farm loans on the Report of Condition and Income ("Call Reports"). The CRA regulatory reform effort has considered those reporting requirements extensively and has required reporting only by larger institutions for CRA purposes.

Regulatory Burden Review The FDIC supports the thrust and purpose of section 232 of the bill, which would require an FFIEC-led review of all agency regulations no less frequently than every 10 years. Such a review is entirely appropriate. Indeed, it will be the FDIC's policy to review regulations as often as every five years to assure that they continue to serve the intended purposes effectively and efficiently without undue burden to financial institutions. We are concerned, however, that the mandated procedures and overlay of the FFIEC may prove awkward and time consuming and thereby impede the ongoing efforts of the agencies to review their regulations independently and to work jointly to make uniform all regulations and guidelines implementing common statutory or supervisory policies. The FFIEC can serve an important function by providing interagency coordination and consistency in the efforts of bank regulators to reduce regulatory burden, as long as the efficiency of its involvement is assured.

In addition, we support section 229 of the bill that requires the regulatory agencies to review the extent to which current regulations require institutions to produce unnecessary internal written policies and to eliminate such requirements where appropriate. We plan to include this review as part of our overall review of regulations.

<u>Country Risk Requirements</u> The FDIC has no objection to section 233 which would amend the International Lending Supervision Act ("ILSA") in two respects. First, section 233 would amend section 905 of ILSA to provide the agencies with discretion to require special reserves in certain circumstances versus mandating such reserves under the existing law. We do not perceive this change as substantive and anticipate that the FDIC will continue to require special reserves as necessary. Second, section 233 would repeal section 905A of ILSA which requires the agencies to review the risk exposure of banking institutions arising from medium- and long-term loans to any highly indebted country and to provide direction to such institutions regarding any necessary additions to general and special reserves. Section 905A also provides very specific guidance to the agencies in determining risk exposure. Section 904A was added by the Financial Institutions Reform, Recovery and Enforcement Act of 1989. This specific mandate is unnecessary, given our authority to assess reserves under Section 904 and other supervisory authorities. The FDIC will continue to assess the risk exposure of institutions we supervise to all types of foreign lending and require additions to general or special reserves as necessary.

Regulatory Impact on Cost of Credit and Credit Availability

We support the thrust of section 234 that removes the requirement that auditors of banks attest to the institution's assertions regarding internal controls and compliance with designated laws and regulations. It also allows for a minority of membership on an institution's audit committee to consist of insiders and allows the agencies to grant a waiver to some or all of the independent audit committee requirements. However, we suggest that the provision calling for individual regulators to issue regulations on this exemption is unnecessarily burdensome and confusing. The FDIC, after consultation with the other agencies, currently is responsible for issuing audit regulations for all FDIC-insured institutions.

Due Process Protections Section 235 of the bill would affect the FDIC in administrative proceedings when it is acting in its regulatory capacity, when it is acting as conservator or receiver, or in its corporate capacity as an assignee of assets of a receiver of a failed insured depository institution. The bill would apply a more stringent standard than currently applies to the FDIC when it seeks to obtain pre-judgement attachment of assets or other injunctive relief. Section 235 of the bill would require the FDIC to show immediate or irreparable injury as a condition for obtaining such relief.

We oppose this provision to the extent it would affect our roles as conservator, receiver, and corporate liquidator of a failed financial institution under section 11(d)(19) of the FDI Act. The law as it stands does not deprive borrowers or other defendants, such as directors and officers of failed institutions, of due process protections. The authority to seek temporary injunctive relief in the form of asset freezes without having to show irreparable and immediate loss allows the FDIC, in appropriate cases, to move quickly to prevent fraudulent conveyances or concealment of assets. The statutory power provided under section 11(d)(19) is consistent with similar statutory injunctive provisions where Congress deems a type of action to merit relief from this common law requirement.

There are times, such as soon after a failure, when we urgently require an injunction to prevent dissipation of assets. On such occasions, we might not yet have sufficient information to satisfy the irreparable and immediate injury standard, and in some cases it can be difficult to establish irreparable harm when money damages, as opposed to land or some other unique asset, are at issue. Congress wanted special status to be applied to cases involving money damages when deposit insurance funds were at risk. Without that authority, the FDIC may be powerless to prevent dissipation of assets. A consequence could be that losses to the deposit insurance funds from bank failures would increase.

Due process protections for borrowers and other defendants are assured under the existing law. Under sections 8 and 11 of the FDI Act, the FDIC must still establish in court that an asset freeze is in the public interest, that the FDIC has a substantial likelihood of winning its case, and that the inconvenience to the defendant is outweighed by the potential harm to the FDIC as receiver or in another capacity. Moreover, the law in its present form has a limited impact because the asset freeze is temporary and does not determine ultimate entitlement. Assets are placed under court supervision, and defendants may still obtain money for legal expenses, or sell the assets for adequate consideration after obtaining prior court approval. Present law is intended to prevent parties from making fraudulent or abusive transfers or dissipation of assets until the FDIC's suit for collection can be heard by a court on the merits. Thus, due process rights are fully protected.

Culpability Standards for Outside Directors The FDIC strongly opposes section 236, which would exclude outside directors from the definition of "institution affiliated party" for purposes of various enforcement actions. Such directors would be excluded from this definition unless the federal banking agencies can first prove that the director "knowingly" or "recklessly" participated in: 1) a violation of law or regulation; 2) a breach of fiduciary duty; or 3) any unsafe or unsound practice that caused or was likely to cause more than minimal financial loss to, or significant adverse effect on, the insured depository institution. This treatment puts outside directors on a par with independent contractors, such as attorneys, appraisers, or accountants who render services to institutions under contract.

We believe that outside directors owe a higher duty of care to a bank than do independent contractors and should be held to the same standard of care as inside directors for purposes of administrative enforcement jurisdiction. For example, our experience has shown that "outside" directors can engage in self-dealing transactions almost as easily as inside directors.

The unbiased and arms-length approach of outside directors is essential to the proper oversight of management and the policies of the institution. Outside directors should be prepared to meet their full fiduciary responsibilities or not serve in this capacity. To the extent that factors unique to the outside directors should affect individual cases, these factors are already considered by the FDIC, as stated in the Statement Concerning the Responsibility of Bank Directors and Officers that the FDIC issued in December of 1992. Moreover, the "knowing" standard would be extremely difficult to meet since it requires the banking agencies to prove what was on a person's mind at the time they took the action.

Rules on Deposit Taking The FDIC supports section 237 which amends section 29(g)(3) of the FDI Act to correct a technical problem in the current law that places restrictions on the interest rates that adequately capitalized banks may provide on deposits. At present the law defines as a "deposit broker" an institution which solicits deposits by paying interest higher than that paid by other institutions in the soliciting bank's market. If an institution is only "adequately capitalized" it must obtain a waiver to take brokered deposits, but even then cannot pay significantly above what other institutions are offering in the marketplace. The bill would correct this circularity. The changes would allow adequately capitalized banks to operate a money desk without our prior waiver. We believe we have adequate supervisory tools to deal with any abuse.

Transition Period for New Regulations Section 238 would amend the Riegle Community Development and Regulatory Improvement Act of 1994 to change the transition period for new regulations that impose additional reporting, disclosure, or other new requirements on insured depository institutions, from a calendar quarter to a semi-annual period.

We believe that delaying the transition period for new regulations from quarterly to semi-annually is too long, where institutions have had notice and an opportunity for comment.

Most regulations implement statutes and a six-month delay can cause confusion on whether the old or new regulations are in place. Our experience is that more specific guidance on the meaning and application of a new statute is ordinarily needed sooner rather than later, and is often requested by regulated institutions.

Title III -- Lender Liability

The FDIC strongly supports section 301 of H.R. 1362, which would protect lenders from liability for the clean-up of hazardous substance contamination for which they had no responsibility. By clarifying and limiting the environmental liability of a lender that holds a security interest or forecloses on property contaminated by a hazardous substance, a lender will be in a better position to assess the potential risks associated with the extension of credit. By assisting lenders in understanding the circumstances under which they could be liable, lenders should be able to make better credit decisions. We support provisions that would clarify situations under which lenders would be liable for contaminated property.

The section would similarly protect the FDIC as receiver from liability for contamination that it did not cause or contribute to and would extend that protection to the first subsequent purchaser of property from the FDIC unless that person was otherwise liable or potentially liable for the contamination. These provisions should greatly assist the FDIC in winding-up the affairs of failed depository institutions in an orderly and timely fashion.

THE FDIC'S SPECIFIC BURDEN REDUCTION EFFORTS TO DATE

As discussed earlier, regulatory burden falls disproportionately on small institutions. In recent years, the FDIC has become increasingly sensitive to the issue of regulatory burden because state nonmember banks are typically small -- half have 25 or fewer employees; a third, 13 or fewer. We are continuing to review our regulations, policies, and procedures and seek to simplify or eliminate them where appropriate. In doing so, we have also recognized that the banks with the best examination ratings need a lighter regulatory hand than those that give us concern. I will highlight previous and ongoing efforts of the FDIC to identify and change areas where burden can be reduced without impairing regulation for safety and soundness purposes or necessary consumer protections.

Safety and Soundness Examinations

The FDIC has acted to minimize the burden of its safety and soundness examination program through careful allocation of resources, a simpler and better focused examination report format and an increased emphasis on coordination with other federal and state bank supervisors. For example, as permitted by statute, well-capitalized insured depository institutions below $250 million in total assets are subject to less frequent examinations if they are rated 1 under the CAMEL rating system, as are well-capitalized CAMEL 1- and 2- rated institutions with total assets of $100 million or less. To promote better consistency among examinations, the FDIC has adopted a Uniform Report of Examination form with the other Federal banking agencies.

To minimize the burden of duplicative and overlapping examinations, the FDIC coordinates its safety and soundness examinations with state banking authorities and in most cases alternates responsibility for examinations of CAMEL 1- and 2-rated institutions with state authorities. We also coordinate safety and soundness examinations of subsidiary banks of large multibank holding companies with other federal and state bank supervisors to eliminate overlap. We have also worked with the Federal Reserve Board and with state regulators to develop a coordinated and unified supervisory program for U.S. operations of foreign banking organizations.

In addition, the FDIC and other federal regulators recently reached an agreement with the National Association of Securities Dealers to coordinate the examination of broker-dealers affiliated with insured depository institutions operating on bank premises.

Compliance Examinations

The FDIC has also undertaken initiatives in the consumer compliance area to minimize and reduce the burden on banks. With the creation of a new Division of Compliance and Consumer Affairs in 1994, the FDIC began a comprehensive review of its compliance examination activities to identify specific areas for modification. To reduce the time and burden associated with on-site compliance examinations, we are streamlining the process by providing examiners with better analytical tools and computer software. For example, to reduce the time examiners spend on-site in banks conducting compliance examinations, the FDIC is expanding and enhancing its off-site pre-examination analysis. The use of specialized data integration software will enable examiners to perform a substantial amount of loan portfolio analysis at the field office, instead of in the bank.

In conjunction with our efforts to streamline the compliance examination function we will be surveying a cross-section of banks over the next month to solicit their views about how that process may be improved. The responses we receive will be compared with a survey conducted again in twelve months to enable us to measure the success of the modifications we are implementing in the compliance examination process.

To ensure a consistent application of the new CRA examination criteria, the agencies will be working together through the FFIEC to develop standardized procedures and to coordinate examiner training. Through this joint effort, we can ensure a well-executed implementation of the new regulation.

Regulation Review and Streamlining

As mentioned earlier, in accordance with section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, the FDIC is undertaking a comprehensive review of its regulations and policy statements to streamline, eliminate or modify them where possible. The purpose of the review is to improve efficiency and reduce unnecessary costs, as well as to eliminate inconsistencies and duplicative requirements. We have developed a schedule for an orderly review of the various regulations and policy statements and have targeted several for early attention. Where appropriate, we are working on an interagency basis to review comparable regulations and policies at all the agencies on a uniform basis. In this regard, we claim an early success in the new CRA regulation.

As I noted at the outset, through a broad range of other previous initiatives that parallel the goals of section 303, the FDIC has sought to change or modify existing regulations to reduce the regulatory burden on banks while improving the regulation of safety and soundness. The breadth and scope of efforts is illustrated by the following examples of recent actions taken to reduce burdensome supervisory requirements:

- The FDIC has implemented pursuant to statute a prompt corrective action regimen under which well-capitalized and well-managed institutions are freed of prohibitions and restrictions otherwise applicable to under-capitalized institutions.

- Institutions with a CAMEL rating of 1 or 2, and that exceed $5 billion in total assets, are eligible for the holding company exception when complying with the FDIC's rules and regulations regarding annual audits. These institutions may now use the holding company's audit committee and submit holding company reports in order to satisfy the FDIC's requirements. Thus, such an institution is no longer required to have its own separate audit committee and need not file annual reports prepared at the institution level as previously had been required.

- The FDIC adopted a final rule clarifying regulatory capital treatment for net unrealized holding gains and losses on "available-for-sale" securities. Including unrealized gains and losses in regulatory capital could cause bank capital levels to be unnecessarily volatile, without appreciable benefit to the safety and soundness of the banking system. The FDIC's rule excludes most of these unrealized gains and losses from Tier 1 capital, thereby minimizing the possibility that temporary fluctuations in market interest rates could cause an institution to fall below its minimum capital requirements.

• The FDIC has acted to waive, under certain conditions, burdensome disclosure requirements related to a bank's commission on securities transactions for bank customers. This waiver eliminates a disparity in the rules for state nonmember banks in relation to other banks, which are not required to provide the disclosures. In addition, it alleviates the problem many banks faced in determining the amount of their fee in advance or immediately after a trade. The FDIC's new waiver authority conforms to authority the Federal Reserve Board and Comptroller of the Currency already have.

• Statutes requiring regulations on real estate lending, safety and soundness standards and external audits and attestations have been implemented with simple, short regulations and supplemented with less draconian supervisory guidelines.

• The FDIC recently withdrew a proposed rule on contracts that may be adverse to a bank's interests. We determined that potential abuses can be handled through normal supervision and existing authority and that it is therefore not necessary to implement additional regulations pursuant to section 30 of FDI Act.

• Banks rated satisfactory or better for CRA purposes have a streamlined and expedited application process when establishing or relocating an automated teller machine instead of filing a formal application and awaiting approval.

• The FDIC adopted a final rule reducing the amount of risk-based capital that FDIC-supervised banks must maintain for low-level recourse transactions. For risk-based capital purposes, when assets are transferred with recourse, capital normally must be held against the full outstanding amount of the transferred assets regardless of the level of recourse retained by the transferor. The final rule relieves banks of this excessive regulatory capital burden by limiting the amount of risk-based capital required to be held in low level recourse transactions to the maximum amount of loss possible under the recourse agreement.

• In 1992 the FDIC, under the auspices of the FFIEC, adopted a uniform policy concerning the frequency and timing of changes to Call Reports and similar reports filed by other depository institutions. Changes in regulatory reporting requirements impose a burden on institutions because they must make modifications to their recordkeeping and reporting system to accommodate the reporting changes. Limiting the frequency of changes and providing lead time between the announcement of the change and its effective date reduce regulatory burden. Under the interagency policy, changes in regulatory reporting requirements are to be announced prior to the start of the calendar year in which the revisions will take effect, thereby giving institutions at least 90 days advance notice.

- The FDIC Board adopted a formal appeals process on March 21, 1995, that provides FDIC-supervised institutions with an avenue to appeal material supervisory determinations including CAMEL, compliance and CRA ratings, the adequacy of loan loss reserve provisions and cited violations of law or regulation.

- The FDIC has adopted a new approach for collecting deposit insurance premiums. Effective April 1, 1995, for the semiannual assessment period beginning July 1, 1995, the assessment amount will be calculated by the FDIC rather than by each institution. This will improve the accuracy of the computations and relieve institutions of the burden of performing the calculations. Furthermore, assessments will be collected via direct debits initiated by the FDIC through automated clearing house processes which reduces paperwork for insured institutions.

Our efforts to identify areas for regulatory relief are ongoing and we continue to seek out opportunities to make further inroads into burden reduction.

ADDITIONAL REGULATORY RELIEF MEASURES

Appendix B provides a description of additional statutory changes that we believe would help to reduce regulatory burden. Our proposed amendments add to the efforts of the Subcommittee to reduce burden without compromising safety and soundness. For example, we recommend repealing section 39 of the FDI Act that requires federal banking agencies to prescribe operational and managerial standards for all insured depository institutions. The standards required by section 39 are widely viewed as unnecessary micromanagement of financial institutions.

Another recommendation, that is mentioned earlier in the testimony, is to amend section 22(g) of the Federal Reserve Act to expand the statutory exceptions to the restrictions on loans to executive officers to include home equity lines of credit. This amendment would provide flexibility in lending to executive officers without compromising safety and soundness.

We have provided language on these and additional suggestions for reducing burden in seven other areas to the Subcommittee staff and would be pleased to assist them further in regulatory and legislative relief efforts.

CONCLUSION

Let me again state that we are encouraged that Congress is committed to reducing regulatory burden. The FDIC too is engaged in an intensive effort to identify regulations and policies that may be modified, streamlined or eliminated, without compromising safety and soundness or essential consumer protections. We are pleased that Congress is engaged in efforts to identify statutory requirements that also add to the level of burden without compensating benefits.

We encourage Congress to continue to review the many laws and resulting regulations that institutions find most burdensome. This review should be subject to the criteria I referred to at the outset of my testimony: 1) whether the laws are necessary to ensure a safe and sound banking system, 2) whether the laws enhance the functioning of the marketplace, or 3) whether the laws can be justified on strong public policy grounds related to consumer protection. Against these criteria, the laws should be reviewed with respect to their underlying premises and whether they achieve their purposes. In addition, the costs and any side-effects should be examined to determine whether there are simpler, less-costly and more straightforward means of achieving those ends.

The regulatory burden on the banking industry grew incrementally over a number of decades -- rule by rule, requirement by requirement, report by report. The time has come to search through the baggage to determine what is really necessary to carry forward. We welcome the opportunity to work with you Madam Chairman, this Subcommittee, and the Congress in this important effort.

APPENDIX A

Costs of Selected Regulatory and Legislative Requirements: An Informal Survey

In conjunction with current efforts to reevaluate the benefits and costs of various legislative and regulatory requirements for the banking industry, the FDIC conducted an informal, voluntary survey of a small group of banks it supervises. (A copy of the questionnaire is attached.) Each institution was asked to estimate its total cost — both direct and indirect — of compliance with the requirements contained in the survey. A cross section of institutions was chosen with regard to size and location. Sixty-one banks participated, representing every region of the country. The smallest participant had assets of only $4.6 million at year-end 1994; the largest had $9.2 billion of total assets. Random sampling could not be used with only 61 banks, so the results are representative of only the institutions selected, but not the banking industry generally.

This study differed from others that have been conducted in recent years. For reasons of time and burden on the institutions surveyed the FDIC focused only on specific provisions for regulatory relief generally supported by the FDIC rather than on overall regulatory cost or broad categories of regulation or legislation. Respondents were asked only to report costs associated with specific requirements that would not otherwise be incurred.

Recurring Regulatory Costs

The annual cost estimates for the recurring legislative and regulatory requirements included in the survey are presented in Table 1. The reported costs of compliance for each question varied considerably among institutions; therefore, median values (the midpoint of estimates received) are used to describe the results. This measure was chosen because it is not affected by extremes in either direction.

Table 1
FDIC REGULATORY BURDEN SURVEY
Estimated Recurring Costs Incurred by a Single Bank: Selected Initiatives

Legislative Initiatives	Median Annual Dollar Cost for Reporting Institutions	Cost as Percent of Net Income (Median for Reporting Institutions)
Truth in Lending Act beyond basic interest rate information	$10,000	1.03%
Truth in Savings Act beyond basic interest rate information	5,400	0.67
Savings from consolidation of RESPA/TIL disclosure requirements	5,000	0.38
Right-of-Rescission provision of Truth in Lending Act	2,500	0.20
Accountant attestations on internal controls & regulatory compliance	3,000	0.28
Pass-through insurance disclosures to employee benefit plan depositors	1,250	0.08
Federal Reserve Act reporting of loans to executive officers	550	0.04
Federal Deposit Insurance Act reporting of bank stock collateral	250	0.01
Small business and agricultural credits reporting	500	0.05
HMDA limit raised to $50 million (for applicable institutions only)	3,000	1.46
Total Recurring Regulatory Costs	**$42,394**	**3.35%**

Consumer and Supervisory Issues. Several questions dealt with various aspects of consumer protection requirements. For instance, respondents indicated that the median cost of providing customers with Truth in Lending information over and above disclosure of the basic, annual percentage rate was $10,000 per annum. The comparable figure for Truth in Savings was $5,400. Lower estimated costs were reported for the overlapping information requirements in RESPA and Truth in Lending and for the cost of right of rescission under Truth in Lending. To put these dollar figures in perspective, in no case did the reported cost of any specific regulation exceed 1.1 percent of net income in 1994 for the relevant institutions.

Other questions focused on supervisory issues. For instance, the median cost of obtaining an outside auditor to attest to an institution's assertions regarding its compliance with internal controls, regulations, and legal requirements was reported to be $3,000. No other question regarding supervisory issues yielded median cost estimates that exceeded $1,250.

Reporting Burden. With respect to reporting burden, the cost of providing data on small loans to business and agriculture was less than $500 for half of the respondents. On a per loan reported basis, the median cost was $1.70. A proposal has been offered to increase the cutoff for the Home Mortgage Disclosure Act (HMDA) reporting exemption from an asset level of $10 million to $50 million. Banks in the $10 million to $50 million range estimated that the median cost of collecting, reporting, and making public HMDA data was $3,000 per year (just under 1.5 percent of net income). The responses regarding HMDA costs are presented in Table 2. The median cost per application received was $119.

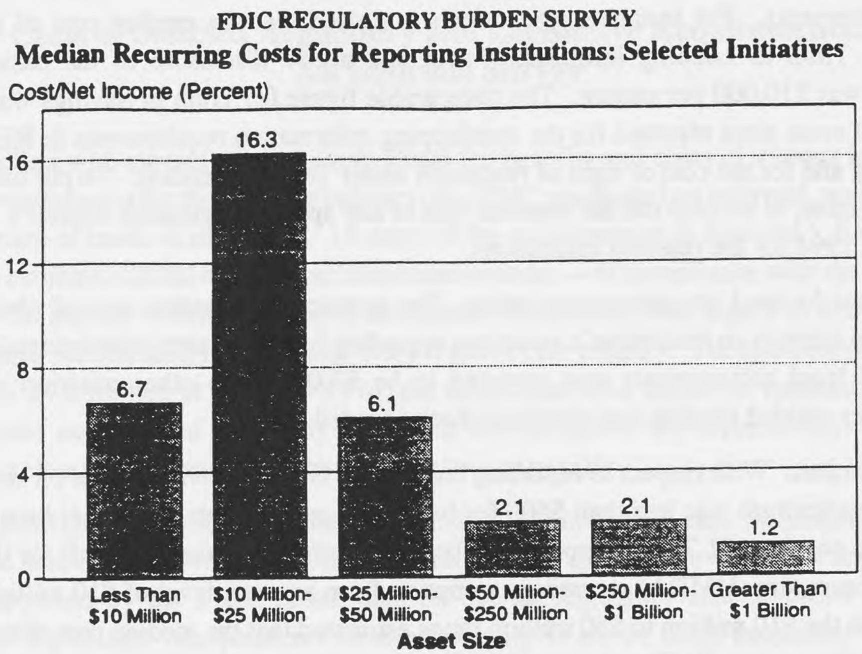
Table 2
FDIC REGULATORY BURDEN SURVEY
HMDA Costs For Selected Size Categories

Institution Size (Assets)	Median Annual Dollar Cost for Reporting Institutions	Cost as Percent of Net Income (Median for Reporting Institutions)	Special Measures (Median for Reporting Institutions)
$10 to $25 million	$ 2,300	1.19%	$ 97.31 / Application
$10 to $50 million	3,000	1.46	$118.80 / Application
Greater than $50 million (Institutions not affected by current proposals)	22,000	0.25	$ 17.52 / Application

Total Recurring Costs. For all recurring requirements included in the survey, the median annual cost of compliance was reported to be approximately $40,000 per institution (3.35 percent of net income). If those requirements had not been in place, the responses suggest that half the institutions would have seen a pre-tax increase in their return on assets of more than 5 basis points.

Differences by Size of Institution

The FDIC survey confirmed the findings of other studies which have shown that small institutions generally bear a higher proportional regulatory burden than large ones. Smaller institutions reported that a clearly higher proportion of their budgets is devoted to meeting the recurring requirements



addressed in the survey. Specifically, the proportion of net income devoted to these items ranged from over 16 percent at the smaller institutions to just over one percent at the largest. As may be seen in Table 2, the cost to comply with HMDA requirements was proportionally higher for small institutions than for larger ones.

The Cost of Various Applications/Notifications

Respondents also were asked to estimate the cost of various applications and notifications that they periodically submit to the FDIC (see Table 3). The estimates for these items ranged from a median cost of $500 for a notification of a change in senior management to $20,000 for reporting

Table 3
FDIC REGULATORY BURDEN SURVEY
Estimated Costs: Selected Applications/Notifications

Legislative Initiatives	Number of Institutions Responding to Question	Median Annual Dollar Cost for Reporting Institutions	Cost as Percent of Net Income (Median for Reporting Institutions)
Establishment or relocation of a branch	40	$5,000	0.15%
Change in senior executive officer or Board of Directors	39	500	0.04
Exercise of trust powers	14	1,000	0.02
"Phantom" merger or corporate reorganization	15	20,000	0.23
FDIC permission to conduct activities not allowed national banks	13	2,500	0.07

major corporate reorganizations. These estimates were based on a subset of the institutions queried, as not all participants had experience in all types of actions.

Overall Costs

Because the survey was informal and voluntary, it could not employ a statistically-representative sample of institutions. Thus, it is not possible to provide statistically-based industry-wide estimates of the potential cost savings from the elimination of the requirements in question. However, to approximate the larger scale of savings for all FDIC-supervised institutions, the figures from the participating banks were generalized to all such institutions. (All FDIC-supervised institutions to which that requirement was applicable were assigned the same proportional costs as those responding to the survey.) For applications and notifications, the overall cost was obtained by multiplying the actual number of filings with the FDIC in 1994, times the estimated per unit cost. Because of the variability of the estimates received, a range of costs was developed based on the median and mean answers in each category.

Using the median cost estimate for each category, the total compliance costs for all questions in the survey for FDIC-insured institutions would sum to approximately $500 million in 1994. Because several institutions reported unusually high estimates of costs for each question, the mean estimate was always higher than the median for each question. Using the mean estimates as a basis for aggregating, the total cost of compliance for those selected requirements for all FDIC-supervised institutions was slightly more than $1 billion. Therefore, the range of costs for compliance of FDIC-supervised institutions can be credibly set at $500 million to $1 billion. These figures compare to total net income of all FDIC-supervised institutions for 1994 of $12.6 billion.

Results Relative to Other Surveys

In recent years two other surveys of banking institutions were undertaken regarding the costs of regulations. These surveys covered a much broader range of regulations than did the FDIC survey. In 1991, the American Bankers Association (ABA) asked a sample of their members about the "cost of regulation" in general; their industry-wide estimate based on the survey answers was $10.7 billion. The Independent Bankers Association of America (IBAA), which surveyed its community banks in 1992 on 13 broad regulations, estimated that compliance costs for all such institutions were $3.2 billion.

Because the questions asked by the FDIC were much narrower and more specific than those contained in the two earlier surveys, our cost estimates are proportionately lower. Moreover, the cost estimates involved a much different set of institutions. Each estimate of total cost was related to total assets of the relevant population of banking institutions to facilitate comparison of the various results. After that adjustment, the estimates from the FDIC survey ranged from 15 to 30 percent of the industry-wide ABA figure of total compliance costs and from 10 to 20 percent of the IBAA figure for all community banks. This was probably a reasonable result given the more limited scope of the FDIC survey.

SURVEY QUESTIONS ON REGULATORY BURDEN

1. What is the overall, estimated <u>annual</u> cost to your institution of Home Mortgage Disclosure Act (HMDA) data collection, review, and reporting, including the cost of making the results available to the public?

   $ ________________

2. What is the overall, estimated <u>annual</u> cost of all other disclosures required by the Truth In Lending Act beyond the disclosure of the basic, annual percentage rate?

   $ ________________

3. What is the:

   a. Percentage of home loans and lines of credit subject to rescission under the Truth In Lending Act that has been rescinded at your institution in recent years?

      _______ %

   b. Overall, estimated <u>annual</u> cost of compliance with the right-of-rescission provision of the Truth In Lending Act?

      $ ________________

4. What is the amount of estimated, <u>annual</u> savings which could be attained from the coordination and/or consolidation (i.e., elimination of overlaps as well as of differences in definitions and coverage) of disclosure requirements of the RESPA and the Truth in Lending Act?

   $ ________________

5. What is the overall, estimated annual cost of providing customers with the disclosures required by the Truth in Savings Act, over and above those revealing the rate and method used to calculate interest?

$ ________________

6. You currently are required to report data on various types and size categories of small business and agricultural credits on the June call report. What is the overall, estimated annual cost of having to comply with this reporting requirement?

$ ________________

Note: Banks are required to report on Part II of Schedule RC-C of the June call both the number, and amount outstanding, of business loans with original amounts of $1 million or less and of outstanding farm loans with original amounts of $500,000 or less. Included are loans secured by nonfarm, nonresidential properties, commercial and industrial loans, loans secured by farm land, and other loans to farmers.

7. What is the anticipated cost of providing required disclosures to employee benefit plan administrators regarding the availability of pass-through deposit insurance coverage on employee benefit plan deposits (effective July, 1995 as outlined in FIL-14-95)?

   a. Initial cost $ ______________

   b. On-going cost $ ______________

8. Section 36 of the FDI Act requires attestation by an institution's independent public accountant to management's assertions regarding internal controls and compliance with FDIC regulations and federal laws. What is the overall, estimated annual cost of compliance with this requirement?

$ ________________

Note: Section 36 (c) of the FDI Act requires an institution's independent public accountant to attest to, and report separately on, the assertions of the institution's management contained in any internal control report required by Section 36(b)(2) of the Act. Section 36(e) of the FDI Act requires the institution's independent public accountant to apply procedures agreed upon by the FDIC to objectively determine the extent of compliance of the institution with laws and regulations designated by the FDIC.

9. Proposals have been made regarding the streamlining of notice and application processes. What is the overall, estimated cost of preparation and submission of an application or notice for:

a. Establishment/relocation of a branch?

$ ________________

b. Change in senior executive officer/board of directors (pursuant to Section 32 of the FDI Act)?

$ ________________

c. Exercise of trust powers?

$ ________________

d. "Phantom" merger/corporate reorganization?

$ ________________

e. An application to conduct activities not permissible for national banks (pursuant to Section 24 of the FDI Act)?

$ ________________

10. What is the estimated, annual cost to your institution of maintaining and reporting data required by Section 22 (g) of the Federal Reserve Act regarding loans to executive officers--both from outside sources and from your institution?

$ ________________

Note: Section 22(g)(6) of the Federal Reserve Act requires executive officers to report to their Board of Directors, detailing the extensions of credit from another institution whenever the aggregate amount of those extensions exceed the permissible limits from their own institution. Section 22(g)(6) is made applicable to insured nonmember banks through Section 18(j) of the FDI Act. Section 22(g)(9) of the Federal Reserve Act requires that each institution include with its call report data on all loans to executive officers since the filing of the previous call report made pursuant to Section 22(g).

11. Section 7(j)9 of the FDI Act requires reporting of credit extensions secured by 25 percent or more of any class of stock of an insured depository institution. What is the overall, estimated <u>annual</u> cost of this reporting requirement?

    $ ________________

Note: Section 7(j)9 of the FDI Act requires any financial institution and any affiliate that has credit outstanding which is secured directly or indirectly by 25 percent or more of any class of shares of another insured depository institution to file a report with its federal banking agency. A copy also is required to be filed with the appropriate federal banking agency of the institution whose stock secures such extensions of credit.

12. Are there any other areas of banking law or regulation which you feel are particularly costly to your institution that you feel should be eliminated?

    Regulation ____

    Estimated annual cost $ ______________

    Regulation ____

    Estimated annual cost $ ______________

APPENDIX B

ADDITIONAL REGULATORY RELIEF MEASURES

The FDIC also believes the following additional statutory changes would help significantly to reduce regulatory burden. We recommend their inclusion in the bill.

- **Repeal section 39 of the FDI Act**. Section 39 requires the Federal banking agencies to prescribe standards, by regulation or guideline, for all insured depository institutions relating to asset quality, earnings, stock valuation, various operational and managerial matters, and compensation. The standards required to be prescribed by the agencies represent an extraordinary foray into the micromanagement of a depository institution and are unnecessary to ensure safety and soundness. Not only are the standards difficult and burdensome for the agencies to establish, but the agencies already have sufficient authority to deal with abuses and unsafe or unsound practices on a case-by-case basis under section 8 of the FDI Act and other provisions of law and regulation. The guidelines which the agencies may issue in satisfaction of this statute are likely to be more confusing than helpful.

- **Repeal section 37(a)(3)(D) of the FDI Act**. Section 37(a)(3)(D) requires the Federal banking agencies to develop jointly a method for insured depository institutions to provide supplemental disclosure of the estimated fair values of their assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition, or other report of any insured depository institution required to be filed with a Federal banking agency.

  Section 37(a)(3)(D) has not only been difficult and burdensome for the agencies to implement but also places additional regulatory burden on insured depository institutions by requiring them to disclose a variety of information, much of which the agencies already are able to obtain. For example, financial statements that are filed annually with the agencies by institutions subject to the audit and reporting requirements of section 36 of the FDI Act (i.e., institutions with $500 million or more in assets) and any other institution with financial statements prepared in accordance with Generally Accepted Accounting Principles already include information on the fair value of their financial instruments. While not all of an institution's assets and liabilities are financial instruments, the vast majority are. Other real estate (which is one of the more significant assets that is not a financial instrument) is carried on an institution's balance sheet at an amount that does not exceed fair value less estimated selling costs. Also, certain securities are carried at fair value on the balance sheet and, for those securities that are not carried at fair value on the balance sheet, supplemental disclosure of their fair value is provided.

In addition, institutions with assets in excess of $100 million will be required to disclose the fair value of their off-balance sheet derivatives beginning March 31, 1995. For institutions subject to section 36 of the FDI Act (i.e., institutions that pose the largest risk to the insurance funds), the fair value disclosures required by section 37(a)(3)(D) essentially duplicate much of the information that they already disclose. For the few assets and liabilities for which fair value is not currently disclosed, it may not be feasible or practicable to determine fair value. Moreover, the agencies have the authority under section 36 of the FDI Act to require fair value disclosure as they determine to be necessary.

- **Amend section 11(a)(1)(D) of the FDI Act**. Section 11(a) of the FDI Act prohibits the FDIC from providing pro rata or "pass-through" deposit insurance coverage to employee benefit plan deposits that are accepted by an insured depository institution at a time when the institution may not accept brokered deposits under section 29 of the FDI Act. Consequently, if an institution accepts employee benefit plan deposits at a time when it is unable to accept brokered deposits (i.e., when it is undercapitalized), such deposits would only be insured up to $100,000 per plan (as opposed to $100,000 per participant or beneficiary). Under existing law, the depositor, rather than the institution, would be penalized for the institution's behavior.

  By limiting "pass-through" coverage on employee benefit plan deposits, the burden is placed on plan administrators every time a deposit is made to inquire as to an institution's capital category and ability to accept brokered deposits before placing plan deposits with the institution, even though many plan administrators may not be aware of such restrictions. Even if they are aware of such restrictions, plan administrators must inquire each time as to the institution's continuing ability to provide "pass-through" coverage. Not only are the "pass-through" restrictions burdensome and unfair to plan administrators and participants, but they also are burdensome to the institution by subjecting it to frequent requests for information concerning its ability to offer "pass-through" insurance to employee benefit plan deposits.

We suggest amending section 11(a)(1)(D) of the FDI Act to prohibit undercapitalized institutions from accepting employee benefit plan deposits. The effect of the suggested amendment would be to provide "pass-through" deposit insurance coverage to employee benefit plan deposits that are accepted by an institution that violates the law and accepts such deposits at a time when it is undercapitalized. Under the amendment, the institution, rather than the depositor would be penalized, which is consistent with the way brokered deposits are treated under the law.

- **<u>Repeal section 29A of the FDI Act</u>**. Section 29A requires deposit brokers to file notices with the FDIC and imposes certain recordkeeping and reporting requirements on deposit brokers. The FDIC believes that the requirements of section 29A serve no useful supervisory purpose and that the receipt and use of brokered deposits can be monitored through call reports and the examination process. The effect of repeal would be to reduce the burden on deposit brokers who have no reason to know what their clients are doing with the brokered funds, and on any institutions that may be acting as deposit brokers, as well as on the FDIC in receiving and maintaining reports filed by deposit brokers. Repeal would in no way change the existing restrictions on depository institutions accepting brokered deposits. The amendment would also eliminate what appears to be an incipient problem whereby individuals or entities file the notice with the FDIC that they are acting as deposit brokers and claim or misrepresent themselves to potential customers as "registered," "licensed," or "approved" by the FDIC.

- **<u>Conform the interest-rate limitations contained in section 29 of the FDI Act</u>**. As currently drafted, section 29 contains three separate and dissimilar provisions that limit the rate of interest payable by insured institutions that are not well-capitalized.

  The first of these provisions is section 29(e) which prohibits an <u>adequately capitalized institution</u> that has received a waiver to accept brokered deposits or an institution for which the FDIC has been appointed conservator from paying interest on brokered deposits that significantly exceeds the rate paid on deposits of similar maturity in the institution's normal market area or the national rate paid on deposits of comparable maturity, for deposits accepted outside the institution's normal market area.

The second provision limiting interest rates is section 29(g)(3). This section provides that any insured depository institution (other than a well-capitalized institution) that solicits deposits by offering significantly higher rates of interest than the prevailing rates in the institution's normal market area is deemed to be a "deposit broker." This provision essentially limits the rate that institutions that are not well-capitalized may pay on deposits obtained without the intermediation of a third-party broker.

The third provision limiting interest rates is section 29(h). This section prohibits an undercapitalized institution from soliciting deposits by offering rates of interest that are significantly higher than the prevailing rates of interest in the institution's normal market areas or in the market area in which such deposits would otherwise be accepted.

Computing effective yields in an institution's normal market area or in any particular area is conceptually difficult. There is a need to simplify and harmonize these provisions by eliminating the references to "normal market area" and "market area in which such deposits would otherwise be accepted" and replacing these "point-of-origin" or "geographically-determined" interest rate restrictions with a single interest-rate restriction that is independent of the geographic origin of the deposit.

- **Repeal section 30 of the FDI Act**. Section 30 prohibits an insured depository institution from entering into a written or oral contract with any person to provide goods, products, or services to or for the benefit of the institution if the performance of such contract would adversely affect its safety or soundness.

  Since enactment of section 30, there has been a significant decrease in the types of activity that the statute was intended to eliminate (i.e., abuses involving contracts made by or on behalf of an insured depository institution that seriously jeopardize or misrepresent its safety or soundness). This decrease is due in part to increased awareness of the potential for contracts to be structured in a manner that is adverse to an institution's safety or soundness and the use of alternative supervisory actions by the agencies to address such abuses if they arise. Not only has section 30 been difficult and burdensome to implement, but the agencies already possess adequate supervisory authority under section 8 of the FDI Act and other provisions of law and regulation to address adverse contracts.

- **Amend section 22(g) of the Federal Reserve Act**. Section 22(g) of the Federal Reserve Act prohibits a member bank from extending credit to its executive officers except in the amounts, and for the purposes, and upon the conditions specified therein. Section 18(j)(2) of the FDI Act and section 11(b) of the Home Owners' Loan Act make such restrictions applicable to nonmember banks and savings associations, respectively. Among the exceptions to the prohibition on loans to executive officers specified in section 22(g) are loans secured by a first lien on a dwelling of an executive officer which is expected to be owned by the executive officer and loans to finance the education of the children of an executive officer. We suggest expanding the statutory exceptions to the restrictions on loans to executive officers to include home equity lines of credit up to $100,000 and loans secured by readily marketable assets up to 50 percent of fair value. The effect of such amendments would be to provide additional flexibility in lending to executive officers without compromising safety and soundness standards.