Donald L Kohn: Regulatory relief

Testimony by Mr Donald L Kohn, Member of the Board of Governors of the US Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, United States Senate, Washington DC, 1 March 2006.

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Chairman Shelby, Senator Sarbanes, and members of the Committee, thank you for the opportunity to discuss the Federal Reserve's views on regulatory relief. The Board commends the Committee for its continued focus and work on this important issue. In particular, I'd like to recognize and thank Senator Crapo and his staff for their ongoing efforts to coordinate the many regulatory relief proposals that have been advanced to date by the federal banking agencies, financial trade associations, and others.

The regulatory requirements imposed on our nation's banking organizations have grown over time. Often the impact of these requirements falls hardest on our nation's community banks, which have fewer resources than larger organizations to meet the challenges posed by new or additional regulations. Although the individual requirements and restrictions imposed by federal law may well have been justified at the time of adoption, changes in the marketplace, technology and, indeed, in the federal banking laws themselves may well have altered the balance of the cost-benefit analysis that should underlie each requirement and restriction. Unnecessary regulatory burdens hinder the ability of large and small banking organizations to meet the needs of their customers, operate profitably, innovate, and compete with other financial services providers. That is why the Board periodically reviews its own regulations and why it is so important for Congress to periodically review the federal banking laws to determine whether there are any provisions that may be streamlined or eliminated without compromising the safety and soundness of banking organizations, consumer protections, or other important objectives that Congress has established for the financial system.

The Board, working with the other banking agencies, has been, and will continue to be, a strong and active supporter of Congress' regulatory relief efforts. In 2003, the Board provided this Committee with a number of legislative proposals for inclusion in a regulatory relief bill. Since then, in response to requests from Senator Crapo, the Board has reviewed numerous other regulatory relief proposals included in the Matrix of Financial Services Regulatory Relief Proposals (Matrix) compiled by Senator Crapo's staff that may affect the Federal Reserve or the organizations we supervise. As a result of that process, I am pleased to report that the Board now supports more than 35 legislative proposals. These proposals would meaningfully reduce regulatory burden, improve the supervision of banking organizations, or otherwise enhance the federal banking laws without compromising the fundamental goals of bank regulation and supervision. A complete listing and summary of the proposals supported by the Board is included in the appendix to my testimony. We believe these proposals provide an excellent starting point for any regulatory relief legislation, and we look forward to working with the Committee as you develop and perfect such legislation.

In my remarks, I will highlight the three items that are the Board's highest regulatory relief priorities. These proposals would allow the Federal Reserve to pay interest on balances held by depository institutions at Reserve Banks, provide the Board greater flexibility in setting reserve requirements, and permit depository institutions to pay interest on demand deposits. These proposals may well sound familiar to you and they should. The Board has supported these amendments for many years because we believe each of them would improve the operation of our financial system. I should note that these three amendments form the core of S. 1586, the Interest on Business Checking Act of 2005, which was introduced last year by Senators Hagel, Reed and Snowe. The Board strongly supports passage of S. 1586, either independently or as part of a broader regulatory relief bill.

In addition to these priority items, I will highlight a few other legislative proposals that we believe would provide meaningful regulatory relief to banking organizations as well as some steps that the Board has taken on its own to reduce regulatory burden. Finally, I will discuss several matters related to industrial loan companies (ILCs). This topic has been raised by some regulatory relief proposals, but it has much broader policy implications for the structure and supervision of the banking industry.

Interest on reserves and reserve requirement flexibility (Matrix Nos. 1 and 2)

The first two of the Board's priority items relate to reserve requirements, which exist to assist the Federal Reserve conduct monetary policy. Federal law currently obliges the Board to establish reserve requirements on certain deposits held at depository institutions and mandates that the Board set the ratio of required reserves on transaction deposits above a certain threshold at between 8 and 14 percent. Because the Federal Reserve does not pay interest on the balances held at Reserve Banks to meet reserve requirements, depositories have an incentive to reduce their required reserve balances to a minimum. To do so, they engage in a variety of reserve avoidance activities, including sweep arrangements that move funds from deposits that are subject to reserve requirements to deposits and money market investments that are not. These sweep programs and similar activities absorb real resources and therefore diminish the efficiency of our banking system.

Besides required reserve balances, depository institutions also voluntarily hold two other types of balances in their Reserve Bank accounts--contractual clearing balances and excess reserve balances. A depository institution holds contractual clearing balances when it needs a higher level of balances than its required reserve balances in order to pay checks or make wire transfers out of its account at the Federal Reserve without incurring overnight overdrafts. Currently, such clearing balances do not earn explicit interest, but they do earn implicit interest in the form of credits that may be used to pay for Federal Reserve services, such as check clearing. Excess reserve balances are funds held by depository institutions in their accounts at Reserve Banks in excess of their required reserve and contractual clearing balances. Excess reserve balances currently do not earn explicit or implicit interest.

The Board has long supported legislation that would authorize the Federal Reserve to pay depository institutions interest on the balances they hold at Reserve Banks. As we previously have testified, paying interest on required reserve balances would remove a substantial portion of the incentive for depositories to engage in reserve avoidance measures, and the resulting improvements in efficiency should eventually be passed through to bank borrowers and depositors. Having the authority also to pay interest on contractual clearing and excess reserve balances as well as required reserves would enhance the Federal Reserve's ability to efficiently conduct monetary policy. In addition, it would complement another of the Board's proposed amendments, which would give the Board greater flexibility in setting reserve requirements for depository institutions.

In order for the Federal Open Market Committee (FOMC) to conduct monetary policy effectively, it is important that a sufficient and predictable demand for balances at the Reserve Banks exist so that the Federal Reserve knows the volume of reserves to supply (or remove) through open market operations to achieve the FOMC's target federal funds rate. Authorizing the Federal Reserve to pay explicit interest on contractual clearing balances could potentially provide a demand for voluntary balances that would be stable enough for monetary policy to be implemented effectively through existing procedures without the need for required reserve balances. In these circumstances, the Board, if authorized, could consider reducing--or even eliminating--reserve requirements, thereby reducing a regulatory burden for all depository institutions, without adversely affecting the Federal Reserve's ability to conduct monetary policy.

Having the authority to pay interest on excess reserves also could help mitigate potential volatility in overnight interest rates. If the Federal Reserve was authorized to pay interest on excess reserves, and did so, the rate paid would act as a minimum for overnight interest rates, because banks generally would not lend to other banks at a lower rate than they could earn by keeping their excess funds at a Reserve Bank. Although the Board sees no need to pay interest on excess reserves in the near future, the ability to do so would be a potentially useful addition to the monetary policy toolkit of the Federal Reserve.

Interest on demand deposits (Matrix No. 3)

Another priority item for the Board would repeal the statutory restrictions that currently prohibit depository institutions from paying interest on demand deposits. Repealing these restrictions would improve the overall efficiency of our financial sector, assist small banks in attracting and retaining business deposits, and allow small businesses to earn direct interest on their checking account balances. As a practical matter, these restrictions currently do not impede the payment of interest on consumer deposits because depository institutions generally are permitted to offer individuals interest-bearing negotiable order of withdrawal (NOW) accounts, which are checkable transaction accounts similar to demand deposits.

To compete for the liquid assets of businesses, however, banks have been compelled to set up complicated procedures to pay implicit interest on compensating balance accounts and they spend resources--and charge fees--for sweeping the excess demand deposits of businesses into money market investments on a nightly basis. Small banks often do not have the resources to develop the sweep or other programs that are needed to compete for the deposits of business customers. Moreover, from the standpoint of the overall economy, the expenses incurred by institutions of all sizes to implement these programs are a waste of resources and would be unnecessary if institutions were permitted to pay interest on demand deposits directly. The costs incurred by banks in operating these programs are passed on to their large and small business customers and many small businesses do not benefit from these programs.

For these reasons, the Board's proposed amendment would allow all depository institutions that have the legal authority to offer demand deposits to pay interest on those deposits. The amendment would eliminate the need for banks to operate, and business customers to pay for, sweep and compensating balance arrangements to pay or earn interest on demand deposits. As I will explain a little later, however, the Board opposes amendments that would separately authorize ILCs that operate outside the supervisory and regulatory framework established for other insured banks to offer, for the first time, transaction accounts to business customers.

The Board believes that, once enacted, the authorization for depository institutions to pay interest on demand deposits should become effective promptly. S. 1586 would achieve this goal by requiring that the authority to pay interest on demand deposits become effective no later than 90 days after enactment. The Board, however, does not advocate the provisions of S. 1586 or other bills that would allow banks to offer a reservable money market deposit account (MMDA) from which twenty-four transfers a month could be made to other accounts of the same depositor. These provisions would permit banks to sweep balances from demand deposits into MMDAs each night, pay interest on them, and then sweep them back into demand deposits the next day. This type of twenty-four-transfer MMDA likely would be useful only during the transition period before direct interest payments were allowed. Moreover, as the Board has explained in previous testimonies, this type of account would represent an inefficient, more costly and less readily available alternative to interest-bearing demand deposits.

De novo interstate branching

The Board also strongly supports an amendment that would remove outdated barriers to de novo interstate branching by banks. Since enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal Act), all fifty states have permitted banks to expand on an interstate basis through the acquisition of an existing bank in their state. Interstate banking is good for consumers and the economy as well as banks. The creation of new branches helps maintain the competitiveness and dynamism of the American banking industry and improve access to banking services in otherwise under-served markets. It results in better banking services for households and small businesses, lower interest rates on loans, and higher interest rates on deposits. Interstate branching also increases convenience for customers who live, work, and operate across state borders.

However, the Riegle-Neal Act permitted banks to open a branch in a new state *without* acquiring another bank only if the host state enacted legislation that expressly permits entry by de novo branching (an opt-in requirement). To date, twenty-two states and the District of Columbia have enacted some form of opt-in legislation, while twenty-eight states continue to require interstate entry through the acquisition of an existing bank.

This limitation on de novo branching is an obstacle to interstate entry for all banks and also creates special problems for small banks seeking to operate across state lines. Moreover, it creates an unlevel playing field between banks and federal savings associations, which have long been allowed to establish de novo branches on an interstate basis.

The Board's proposed amendment would remove this last obstacle to full interstate branching for banks and level the playing field between banks and thrifts by allowing banks to establish interstate branches on a de novo basis. The amendment also would remove the parallel provision that allows states to impose a minimum requirement on the age of banks that are acquired by an out-of-state banking organization. While the Board supports expanding the de novo branching authority of banks, the Board continues to believe that Congress should *not* grant this new branching authority to ILCs unless the corporate owners of these institutions are subject to the same type of consolidated supervision and activities restrictions as the corporate owners of other full-service insured banks.

Small bank examination flexibility (Matrix No. 68)

The Board also supports expanding the number of small institutions that may qualify for an extended examination cycle. Federal law currently requires that the appropriate federal banking agency conduct an on-site examination of each insured depository institution at least once every twelve months. The statute, however, permits institutions that have less than $250 million in assets and that meet certain capital, managerial, and other criteria to be examined on an eighteen-month cycle. As the primary federal supervisors for state-chartered banks, the Board and Federal Deposit Insurance Corporation (FDIC) may alternate responsibility for conducting these examinations with the appropriate state supervisory authority if the Board or FDIC determines that the state examination carries out the purposes of the statute.

The $250 million asset cutoff for an eighteen-month examination cycle has not been raised since 1994. The Board's proposed amendment would raise this asset cap from $250 million to $500 million. Importantly, this change would not exempt any insured depository institution from routine safety and soundness examinations, and would not lengthen the examination cycle for institutions experiencing financial or managerial difficulties. This change is unanimously supported by the federal banking agencies and potentially would allow approximately an additional 1,200 insured depository institutions to qualify for an eighteen-month examination cycle. The Board believes this change would provide meaningful relief to small, financially strong institutions without compromising safety and soundness.

The Board's supervisory experience, however, indicates that institutions with assets approaching $1 billion tend to have more complex risk profiles and are more likely to operate business lines on a regional or national basis than institutions with assets of less than $500 million. For these reasons, the Board is not comfortable raising the asset threshold for an eighteen-month examination cycle to $1 billion, as items No. 112 and No. 169 in the Matrix would do. The Board also does not support proposals, such as item No. 42 in the Matrix, that would allow a federal banking agency to extend the examination cycle for a potentially indefinite period of time for institutions of any size. Despite advances in off-site monitoring, the Board continues to believe that regular on-site examinations play a critical role in helping bank supervisors detect and correct asset, risk-management, or internal control problems at an institution before these problems result in claims on the deposit insurance funds. If an agency is experiencing shortages in its examination resources, we believe it would be better to address these constraints through the supplementation of the agency's resources, rather than by extending the mandated frequency of safety and soundness examinations.

Other Board legislative proposals and actions to reduce regulatory burden

In addition to these proposals, the Board supports a variety of other regulatory relief amendments included in the Matrix. These amendments, which are discussed more fully in the Appendix, would among other things:

- Restore the Board's ability to determine that nonbanking activities are "closely related to banking" for purposes of section 4(c)(8) of the Bank Holding Company Act (BHC Act) and, thus, permissible for all bank holding companies to conduct directly or through a nonbank subsidiary (Matrix No. 137(a));
- Streamline the process for insured banks to acquire savings associations and trust companies in interstate merger transactions (Matrix No. 138);
- Modify the cross-marketing restrictions that apply to the merchant banking and insurance company investments of financial holding companies (Matrix No. 139);
- Eliminate certain reporting requirements imposed on banks and their executive officers and principal shareholders that do not contribute significantly to the monitoring of insider lending or the safety and soundness of insured depository institutions (Matrix No. 4);
- Streamline the inter-agency consultation process for transactions under the Bank Merger Act (Matrix No. 5);

- Shorten the post-approval waiting period for bank acquisitions and mergers where the Attorney General and the relevant federal banking agency agree the transaction will not have a significant adverse effect on competition (Matrix No. 6);
- Simplify the restrictions governing dividend payments by national and state member banks in a way that would not adversely affect the safety and soundness of member banks (Matrix No. 31); and
- Facilitate the flow of information during the supervisory process by clarifying that depository institutions and others do not waive any privilege they may have with respect to information when they provide the information to a federal, state or foreign banking authority as part of the supervisory process (Matrix No. 100).

In our discussions with banking organizations about regulatory relief, one topic that frequently comes up is the Bank Secrecy Act (BSA). We recognize that provisions of the BSA require considerable effort by the banking industry to obtain, document and provide information to law enforcement. To further promote the uniform application of BSA and anti-money laundering (AML) requirements, the federal banking agencies, working with the Financial Crimes Enforcement Network of the Treasury Department, recently issued a joint BSA/AML Examination Manual that is designed to promote the effective and consistent examination of BSA/AML compliance. The Board will continue to work with our fellow banking agencies and FinCEN to address key issues related to BSA/anti-money laundering compliance. With respect to currency transaction reports (CTRs), we support the efforts of the Treasury Department and others to develop ways of reducing the burdens imposed on banks in a manner that would not adversely affect the ability of banks to manage their risk or unintentionally impede the investigative tools available to law enforcement.

Before moving on, I'd like to mention some recent changes that the Board itself has made to its Small Bank Holding Company Policy Statement ("Policy Statement") and capital guidelines that we believe should provide significant relief to community banking organizations. The Board adopted the Policy Statement in 1980 to help facilitate the transfer of ownership of small, community-based banks. Currently, the Policy Statement applies to bank holding companies that have consolidated assets of less than $150 million and that meet certain qualitative criteria. These qualitative criteria are designed to ensure that a small bank holding company does not qualify for the Policy Statement if it engages in significant activities outside its supervised bank subsidiaries. Small bank holding companies that qualify for, and operate under, the Policy Statement also are subject to several additional restrictions and conditions that are designed to ensure that they do not present an undue risk to the safety and soundness of their subsidiary banks.

Last week, the Board approved an amendment that increases to $500 million the asset size threshold for determining whether a bank holding company may qualify for the Policy Statement and the related exemption from the Board's capital guidelines for bank holding companies. The Board also has proposed to make conforming revisions to its regulatory reporting framework, which should further lower reporting and compliance costs for small bank holding companies. The Board believes these actions properly balance the goals of facilitating the transfer of ownership of small banks, on the one hand, and ensuring capital adequacy and access to necessary supervisory information on the other hand. The Board, however, does not support amendments, like item No. 116 in the Matrix, that potentially would require the Board to raise the asset size threshold in the Policy Statement to $1 billion.

Industrial loan companies

As I noted earlier, the Board strongly supports amendments that would allow depository institutions to pay interest on demand deposits and allow banks to open de novo branches on an interstate basis. The Board, however, believes that, because the corporate owners of ILCs operate outside the prudential and legislative framework applicable to the corporate owners of other types of insured banks, ILCs should *not* be authorized to offer transaction accounts to business customers or branch de novo across state lines. Our position on these matters is long-standing and based on the broad policy issues presented by the special exemption in current law for ILCs chartered in certain states.

ILCs are banks; specifically, they are state-chartered FDIC-insured banks. However, due to a special exemption in the federal BHC Act, any type of company, including a commercial or retail firm, may acquire an ILC in a handful of states--principally Utah, California, and Nevada--and avoid the activity restrictions and consolidated supervisory requirements that apply to bank holding companies.

ILCs were first established early in the twentieth century to make small loans to industrial workers. When the special exemption for ILCs initially was granted in 1987, ILCs were still mostly small, local institutions that had only limited deposit-taking and lending powers. For example, in 1987, most ILCs had less than $50 million in assets and the largest ILC had assets of less than $400 million. Moreover, in 1987, the relevant states were not actively chartering new ILCs. Utah, for example, had a moratorium on the chartering of new ILCs at the time the exemption was enacted.

However, as the Government Accountability Office (GAO) recently documented, the ILC exemption has been actively exploited in recent years, resulting in a significant change in the character, powers and ownership of ILCs. For example, one ILC operating under the exception now has more than $60 *billion* in assets and more than $52 *billion* in deposits, and an additional nine exempt ILCs each have more than $1 billion in deposits. The aggregate amount of estimated insured deposits held by all ILCs has grown by more than 500 percent since 1999, and the total assets of all ILCs has grown from $3.8 billion in 1987 to $140 billion in 2004. Several large, internationally active commercial companies now own ILCs under this exception and use these banks to support various aspects of their global commercial operations.

While only a handful of states have the ability to charter exempt ILCs, there is no limit on the number of exempt ILCs these grandfathered states may charter in the future. In addition, due to the limited restrictions that apply under federal law to the ILCs operating under this exemption, an exempt ILC legally may engage in the full range of commercial, mortgage, credit card and consumer lending activities; offer payment-related services, including Fedwire, automated clearing house (ACH) and check clearing services, to affiliated and unaffiliated persons; and accept time and savings deposits, including certificates of deposit (CDs), from any type of customer.

Why does this growth and potential further expansion of ILCs matter? Simply stated, it has the potential to undermine several important policies that Congress has established for the banking system. Let me explain.

Congress has established a prudential framework for banking organizations in the United States that is based both on the supervision of insured banks *and* the supervision of their corporate owners on a group-wide or consolidated basis. Consolidated supervision refers to the legal framework that provides a supervisor the tools it needs--such as reporting, examination, capital and enforcement authority--to understand, monitor and, when appropriate, restrain the risks associated with an organization's consolidated or group-wide activities. Consolidated supervision of the organizations that control banks not only helps prevent bank failures, it also provides important tools for managing and resolving bank failures if and when they do occur. In fact, following the collapse of Bank of Commerce and Credit International (BCCI), which lacked a single supervisor capable of monitoring its diverse and global activities, Congress amended the BHC Act in 1991 to require that foreign banks demonstrate that they are subject to comprehensive supervision on a consolidated basis prior to acquiring a bank in the United States.

For a variety of reasons, Congress also has long sought to maintain the general separation of banking and commerce in the United States. This position was reaffirmed by Congress in the Competitive Equality Banking Act of 1987 and again in the GLB Act of 1999. In fact, in each of these acts the Congress took affirmative action to close the main loophole then being used by commercial firms to acquire FDIC-insured depository institutions--the so-called "nonbank bank" loophole in 1987 and the unitary thrift loophole in 1999.

ILCs have developed and expanded in recent years outside this framework that governs banking organizations generally. Because of their special exemption in federal law, any type of company may acquire an FDIC-insured ILC that is chartered in certain states without regard to the activity restrictions that Congress has established to maintain the general separation of banking and commerce. The exemption also allows a company to acquire an FDIC-insured bank and avoid the consolidated supervisory framework--including consolidated capital, examination and reporting requirements--that applies to the corporate owners of other full-service insured banks under the BHC Act. In addition, the exemption allows a foreign bank to acquire a U.S. bank engaged in retail banking activities without meeting the requirement under the BHC Act that the foreign bank be subject to comprehensive supervision on a consolidated basis in its home country.

As insured banks, each ILC is supervised by the FDIC as well as by its chartering state. The Board has never questioned either the need for, or the adequacy of, this supervision of an ILC. However, experience has led Congress to determine that supervision of a full-service insured bank is not sufficient, by itself, to protect the taxpayer and the financial system when the bank operates as part of a larger corporate organization. The FDIC does not have the authority to supervise the corporate owners of ILCs and their affiliates in the same manner that bank holding companies and their nonbank affiliates are supervised under the BHC Act. The GAO recently concluded that, due to these differences in authority, exempt ILCs may pose more risk to the deposit insurance funds than banks operating in a bank holding company structure.

The exemption for ILCs in the BHC Act also permits a diversified securities, insurance or financial firm to acquire an FDIC-insured bank without complying with the enhanced capital, managerial and Community Reinvestment Act (CRA) requirements established by Congress in the GLB Act for financial holding companies. In addition, although the USA PATRIOT Act requires the Board to consider the effectiveness of a company's policies in combatting money laundering prior to approving the company's application to acquire a bank, this requirement does not apply to companies that seek to acquire an exempt ILC.

Affirmatively granting ILCs the ability to offer transaction accounts to business customers or open de novo branches nationwide would significantly expand the powers of exempt ILCs, increase the attractiveness of the current loophole, and eliminate any vestige of a distinction between ILCs and full-service insured banks. This result would be inconsistent with both the historical functions of ILCs and the terms of their special exemption in current law. These proposals individually and collectively also would exacerbate the competitive advantage that the corporate owners of ILCs have over other banking organizations that operate within the supervisory framework established by Congress.

The Board believes that the important principles governing the structure of the nation's banking system--such as the separation of banking and commerce, consolidated supervision, and the supervisory criteria applicable to companies that seek to own or control a bank--should be decided by Congress and, once established, should apply to all organizations that own a bank in a competitively equitable manner. We are concerned that the expansion and exploitation of the ILC exemption is undermining the prudential framework that Congress has carefully crafted and developed for the corporate owners of insured banks. Importantly, these changes also threaten to remove from Congress' hands the ability to determine the direction of our nation's financial system with regard to the mixing of banking and commerce.

Congress should not permit the nation's policy on these important issues to be decided for it on a de facto basis through the expansion of a loophole that is available to only one type of institution chartered in a handful of states. Rather than expanding the powers of ILCs that operate under this special exemption in a regulatory relief bill, we believe it is important for Congress separately to conduct a thorough review of the special exemption for ILCs and its potential to change the landscape of our financial system and create an unlevel competitive playing field.

Conclusion

I appreciate the opportunity to discuss the Board's legislative suggestions and priorities concerning regulatory relief. The Board looks forward to working with the Committee and your staffs in developing and advancing meaningful regulatory relief legislation that is consistent with the nation's public policy objectives.

Appendix

Regulatory relief proposals supported by the Board of Governors of the Federal Reserve System

The Board believes the first 20 items listed below would provide meaningful regulatory relief to banking organizations within the jurisdiction of the Federal Reserve. The remaining 16 items would improve the supervision of banking organizations, facilitate the resolution of failed banks, streamline procedural or other requirements under the federal banking laws, or eliminate outdated provisions of law.

1. **Authorize the Federal Reserve to pay interest on balances held at Reserve Banks** (Matrix No. 1)

   Amendment gives the Federal Reserve explicit authority to pay interest on balances held by depository institutions at the Federal Reserve Banks.

2. **Grant the Board additional flexibility in establishing reserve requirements** (Matrix No. 2)

   Amendment provides the Federal Reserve with greater flexibility to set the ratio of reserves that a depository institution must maintain against its transaction accounts below the current ranges established by the Monetary Control Act of 1980.

3. **Authorize depository institutions to pay interest on demand deposits** (Matrix No. 3)

   Amendment repeals the provisions in current law that prohibit depository institutions from paying interest on demand deposits. If adopted, the amendment would allow all depository institutions that have the authority to offer demand deposits to pay interest on those deposits.

4. **Ease restrictions on interstate branching and mergers in a competitively equitable manner** (Amendment provided to Committee in July 2003)

   Amendment affirmatively authorizes national and state banks to open de novo branches on an interstate basis. Currently, banks may establish de novo branches in a new state only if the state has affirmatively authorized de novo branching. This existing limitation places banks at a disadvantage to federal savings associations, which currently have the ability to branch de novo on an interstate basis. The amendment also would remove a parallel provision that allows states to impose a minimum requirement on the age of banks that may be acquired by an out-of-state banking organization.

   The amendment would not allow industrial loan companies (ILCs) that operate under a special exemption in federal law to open de novo branches on a nationwide basis. The corporate owners of these ILCs are not subject to the type of consolidated supervision and activities restrictions that generally apply to the corporate owners of other banks insured by the Federal Deposit Insurance Corporation (FDIC). Granting exempt ILCs nationwide branching rights also would be inconsistent with the terms of their special exemption in federal law.

5. **Small bank examination flexibility** (Matrix No. 68)

   Amendment would expand the number of small institutions that may qualify for an eighteen-month (rather than a twelve-month) safety and soundness examination cycle. Under current law, an insured depository institution may qualify for an extended eighteen-month examination cycle only if the institution has less than $250 million in total assets. *See* 12 U.S.C. § 1820(d). The amendment would raise this asset cap to $500 million, thereby potentially allowing approximately an additional 1,200 institutions to qualify for an extended examination cycle.

6. **Modification of the cross-marketing restrictions applicable to merchant banking and insurance company investments** (Matrix Nos. 139, 171 and 187)

   Amendment allows the depository institution subsidiaries of a financial holding company to engage in cross-marketing activities with portfolio companies that are held under the merchant banking authority in the Gramm-Leach-Bliley Act (GLB Act) to the same extent as such activities are currently permissible for portfolio companies held under the GLB Act's insurance company investment authority. The amendment also would allow the depository institution subsidiaries of a financial holding company to engage in cross-marketing activities with a portfolio company held under either the merchant banking or insurance company investment authority if the financial holding company does not control the portfolio company.

7. **Permit the Board to grant exceptions to the attribution rule concerning shares held by a trust for the benefit of a bank holding company or its shareholders or employees** (Matrix No. 140)

   The amendment would allow the Board, in appropriate circumstances, to waive the attribution rule in section 2(g)(2) of the Bank Holding Company Act (BHC Act). This attribution rule currently provides that, for purposes of the BHC Act, a company is deemed in all circumstances to own or control any shares that are held by a trust (such as an employee benefit plan) for the benefit of the company or its shareholders or employees. The amendment would allow the Board to waive the rule when, for example, the shares in question are held by a 401(k) plan that is widely held by the bank holding company's employees and the facts indicate that the bank holding company does not have the ability to control the shares held by the plan.

8. **Allow insured banks to engage in interstate merger transactions with savings associations and trust companies** (Matrix No. 138)

   The amendment would allow an insured bank to directly acquire, by merger, an insured savings association or uninsured trust company in a different home state without first converting the target savings association or trust company into an insured bank. As under current law, the insured bank would have to be the survivor of the merger.

9. **a. Restore Board's authority to determine that new activities are "closely related to banking" and permissible for all bank holding companies** (Matrix No. 137a)

   Amendment would restore the Board's ability to determine that nonbanking activities are "closely related to banking" under section 4(c)(8) of the BHC Act and, thus, permissible for all bank holding companies, including those that have not elected to become financial holding companies. Bank holding companies would still be required to become a financial holding company to engage in the types of expanded activities authorized by the GLB Act--including full-scope securities underwriting, insurance underwriting, and merchant banking activities--as well as any new activities that the Board determines under the GLB Act are "financial in nature," "incidental to a financial activity" or "complementary to a financial activity."

   b. Allow bank holding companies to engage in insurance agency activities (Alternative to Item 9.a.) (Matrix No. 137b)

   Alternative amendment would allow all bank holding companies, including those that have not elected to become financial holding companies, to act as *agent* in the sale of insurance. Currently, bank holding companies that do not become a financial holding company may engage only in very limited insurance sales activities (primarily involving credit-related insurance). However, most *banks* are permitted to sell any type of insurance, either directly or through a subsidiary. The amendment would rectify this imbalance by permitting all bank holding companies to act as agent in the sale of insurance. Insurance agency activities involve less risk than insurance underwriting and other principal activities. Bank holding companies would continue to be required to become a financial holding company to underwrite insurance (other than credit-related insurance).

10. **Shorten the post-approval waiting period for bank mergers and acquisitions where the relevant banking agency and the Attorney General agree the transaction will not have adverse competitive effects** (Matrix No. 6)

    Amendment allows the responsible federal banking agency, with the concurrence of the Attorney General, to reduce the post-approval waiting periods under the Bank Merger Act and BHC Act from fifteen days to as few as five days. The amendment would *not* alter the time period that a private party has to challenge a banking agency's approval of a transaction for reasons related to the Community Reinvestment Act.

11. **Repeal certain reporting requirements imposed on the insiders of insured depository institutions** (Matrix No. 4)

    Amendment repeals the provisions of current law that require: (i) an executive officer of a bank to file a report with the bank's board of directors concerning the officer's indebtedness to other banks; (ii) a member bank to file a separate report each quarter concerning any loans made to its executive officers during the quarter; and (iii) executive officers and principal shareholders of a bank to report to the bank's board of directors any loans received from a correspondent bank. The Board has found that these reporting requirements do not contribute significantly to the monitoring of insider lending. These amendments would not alter the statutory limits or conditions imposed on loans by banks to their insiders.

12. **Provide an adjustment for the small depository institutions exception under the Depository Institution Management Interlocks Act (DIMIA)** (Matrix No. 49)

Currently, the DIMIA generally prohibits a management official of one depository institution from serving as a management official of any other non-affiliated depository institution or depository institution holding company if the institutions or an affiliate of such institutions have offices that are located in the same metropolitan statistical area. The statute provides an exception from this restriction for institutions that have less than $20 million in assets, but this dollar figure has not been updated since 1978. The amendment would increase this amount to $100 million.

13. **Simplifying dividend calculations for national and state member banks** (Matrix No. 31)

    Amendment would simplify the process for national and state member banks to pay dividends by eliminating the restrictions that currently allow a national bank or state member bank to pay dividends only if the bank's surplus is equal to or greater than its capital account or the bank has transferred at least 10 percent of its recent net income to its surplus fund. The amendment would not alter the other restrictions in current law that ensure that national and state member banks do not pay excessive dividends. For example, national and state member banks would continue to be prohibited from paying any dividend if such action would cause the bank to become undercapitalized.

14. **Authorize member banks to use pass-through reserve accounts** (Matrix No. 141)

    Amendment permits banks that are members of the Federal Reserve System to count as reserves their deposits in other banks that are "passed through" by those banks to the Federal Reserve as required reserve balances. Nonmember banks already are able to use such pass-through reserve accounts.

15. **Protection of information provided to banking agencies** (Matrix No. 100)

    Amendment allows a depository institution to share information with a federal, state or foreign bank supervisor as part of the supervisory or regulatory process without waiving any privilege the institution may have with respect to the information. The Board strongly supports broadening the amendment to ensure that other persons, including bank holding companies, foreign banks and Edge or agreement corporations, also may provide information to a federal, state or foreign supervisor as part of the supervisory or regulatory process without waiving any privilege they may have with respect to the information.

16. **Repeal of CRA Sunshine requirements** (Matrix No. 7)

    The amendment would repeal the so-called "CRA Sunshine" requirements that were adopted as part of the GLB Act in 1999. These provisions require nongovernmental entities or persons and banking organizations that enter into certain agreements that are in fulfillment of the Community Reinvestment Act (CRA) to (1) make the agreements available to the public and the appropriate banking agency, and (2) file an annual report with the appropriate banking agency concerning any payments made or received pursuant to the agreement.

17. **Flood insurance amendments** (Matrix No. 65)

    These amendments would:

    (a) Allow lenders to rely on information from licensed surveyors to determine whether a property is in a flood zone, if the flood map is more than ten years old;

    (b) Increase the "small loan" exception to the flood insurance requirements from $5,000 to $20,000 and adjust this amount periodically based on changes in the Consumer Price Index;

    (c) Reduce the forty-five-day waiting period required after policy expiration before a lender can "force place" flood insurance by fifteen days to coincide with the thirty-day grace period during which flood insurance coverage continues after policy expiration, which would better enable lenders to avoid gaps in coverage on the relevant collateral; and

    (d) Give the federal banking agencies discretion to impose civil money penalties on institutions found to have engaged in a pattern or practice of violating the flood insurance requirements.

18. **Permit credit card banks to make a limited amount of community development loans for CRA purposes** (Matrix No. 179) (Support with Minor Modifications)

The amendment would allow a limited-purpose credit card bank--without losing its exemption under the BHC Act--to make and purchase loans that help meet the credit needs of low- and moderate-income persons and neighborhoods or promote economic development by financing small businesses or farms. The aggregate amount of these non-credit card loans could not exceed 5 percent of the bank's capital and surplus.

The Board supports this amendment subject to a slight modification. The modification is designed to ensure that any non-credit card loans made by a credit card bank under the amendment are made for eligible community development purposes. Because credit card banks are evaluated for CRA purposes under a special community development test, there is no need to allow them to make non-credit card loans for CRA purposes unless those loans would qualify as community development loans under the CRA.

19. **Periodic interagency review of call reports** (Matrix No. 109)

    Amendment requires that the federal banking agencies jointly review the Call Report forms at least once every five years to determine if some of the information required by the reports may be eliminated. The federal banking agencies would retain their current authority to determine what information must be included in the Call Reports filed by the institutions under their primary supervision.

20. **Electronic Fund Transfer Act (EFT Act) notifications** (Matrix No. 115, first bullet)

    Amendment would increase, from 21 days to 30 days, the amount of advance notice an institution must give to a consumer under the EFT Act before the effective date of any changes in the terms of the consumer's account. The amendment would conform the timing provisions of the EFT Act regarding notices of a change in account terms with the similar provisions in the Truth in Savings Act.

21. **Technical and conforming amendments related to D.C.-chartered banks** (Matrix No. 164)

    The amendment would make technical and conforming amendments to the federal banking laws to ensure that banks chartered by the District of Columbia are treated as "state" banks consistent with the purposes of the 2004 District of Columbia Omnibus Authorization Act.

22. **Electronic records** (Matrix No. 161)

    This amendment would allow each federal banking agency to preserve the agency's records in electronic or photographic form and determine when such electronic or photographic records may be destroyed. In addition, the amendment would provide that any record maintained electronically or photographically by a federal banking agency in accordance with the agency's regulations shall be considered an original record for all purposes, including submission into evidence in a judicial or administrative proceeding.

23. **Ensure protection of confidential information received from foreign supervisory authorities** (Matrix No. 46)

    Amendment ensures that a federal banking agency may keep confidential information received from a foreign regulatory or supervisory authority if public disclosure of the information would violate the laws of the foreign country, and the banking agency obtained the information in connection with the administration and enforcement of federal banking laws or under a memorandum of understanding between the authority and the agency. The amendment would not authorize an agency to withhold information from Congress or in response to a court order in an action brought by the United States or the agency.

24. **Eliminate requirement that the reviewing agency request a competitive factors report from the other banking agencies in Bank Merger Act transactions** (Matrix Nos. 5 and 69)

    Amendment would eliminate the requirement that the reviewing agency request a competitive factors report from the other banking agencies on Bank Merger Act transactions. The reviewing agency would, however, continue to be required to (i) conduct a competitive analysis of the proposed merger, and (ii) request a competitive factors report from the Attorney General and provide a copy of this request to the FDIC (when the FDIC is not the reviewing agency).

25. **Streamline Bank Merger Act procedural requirements for transactions involving entities that are already under common control** (Matrix No. 61)

The amendment eliminates the need for the reviewing agency for a bank merger involving affiliated entities to request a report on the competitive factors associated with the transaction from the other banking agencies and the Attorney General. The amendment also would eliminate the post-approval waiting period for Bank Merger Act transactions involving affiliated entities. The merger of depository institutions that already are under common control typically does not have any impact on competition.

26. **Repeal requirement that the Board approve removal actions brought by the Office of the Comptroller of the Currency (OCC)** (Matrix No. 32)

    Amendment repeals the requirement that the Board approve removal actions brought by the OCC against institution-affiliated parties of a national bank.

27. **Clarify and confirm the ability of the banking agencies to enforce conditions imposed in Change in Bank Control ("CIBC") Act Notices** (Matrix No. 147)

    Amendment confirms the existing authority of a federal banking agency to enforce a written condition imposed on a depository institution or an institution-affiliated party in connection with a notice filed under the CIBC Act.

28. **Expand factors that the banking agencies may consider in evaluating CIBC Act notices** (Matrix No. 40 and No. 146)

    Amendment expands the factors the federal banking agencies may consider in determining whether to disapprove a notice under the CIBC Act to include the financial condition and future prospects of the depository institution involved in the transaction. The amendment also would allow the agencies to extend the time period for processing CIBC Act notice (up to an additional 90 days) if the agency determined that additional time is needed to analyze any plans the notificant may have to make major changes in the business, corporate structure, or management of the institution.

29. **Enforcing conditions imposed by another banking agency** (Matrix No. 148)

    Amendment would allow the appropriate federal banking agency for a depository institution, bank holding company or savings and loan holding company to enforce a written condition imposed on the institution or company by another federal banking agency. This would allow, for example, the Board (as the appropriate agency for a state member bank) to enforce a condition imposed on a state member bank by the FDIC in connection with the bank's application for deposit insurance.

    The Board supports the amendment subject to a minor modification. The modification is designed to clarify that, regardless of what agency imposes a condition on a depository institution or holding company, only the appropriate federal banking agency for the depository institution or holding company has the authority to enforce the condition against the depository institution or holding company. (As under current law, the FDIC would retain its "back-up" authority under section 8(t) of the Federal Deposit Insurance Act (FDI Act) to take action against an insured depository institution if certain conditions are met.)

30. **Eliminate the special treatment of holding companies that control only ILCs and credit card banks under the cross-guarantee and "golden parachute" provisions of the FDI Act** (Matrix Nos. 151 and 152)

    Amendment would modify the cross-guarantee provisions of the FDI Act (12 U.S.C. § 1815(e)) to cover insured depository institutions whenever they are controlled by the same company and even if the parent company is not a bank holding company or a savings and loan holding company. In addition, the amendment would modify the "golden parachute" provisions of the FDI Act (12 U.S.C. § 1828(k)) to cover a company that owns an insured depository institution, but that is not a bank holding company or savings and loan holding company. Currently, these provisions do not apply to a company that owns one or more ILCs or credit card banks, but that is not otherwise a bank holding company or savings and loan holding company.

    While the Board supports these limited changes, the Board notes that these amendments would *not* alter the much more significant exemption for ILCs from the definition of "bank" in the BHC Act. The exemption for certain ILCs in the BHC Act permits a company to own an

FDIC-insured ILC and avoid the activity restrictions and consolidated supervisory requirements that generally apply to the corporate owners of other insured banks.

31. **Contractual arrangements with a failed bank** (Matrix No. 155)

    Amendment would prohibit a party, for 90 days after the FDIC is appointed receiver or conservator for an insured depository institution, from exercising any contractual right the party may have to terminate, accelerate or declare a default under a contract with the failed institution, or obtain possession of collateral pledged under such a contract, unless the FDIC consented to the action.

32. **Barring convicted felons from participating in the affairs of an uninsured depository institution** (Matrix No. 38)

    Amendment extends to *uninsured* national banks, state member banks and U.S. branches of a foreign bank the provisions of section 19 of the FDI Act, which automatically prohibits a person that has been convicted of a criminal offense involving dishonesty, a breach of trust or money laundering from participating in the affairs of an insured depository institutions. The amendment also would allow the OCC or Board, as appropriate, to waive this prohibition as it applies to an uninsured bank or branch, just as the FDIC currently has the authority to waive this prohibition as it applies to insured banks.

33. **Restricting the ability of convicted individuals to participate in the affairs of a bank holding company or Edge Act or agreement corporation** (Matrix No. 142)

    Amendment would prohibit a person convicted of a criminal offense involving dishonesty, breach of trust, or money laundering from participating in the affairs of a bank holding company (other than a foreign bank) or an Edge Act or agreement corporation without the consent of the Board. The amendment also would provide the Board with greater discretion to prevent individuals convicted of crimes involving dishonesty or a breach of trust from participating in the affairs of a nonbank subsidiary of a bank holding company.

34. **Enhancing the ability of the banking agencies to suspend or remove bad actors** (Matrix No. 43 and No. 150)

    Amendment revises section 8(g) of the FDI Act, which currently allows the appropriate Federal banking agency to suspend a person from participating in the affairs of a depository institution, bank holding company or savings and loan holding company if the person has been *charged* with the commission of certain crimes involving dishonesty, a breach of trust or money laundering. The amendment would prohibit a person who has been suspended from service at one depository institution, bank holding company or savings and loan holding company from becoming employed by another depository institution or holding company during the length of the suspension order. In addition, the amendment would clarify that a person may be suspended under section 8(g) even if the person was charged with the relevant crime before becoming affiliated with the depository institution or holding company in question.

35. **Clarify application of section 8(i) of the FDI Act** (Matrix No. 144)

    Amendment clarifies that a federal banking agency may take enforcement action against a person for conduct that occurred during his or her affiliation with a banking organization regardless of whether the enforcement action is initiated through a notice or an order.

36. **Elimination of outdated provisions of the BHC Act** (Matrix No. 143)

    Amendment eliminates certain outdated provisions of the BHC Act that no longer have any effect.