deral Financial Institutions Examination Council

Study on Regulatory Burden

Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision

Federal Financial Institutions Examination Council

Study on Regulatory Burden

December 17, 1992

Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision

Federal Financial Institutions Examination Council

2100 Pennsylvania Avenue, NW, Suite 200 • Washington, DC 20037 • (202) 634-6526 • FAX (202) 634-6556

December 17, 1992

The President of the Senate
The Speaker of the House of Representatives

Pursuant to Section 221 of the Federal Deposit Insurance Corporation Improvement Act of 1991, I am pleased to submit to the Congress, on behalf of the Federal Financial Institutions Examination Council, this study on Regulatory Burden.

Section 221 requires the FFIEC in consultation with interested parties, including both insured depository institutions and consumer and community groups, to undertake four tasks:

1) To review the policies, procedures, recordkeeping and documentation requirements used to monitor and enforce compliance with all laws under the jurisdiction of the federal banking agencies and the Department of the Treasury;

2) To determine whether such policies, procedures, and requirements impose unnecessary burdens on the insured depository institutions;

3) To identify any revisions of such policies, procedures, and requirements that could reduce unnecessary burdens without diminishing compliance with or enforcement of consumer laws or endangering the safety and soundness of insured institutions; and

4) To report on such identified revisions to the Congress within one year.

To meet the requirements of the Act, the four federal banking agencies[1] and the Department of the Treasury undertook extensive reviews of their policies, procedures, recordkeeping and documentation requirements. The five organizations formed an interagency task force on Section 221 under the jurisdiction of the Council.

---

[1] The four federal banking agencies for purposes of Section 221 are the Federal Insurance Deposit Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

This task force met approximately every other week through 1992 in order to guide the process and shepherd the report through the planning, preparation, and writing stages.

The Council found that the regulatory burden on the banking system is large and growing. Our review of the available evidence suggests that the annual cost of regulatory compliance may be as high as $17.5 billion, or up to 14 percent of total noninterest expenses of the banking industry in 1991. Numerous suggestions were forthcoming from the Council's member agencies and from the public on ways to ease unnecessary regulatory burden. The Council has recommended over 60 specific initiatives which the agencies could undertake themselves to relieve individual burden requirements. Those initiatives are in addition to the numerous actions undertaken by the agencies during the past year, which are included separately in this study.

Those specific suggestions are only a beginning, however. Many aspects of regulatory burden flow not solely from the agencies themselves, but rather are imposed through legislation. Although proposed statutory reforms to ease regulatory burden were not the intended or primary focus of the study, the Council recognized when it undertook this process that suggestions regarding appropriate statutory revisions to ease regulatory burden might well arise. During the course of the study, many valuable suggestions regarding potential statutory revisions were indeed forthcoming. Accordingly, after submission of this study, the Council's member agencies have agreed to continue meeting to identify and recommend possible statutory changes to reduce regulatory burden further. The Council hopes to prepare a separate report to the Congress on those issues in the Spring of 1993.

The Council's member agencies look forward to working constructively with the Congress on the ongoing process to relieve regulatory burden.

Sincerely,

John P. LaWare

John P. LaWare
Chairman

Table of Contents

V. Appendices

A. Summaries of Public Comments On Regulatory Burden:
   FDIC, FFIEC, OCC, OTS

B. Summary of Comments Received by NCUA

C. The Cost of Regulation: A Review of the Evidence

D. Federal Agency Actions to Reduce Regulatory Burden

E. Prior Governmental Studies

F. References

G. Text of Section 221 of the Federal Deposit Insurance Corporation
   Improvement Act of 1991

EXECUTIVE SUMMARY

Financial institutions in general, and banks and savings associations in particular, are among the most heavily regulated businesses in the American economy. Much of the regulation arises ultimately from three fundamental concerns that date back to the early days of the republic: banking market structure and competition, banking safety, and monetary and systemic stability. More recently, a fourth area of concern, consumer protection in financial matters, has also become important, especially in the past 25 years.

Specific issues and goals of regulation in each of the four areas have changed and evolved along with the times and conditions. Consequently, much of the regulatory apparatus currently in place is a product of the twentieth century and especially the years since 1933. Today, four major federal agencies and dozens of state agencies directly regulate banks and saving associations under provisions of numerous public laws.

The purpose of this study, which is required by Section 221 of the FDIC Improvement Act of 1991 (FDICIA), is to report on possible revisions of agency regulations and requirements that could reduce unnecessary regulatory burden on banks and savings associations. Specifically, Section 221 of FDICIA requires the Federal Financial Institutions Examination Council (FFIEC), in consultation with interested parties, including individuals representing both insured depository institutions and consumer and community groups to undertake four tasks:[1]

1) To review the policies, procedures, recordkeeping and documentation requirements used to monitor and enforce compliance with all laws under the jurisdiction of the banking agencies and the Department of the Treasury:

2) To determine whether such policies, procedures, and requirements impose unnecessary burdens on the insured depository institutions;

3) To identify any revisions of such policies, procedures, and requirements that could reduce unnecessary burdens without diminishing compliance with or enforcement of consumer laws or endangering the safety and soundness of insured institutions; and

4) To report on identified revisions to the Congress within one year.

[1]The text of Section 221 is included as Appendix G to this report.

Study Procedures

To meet the requirements of the Act, during 1992 the four federal banking agencies and the Department of the Treasury undertook extensive internal reviews of their policies, procedures, recordkeeping and documentation requirements. To gather additional information, an interagency task force assembled the public comments that the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) had received in response to their Spring 1992 requests for comments on regulatory burden. Further, the FFIEC also requested public comments specifically on Section 221 and received 449 additional letters. The FFIEC also held "Town Meetings" or hearings in Kansas City, San Francisco, and Washington, D.C. in June 1992. In all, the interagency task force had available for its consideration 1,148 public comments (including comments from more than 100 consumer and community groups) and the testimony of 79 witnesses. Representatives of consumer and community groups also attended the November 1992 meeting of the FFIEC's Consumer Compliance Task Force and expressed their particular concern that any proposed relief from regulatory burden not diminish compliance with or enforcement of consumer laws.

In announcing its request for public comments on regulatory burden the FFIEC indicated its views on the scope of the study. The Council stated its belief that the intended focus of the study was not to examine and develop proposed revisions to the overall statutory scheme governing financial institutions. Rather, it appeared to the Council that the Congressional intent was to accept the statutory scheme devised by the Congress as a given and instead to examine the manner in which the federal banking agencies and the Treasury Department have implemented that scheme by means of regulations, policy statements, procedures, and recordkeeping requirements.

The Council further indicated that although proposed statutory reforms to ease regulatory burden did not appear to be the intended or primary focus of the study, it recognized that suggestions regarding appropriate statutory revisions might well arise. During the course of the study, many valuable suggestions regarding potential statutory revisions did indeed arise. Accordingly, the Council's member agencies have agreed to continue meeting to identify and recommend possible statutory changes to further reduce regulatory burden. The Council hopes to prepare a separate report on those issues in the Spring of 1993.

Findings

In producing the current report the Council made a number of findings concerning regulatory burden. Chapter II of the report discusses the nature of regulatory burden on depository institutions. Most entities in the domestic economy are subject to various forms of regulation, but not generally to the same extent as depository institutions. Depositories face extra stringencies in areas of regulation common to all businesses (such as aiding in government efforts to collect taxes and pursue money laundering). They also are subject to a variety of additional areas of regulation, however, that arise from the nature of their customers as creditors of the institution as well as purchasers of services. The core of bank regulation involves the goals of safety and stability, which other enterprises do not face.

Defined broadly, regulatory burden consists of any opportunity losses, operating costs, or cost-causing activities that are necessitated by government actions and would not arise in the normal course of business except for the government policy. Defined broadly in this way, burden ultimately arises from two sources: 1) prohibitions that prevent regulated institutions from engaging in activities that they would otherwise undertake; and 2) requirements for certain actions or behaviors that regulated institutions would not undertake in the absence of the requirements. Restrictions on activities fall into the first category, while paperwork and required compliance activities fall into the second.

Both prohibitions and requirements can be costly to the regulated entity. Although precisely measuring either type of burden is difficult, understanding and measuring the impact of prohibitions typically is even more difficult than quantifying the impact of requirements. Furthermore, often it is not only the prohibitions and requirements themselves but changes in either of these sources of burden that can lead to costs. In practice, since requirements seem to change more frequently, prohibitions on engaging in preferred activities are often overlooked in discussions of regulatory burden.

Despite methodological complexities, researchers have conducted some studies of regulatory burden on depository institutions. Most of the studies attempt to measure the costs of regulatory requirements and have found that the costs attributable to banking regulation are substantial. Despite methodological and coverage differences, findings are reasonably consistent that regulatory costs might be 6-14 percent of noninterest expenses, without including any measurement of the opportunity cost of reserve requirements. Since noninterest expenses of the banking industry were $124.6 billion in 1991, if the percentage estimates are correct, regulatory costs to the industry in 1991 could be between $7.5 and $17 billion, without any adjustment for the costs of reserve requirements. Another finding from the cost studies is that there appear to be economies of scale in compliance costs; in other words, large banks have an advantage in this area. A variety of econometric studies associated with consumer-protection regulations suggest that for a 10 percent increase in output, compliance costs increase only 6-8 percent.

Review of the materials assembled for this report suggests several recurring themes and common threads which cut across issues of regulatory burden. The last section of Chapter II reviews these general findings in more detail:

Cumulative Burden. Comments, testimony and cost studies suggest that cumulative regulatory burden may well be more than the sum of its parts.

Balancing of Costs and Benefits. While there are generally some benefits from each regulatory proposal, it is important to recognize that those benefits are not free for consumers because they are paid by institutions. While people enjoy all the benefits of legislation and regulation, they also pay all of the costs.

Coordination Among Regulatory Agencies. During 1992 regulators increased their efforts to coordinate policies and procedures. Further efforts in this direction will lessen the burden on depository institutions.

Pace of Change. Because startup costs are such an important component of regulatory burden, slowing the pace of legislative and regulatory change could reduce burden. In order to minimize the burden, rules should be revised as infrequently as possible, changes should be made only if they are significant, and reasonable transition times should be allowed for implementation.

Lack of Flexibility. Compliance requirements necessarily bring specificity and standardization, especially when compliance standards or methods are placed in the law itself with no exceptions. Forcing uniformity can be costly by precluding new approaches, preventing innovation, and even by limiting access to new technology and new markets.

Smaller Banks. The regulation of internal processes within banks has become increasingly intrusive, especially for smaller banks. Exemptions for smaller institutions might be a good approach on some matters, particularly data collection, but they may be more difficult to justify on others. At the same time, the Congress should realize that regulations affect different institutions differently and that the smaller ones tend to feel the brunt more heavily.

Well-run Banks. Legislation and regulation should distinguish between well-run and other banks whenever possible.

Obsolescence. Legislative and regulatory oversight should constantly be on the lookout for obsolescence and rules that can be deleted, rendering moot the need for sunsets which produce their own problems, especially uncertainty.

Directors. It appears from comments and testimony that regulation and the fear of litigation may have reached the point where attracting and retaining competent bank directors has become more difficult. Since competent directors are one of the first lines of defense against bank difficulties and losses, the important issue of how to attract and retain competent directors should be addressed.

Civil Liability. Imposing civil liability and permitting class action suits can increase burden because of potential litigation and requests for standardization and legal safe harbors. Administrative enforcement, even with its problems of intrusiveness and possibly inconsistent application on occasion, may be less burdensome in many cases.

Exception Authority. Some strictly limited "exception authority" for regulators to resolve anomalies and inconsistencies, such as the exception authority in the Truth in Lending Act, could help resolve possible inconsistencies and ambiguities.

Regulatory Language. New regulations and changes should be written clearly. Unnecessary regulatory burden results from regulations, policies, and procedures that are difficult to decipher and understand.

Statutory Source. Many regulatory requirements are mandated by statute and are not initiated by the agencies. Many commentators do not distinguish statute from regulation, and much of the complaints to regulators involves statutory requirements. This clearly suggests that if regulatory burden is to be reduced significantly, legislative changes may be needed.

Commission on Regulatory Improvement. Because of the difficulty of achieving political consensus, an independent nonpolitical group or commission charged with exploring possibilities for legislative improvement and possibly for achieving political consensus may be useful.

Agency Actions

In addition to these general findings, the agencies have considered many specific recommendations for regulatory change. These proposals originated from public comments and testimony at the Town Meetings, as well as from the agencies themselves. Chapter III contains the results of the interagency review of these recommendations. The recommendations in Chapter III--the bulk of the study--are divided into three groups. The first group contains recommendations that the FFIEC believes represent effective and efficient steps to reduce regulatory burden. In many cases, the agencies achieved a consensus position supporting the recommendation, while in other cases some agencies support the recommendation in part or prefer an alternative approach to meet the goal of the recommendation. Alternative positions are set forth in the discussion of individual recommendations where appropriate. In most cases, the agencies agreed on the general approach contained in the recommendation, although a few may require some further consideration and possibly some compromise.

The second group contains the recommendations that the agencies felt, after careful consideration, did not meet fully the standards set forth in Section 221. The pros and cons with respect to these recommendations are set forth in the discussion as well. Fewer recommendations fall into this grouping than into the first.

The third group contains recommendations from the public concerning non-Council member agencies. The Department of the Treasury has contributed an analysis of the public recommendations concerning the rules implementing the Bank Secrecy Act (BSA). Recommendations for other agencies are listed without discussion.

During 1992 the agencies took action on many of the suggested proposals to reduce regulatory burden. Consequently, these initiatives do not appear in Chapter III--Regulatory Recommendations--as matters for further action. Instead, a summary of those initiatives appears as Appendix D to this report.

I. INTRODUCTION

Financial institutions in general, and banks in particular, are among the most heavily regulated businesses in the American economy.[1] Although many specific components of financial regulation are products of the twentieth century, debate over the appropriate role of government in the banking and financial system is as old as the republic itself. As long ago as the administration of President George Washington, the Congress deliberated over the role of government in chartering banks and influencing their activities. In the intervening two hundred years, and particularly since 1933, government regulation of banking and finance has grown significantly.

Today four major federal agencies and dozens of state agencies directly regulate banks under provisions of numerous public laws, and banking law has become an important specialty in the legal profession. This study, which is required by Section 221 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), identifies possible revisions of agency regulations and requirements that could reduce unnecessary regulatory burden on banks and savings associations without endangering safety and soundness or diminishing compliance with or enforcement of consumer protection laws in any respect.

Historical Background

Throughout American history, three banking concerns have been fundamental: banking market structure and competition, banking safety, and monetary and systemic stability. Efforts to address each concern have produced specific regulatory rationales and actions. In the late twentieth century, a fourth concern has arisen: consumer protection in the financial area. Most of today's regulatory apparatus fits into one or more of these four categories.

In the earliest days of the country the first of these concerns--market structure and competition--focused on the role of government in establishing financial institutions. At issue was whether banking was a private or a public function and whether it was a federal or a state concern. In 1832, the Congress temporarily resolved this matter in favor of private banking under state charters when, by not overriding the veto of President Andrew Jackson, it did not

[1] In much of this report, the term "banks" is used generically to refer to bank-like insured depository institutions. Likewise, "regulation" is used generically to include the legislative framework as well as the implementing regulations.

renew the charter of the only federally chartered bank, the Second Bank of the United States. Ultimately, this 1832 decision led to the American pattern of numerous competing private banks with each bank limited in its geographic scope.

The National Currency Act of 1863 again permitted federal chartering of national banks, but the power of state governments to influence banking structure has remained important into the twentieth century. The McFadden Act (1927) and the Bank Holding Company Act (1956) reaffirmed state powers by subjecting the geographic expansion of national and state banks and their holding companies in part to the preferences of state legislatures. Controversy over both competition and local orientation has survived, however, and continues in the 1990s with disputes over mergers and antitrust considerations, interstate banking, and community reinvestment.

Similarly, government policies addressing banking safety have a long history. In the early nineteenth century, the central concerns were the value and redeemability of bank notes issued by the state-chartered banks. For a time the Second Bank of the United States, in effect, regulated the note issuance of state-chartered banks by periodically presenting their circulating notes for redemption. This central bank-like function helped with the problems of over-issuance and declining value of state-bank notes until the Second Bank's federal charter expired in 1836 and (under state charter) it failed in the recession that began the next year.

After the demise of the Second Bank of the United States, some states experimented with various forms of regulation of state banks, including note-insurance schemes that functioned like deposit insurance. The issue of bank safety became more settled for a time with passage of the National Currency Act of 1863 and the National Bank Act of 1864. These laws provided for a system of national banks that would issue safer national bank notes backed by Treasury securities. (This arrangement also helped finance the Civil War by providing a market for Treasury securities.)

The increased use of demand deposits later in the nineteenth century reopened the bank safety issue; this concern continued into the first third of the twentieth century. Establishment of the Federal Reserve System in 1913, the Federal Deposit Insurance Corporation in 1933 and the Federal Savings and Loan Insurance Corporation in 1934 again seemed to resolve the safety issue until the failures of banks and savings and loan associations increased in the 1980s. As with the structure and competition issue, the subject of government policies to provide for banking safety remains under active debate.

Deliberations over government policies to provide a stable monetary and financial system are also as old as the country. Following inflationary finance during the War for Independence, Treasury Secretary Alexander Hamilton advocated sound money to bolster the new country's credit during the years of the Washington Administration. On his advice, the Congress in 1792 established a monetary system based on a metallic standard (both gold and silver) which lasted as a gold standard until 1933 despite periodic debate and disruption.

Discussion of appropriate governmental monetary policies was particularly heated after the Civil War. After the wartime inflationary monetary expansion, the country in 1879 again resolved the political issues in favor of hard money with resumption of the metallic standard (this time only gold). Intensive political disputes over the role of government in the monetary system occurred during this era of the Greenback Party and the Free Silver Movement and culminated in 1896 with the political triumph of William McKinley and the gold standard over William Jennings Bryan and the silver advocates.

During these postwar years, banking panics resulted in disruptions of payments in 1873, 1884, 1893, and again in 1907. This uncertainty concerning the payments system contributed to creation of the Federal Reserve System in 1913. The Great Depression and the failure of thousands of banks in the early 1930s led to a collapse of the money supply, the suspension of the gold standard, and a dramatic expansion of the direct role of government in the monetary and payments system. Since 1933, the major responsibility for monetary and financial stability has rested upon the central banking functions of the Federal Reserve System and federal deposit insurance. Today, most observers acknowledge the importance of government in providing reasonably stable monetary values and a smoothly functioning payments system; however, they frequently disagree on the best means for achieving these goals.

Consumer protection in the financial area has a shorter history of federal legislative interest, but it has received particular attention in the past twenty five years. A competitive, safe, and stable banking system clearly benefits consumers, but since 1968 the Congress has also enacted specific legislation with the aim of protecting individual consumers in their relationships with financial institutions. Today, both the Senate and House of Representatives have subcommittees that focus on consumer affairs issues, and the federal banking regulatory agencies have consumer affairs specialists on their staffs and undertake consumer-compliance examinations of regulated institutions.

Federal legislation to protect consumers in the financial area over the past quarter century has been extensive. Among the more important acts are Truth in Lending (1968), Equal

Credit Opportunity (1974), Community Reinvestment (1977), Electronic Fund Transfer (1978), Expedited Funds Availability (1987), and Truth in Savings (1991). This list is not comprehensive, and the Congress has also amended its consumer-protection statutes from time to time. For example, Truth in Lending has been amended thirteen times since its passage in 1968.

Since the end of the Depression, the role of government in the financial system has generally been much less of a political issue than it was in the nineteenth century. While many of the specifics of government regulation of financial matters have been actively discussed, the absence of widespread banking panics or disruptions of payments since 1933 has meant that debates have been largely the province of specialists. Before the collapse of much of the savings and loan industry in the 1980s, political discussion over financial matters commanded relatively little public attention compared with that a century earlier.

Yet federal regulation of the financial system in recent years has not been dormant or unchanging. In fact, federal regulation of banking has steadily expanded since World War II. Landmark federal legislation enacted during this period includes the Bank Holding Company Act (1956), the Bank Merger Act (1960), the Savings and Loan Holding Company Amendments (1967), Bank Holding Company Act Amendments (1970), the Financial Institutions Regulatory and Interest Rate Control Act (1978), the Depository Institutions Deregulation and Monetary Control Act (1980), the Garn-St Germain Depository Institutions Act (1982), the Competitive Equality Banking Act (1987), the Financial Institutions Reform, Recovery, and Enforcement Act (1989), and the Federal Deposit Insurance Corporation Improvement Act (1991). This short list of legislation since World War II not only is incomplete but also ignores the many separate sections or titles establishing or amending several laws contained in each major legislative effort. The volume and the pace of changes have led the banking and financial industries sometimes to argue that the burden of regulation has increased beyond the usefulness of the regulations. Other observers contend that there are still regulatory gaps that should be covered by new laws.

Certainly federal regulation of banking is pervasive in 1992; it affects virtually every aspect of industry behavior. While most regulations originate from a worthy idea and each regulation in itself appears to present a manageable cost burden, complaints arise that the cumulative burden of regulation has become so severe that it stifles imagination and innovation and that regulatory costs now outweigh public benefits. This cumulative burden of regulation (along with available evidence of its measurable costs) is the subject of this report.

Rationales for Regulation

Although the general regulatory context of competition, safety, stability, and consumer protection has long been important, specific issues have evolved, and the questions have changed. Some of the most heated controversies of the past no longer exist. For example, the merits of the gold standard versus silver or bimetal standards are largely of historical interest. Some issues that are particularly important today, such as electronic transfers of money, were largely unknown until recent years. As these issues change and evolve, so do the laws, regulations, and regulatory structure.

In general, regulation is considered when fears arise concerning a market failure or dislocation that might be rectified by government intervention.[2] Monopoly is an example. Common experience, as well as economic theory, suggests that members of the public are likely to be worse off when monopolists provide goods or services. Under a monopolistic selling structure, price will be higher and output lower than in a more competitive market. If (low-cost) government action can prevent, limit, or control monopoly, then the public should be better off.

Another kind of market failure arises from economic "externalities"--social benefits or costs outside the private benefits and costs that form the basis of individual transactions. If private transactions, which presumably fully reflect private benefits and costs, fail to reflect some important social benefit or cost, then regulation may be able to provide a better balance. The argument of potential economic externalities has become significant in many regulatory contexts. If, for example, private agreements result in unclean air affecting people not party to the benefits of the agreement, or if private contracts destroy habitats of endangered animal species or defile unspoiled wilderness lands that are important to people not individually involved in the contract, regulation may protect the interests of these "external" parties. Some of these situations are controversial.

Overcoming potential market failures, including monopoly and positive or negative externalities, is a common justification advanced for regulating banking services. As already noted, public concern over monopoly and centralized economic power (as well as centralized

[2] A relatively new branch of economic theory known as Public Choice Theory suggests that regulation arises from an economic market characterized by a demand for, and supply of, regulation. While this branch of theory is important and provides many interesting insights and hypotheses for further thought, extensive theoretical review of the economic origins of regulation is beyond the scope of this report.

political power) dates from the founding fathers. It was a core worry in the debates over the First and Second Banks of the United States, and it is still heard today in the context of "Wall Street" versus "Main Street." Likewise, many social benefits to a safe and well-functioning banking system extend beyond the private benefits that accrue to the providers and users of specific services. For example, a smoothly functioning banking and financial system, it is widely agreed, is a prerequisite for healthy economic growth and thereby benefits all of society besides providing private benefits to parties entering into banking transactions.

Recognizing that overcoming market failures is the general rationale for regulation, each potential government action also has its own specific goal (see Table I). The listing in Table I clearly shows the underlying importance of the four general areas noted above: structure and competition, safety, stability, and consumer protection (groups I-IV). From time to time other reasons for regulation have surfaced, including reallocation of resources, assistance with public finance, and other goals of government (group V).

Certainly the goals in group I--preventing concentrations of power, promoting competition and efficiency, preventing conflicts of interest, and preventing the extension of the banking safety net--have been motivations behind regulations concerning structure and competition. Preventing monopoly (and associated economic and financial power) and the inverse, promoting competition and efficiency (lines 1 and 2), have been important not only because of the fear that centralized economic power may be connected with political power but also because monopoly affects volume and prices. Policies that by their nature promote competition should tend to limit monopoly and promote efficiency (which refers to maximum output per unit of input). Competition and greater efficiency mean that prices of loans and other bank services will be lower than they would be under a less competitive framework. The lower prices certainly benefit bank customers and the rest of the economy. Antitrust enforcement generally and the Bank Merger Act and the Bank Holding Company Act specifically involve attempts to ensure competitive conditions in the banking industry through regulatory action.

In the past, many observers held the view that banking should be separate from other areas of commerce to prevent conflicts of interest and concentrations of power. A more recent concern has been that combining banking and commerce could extend the federal banking "safety net" from banking to commerce and thereby increase taxpayer liability and confer competitive advantages on such firms (see group I). Increasing stresses in U.S. banking and concern over the competitive position of the industry, however, have led to a reconsideration of the separation of banking and commerce, within the context of comprehensive reform of the U.S. banking industry.

A second rationale for banking regulation concerns banking safety (group II in Table I), which entails a considerable subset of regulatory requirements and procedures. These include the requirement to file periodic and often extensive reports, restrictions on transactions with affiliates and insiders, limits on loans to individual borrowers, capital requirements, accounting rules, and various supervisory policies including general regulatory oversight of bank-management and bank-examination procedures. FDICIA, signed in December 1991, added a list of new--and detailed--requirements in the supervisory area.

Many of the historic rationales for regulation in this area are interrelated and concern attempts to limit the riskiness of individual institutions to prevent insolvency and failure (lines 5-9). Unquestionably, this goal of regulation has become central, particularly in recent years when insolvency has threatened the deposit insurance funds and has resulted in the use of tax funds to cover losses from insured deposits in the savings and loan industry. Many of the strict limits on bank behavior have arisen from this concern, including many of the new restrictions contained in FDICIA.

Stability in the monetary and payment system has clearly been another reason for regulation (group III). Many of the provisions in this area have been particularly important to the Federal Reserve in its central banking responsibilities; they include reserve requirements, discount window rules, and operating requirements for the monetary and payments system, as well as the deposit insurance requirements under the jurisdiction of the FDIC.

Consumer protection in the financial area (group IV) has become an increasingly significant motivation for regulatory activity since the passage of Truth in Lending (Title I of the Consumer Credit Protection Act) in 1968. Regulatory requirements that reduce the potential for deposit losses or otherwise contribute to monetary and systemic stability certainly protect consumers, but requirements regarding consumer protection have also become much more specific. Since 1968, most consumer protection legislation in the financial area follows one of two general directions: either mandatory disclosures (line 15) or mandatory fairness procedures (line 16). Truth in Lending and other disclosure laws have attempted to improve consumers' understanding and choices in their financial transactions, whereas Equal Credit Opportunity and Fair Housing laws aim at providing impartiality regarding sex, race, marital status, and other individual characteristics.

A final grouping of rationales for banking regulation may be characterized simply as "Other" (group V). One such rationale is reallocation of banking resources toward socially preferred ends, particularly toward lending within a bank's home community. Laws such as the Community Reinvestment Act (1977) and remaining restrictions on interstate branching reflect the view that if regulation requires banks to maintain local orientation, at least to a degree, then social benefits (externalities) will accrue as well as private benefits to those who actually use banking services. Bankers generally agree on the importance of their banks' home communities, but laws that potentially reallocate resources can nonetheless be controversial. For example, in the case of the Community Reinvestment Act many bankers complain about additional paperwork involved in documenting their local efforts.

Additional rationales for bank regulation arise not from needs related to banking itself, but from other governmental goals. These include requirements for bank cooperation in the issuance of the public debt (including savings bonds), in government efforts to raise necessary revenues through taxes (line 18), and in investigations of taxpayers undertaken by the Internal Revenue Service. Rules associated with drug enforcement efforts, such as required reporting of large cash transactions by financial institutions, also fall into this category (line 19).

Current Structure of Banking Regulation

As a result of the "dual" banking system that has developed in the United States, agencies at both federal and state levels today have regulatory responsibility over banks and thrifts. State governments generally can charter banks, savings banks, and savings associations. Such state-chartered financial institutions are subject to primary regulation and supervision by state agencies.

At the federal level, four agencies operate concurrently, each with primary responsibility for a particular type of financial institution. The Office of the Comptroller of the Currency (OCC), an organization within the Department of the Treasury, was established by the National Currency Act of 1863 to charter national banks and is their primary regulator. The Federal Reserve System, created by the Federal Reserve Act in 1913, is most often recognized for its responsibilities in influencing the money supply; however, it is also responsible for regulating U.S. bank holding companies (and their nonbank subsidiaries), overseeing foreign banks doing business in the U.S., and serving as the primary federal regulatory agency for state-chartered banks that are members of the Federal Reserve System.

In addition, the Federal Reserve writes the implementing rules under most of the federal financial consumer protection statutes.

The Federal Deposit Insurance Corporation (FDIC), established by the Banking Act of 1933 in response to the serious problems of the banking system in the early 1930s, oversees the deposit insurance funds and, in that role, can examine any insured bank or thrift to determine its condition for insurance purposes. It is also the primary federal regulator of federally insured state-chartered commercial and savings banks that are not members of the Federal Reserve System. Another organization within the Department of the Treasury, the Office of Thrift Supervision (OTS), was established in 1989 to succeed the Federal Home Loan Bank Board. It issues charters for federal savings associations and federal savings banks and is the primary federal regulator for federal and state savings associations and thrift holding companies.

In this regulatory arena, not surprisingly, overlaps of jurisdiction and inconsistency of rules occasionally occur. A bank holding company owning a national bank, state-chartered banks, and a savings association could find itself under the supervision of up to four federal banking agencies plus the state authorities: the Federal Reserve for the holding company and the state-chartered bank if it is a Federal Reserve member; the OCC for the national bank; the FDIC for the state-chartered bank if it is not a member of the Federal Reserve System; and the OTS for the savings association. It would also be under the supervision of state agencies concerning the state-chartered bank and any state-chartered savings associations.

The typical banking organization also is subject to the rules of many other federal and state agencies, besides the banking agencies. These may include organizations with responsibilities governing all businesses, such as the Internal Revenue Service, the Occupational Safety and Health Administration, and the Department of Justice (for various matters, including antitrust and civil rights). Depending on its lines of business and the products it offers, the bank or holding company may also be subject to the rules of the Federal Housing Administration, the Securities and Exchange Commission (if the banking organization publicly issues securities), the Federal Housing Finance Board (if the institution is a member of a Federal Home Loan Bank), the Department of Housing and Urban Development (if it has a mortgage banking subsidiary), and the Federal Trade Commission (if it has a finance company subsidiary). It may even answer to the Architectural and Transportation Barriers Compliance Board under the Americans with Disabilities Act, which has issued a new standard concerning the height of activating keyboards on banks' automated teller machines.

Previous Studies of Regulatory Burden

Study of the issues surrounding government regulation of banking is not new. Over the years, hundreds of researchers have undertaken thousands of studies and reports on various aspects of financial regulation. Study results are found in academic journals and monographs and in various other publications issued by public and private sources.[3] Many of the studies are highly technical and use economic theory and advanced mathematical and statistical techniques. The volume of studies makes providing a meaningful summary difficult; even constructing a summary outline of subject matter represents a considerable task. A recent study of regulatory burden[4] has suggested one classification scheme: the need for regulation, the structure of regulation, the efficiency of regulation, and the burden of regulation. Table II outlines an alternative scheme based on the rationales for regulation found in Table I and the four-part division of the issues found in the historical record of banking regulation in the United States. Numerous studies exist in each of these areas.

Besides the studies by academic researchers, government commissions and study groups have reviewed banking and financial regulation. In the past, most of these government reports have focused on the organization and structure of the regulatory agencies rather than on the burden of the regulations. The primary governmental studies that have addressed this issue include:[5] the Commission on Organization of the Executive Branch of Government (the "Hoover Commission"), 1949; the Commission on Money and Credit, 1961; the President's Commission on Financial Structure and Regulation (the "Hunt Commission"), 1971; the

---

[3] Some of the best known academic journals reporting such work are the Journal of Banking and Finance, the Journal of Finance, the Journal of Financial Services Research, and the Journal of Money, Credit, and Banking. Other sources include the monthly or quarterly economic reviews of the Federal Reserve Banks, law reviews, and journals specifically dedicated to regulatory matters but not concentrating solely on financial matters. Useful summaries of some of these issues may be found in Federal Reserve Bank of Kansas City [1987], Fischer [1968], Fischer [1986], Kaufman, et al. [1990], and Spong [1990]. (See references for complete citations.)

[4] Carroll, et al. [1989].

[5] Brief discussion of these studies is included as Appendix E to this report.

House Banking Committee report, "Financial Institutions in the Nation's Economy" (the FINE study), 1975; Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services (the "Bush Task Force Report"), 1984; and the Department of the Treasury's Modernizing the Financial System: Recommendations for Safer, More Competitive Banks, 1991.

Unlike these previous reports of government study groups, the current study does not focus on the structure of the regulatory agencies per se, except to the extent that greater cooperation among the agencies could result in reduced burden on regulated entities. Rather, this study takes the structure and responsibilities of the agencies as a given and examines ways that the regulations themselves might be improved to reduce burden on regulated institutions without compromising the goals of safety and soundness and consumer protection.

TABLE I: Goals and Rationales for Banking Regulation

I. Structure and Competition

1. Prevent Concentration of Power
2. Promote Competition and Efficiency
3. Prevent Conflicts of Interest
4. Prevent Extension of Federal Banking "Safety Net" to Commercial Firms

II. Banking Safety

5. Promote Safety and Soundness
6. Prevent Undue Risk Taking
7. Prevent Insolvencies and Failures
8. Protect the Deposit Insurance Funds
9. Provide for Competitive Equity

III. Monetary and Systemic Stability

10. Provide for Monetary Stability
11. Provide for Adequate Liquidity
12. Permit Effective Monetary Policy
13. Prevent Runs
14. Provide for Financial Stability / Prevent Systemic Risk

IV. Consumer Protection

15. Provide for Financial Disclosures
16. Prevent Unfair Treatment of Customers

V. Other

17. Reallocate Credit / Resources
18. Aid With Public Finance
19. Other Rules for Governmental Purposes (for example, Law Enforcement)

TABLE II: Subjects of Banking Regulation Studies

I. Banking Structure and Competition

1. Branching and Branch Banking
2. Competition and Performance
3. Mergers and Acquisitions
4. Bank Holding Companies
5. International Banking
6. Banking Structure Reform Proposals

II. Banking Safety and Soundness

1. Activity and Product Limits
2. Capital Requirements
3. Accounting Rules
4. Operating Requirements
5. Supervisory Policies and Procedures

III. Monetary and Systemic Stability

1. Monetary Policy and the Price Level
   A. Monetary Aggregates, Targets, and Instruments
   B. Federal Reserve Policy and Procedures
   C. Effects of Monetary Policy
   D. Problems of Monetary Policy
2. Deposit Insurance and Stability

IV. Consumer Protection Policies

1. Consumer Disclosures
2. Unfair Practices

V. Other Requirements

1. Allocation of Credit
2. The Financial System and the Public Debt
3. Other Governmental Purposes (for example, Law Enforcement)

II. THE NATURE OF REGULATORY BURDEN

Banks are regulated for important public policy reasons--competition, safety, economic stability, consumer protection, and other goals of government. Other entities in the domestic economy are also subject to regulation but not, generally, to the same extent as banks. Antitrust statutes, for example, govern competitive market structure and behavior for all businesses (except those with specific exemptions); but banking has its own additional set of competition rules, which extend and supplement general antitrust requirements.[1] Similarly, other businesses are subject to various federal and state consumer protection requirements; but banking has an additional set of consumer protection provisions, only some of which affect nonbank financial or other institutions.[2] Further, while all businesses must be concerned with tax compliance and illegal drug traffic, banks face extensive special requirements to aid the Department of the Treasury in collecting taxes from the public and in pursuing illegal money laundering.

Beyond these extra stringencies in common areas of business regulation, the core of bank regulation involves the goals of financial safety and stability, which most other enterprises do not face. The nature of bank depositors as creditors as well as customers of the bank sets banks and their regulation apart from other businesses. Few other businesses enjoy the implicit government guarantee that results from federal deposit insurance. As a result, the regulation of banks is much more extensive, specific, and detailed. For example, banks face restrictions on their lines of business, on the amount of business they may conduct with individual customers, and on their capital structure and sources of funding. They also are subject to substantial reporting requirements and extensive examinations.

Moreover, banks are subject to a vast array of requirements besides to those imposed by legislation and formal regulation. Court decisions and interpretations of laws and regulations, regulatory agency and staff policy statements (which interpret laws, regulations, guidelines,

---

[1] These banking-specific competition rules are articulated in the Bank Merger Act, the Bank Holding Company Act, the Home Owners' Loan Act, and the Change in Bank Control Act.

[2] The Truth in Lending Act applies to all institutions extending consumer credit, and the Equal Credit Opportunity Act covers all creditors. Some other consumer protections in the financial area primarily or solely affect depository institutions, however. These include the Home Mortgage Disclosure Act, the Expedited Funds Availability Act, the Community Reinvestment Act, and the Truth in Savings Act.

and court interpretations), and interpretations by individual regulatory staff members and bank examiners all contribute to the regulatory obligations of the banking industry.

Defining Burden

Defined broadly, regulatory burden consists of any opportunity losses, operating costs, or cost-causing activities or changes in activities that are necessitated by government requirements and that would not otherwise arise in the normal course of business. Thus, the burden of regulation is more than just required reporting and paperwork, as is sometimes suggested, although these are certainly elements. Defined broadly in this way, burden ultimately arises from two sources: (1) prohibitions that prevent regulated institutions from engaging in activities that they would otherwise undertake; and (2) provisions of law or regulation that require certain actions or behaviors that regulated institutions would not undertake in the absence of such requirements. For convenience, these two sources of burden can be called "prohibitions" and "requirements," respectively. Paperwork and required compliance activities usually fall into the second of these categories.

Prohibitions

Numerous prohibitions restrict bank activities and portfolios. The National Bank Act of 1864 describes the business of banking as it relates to national banks. Evaluating the scope of authority granted by the Act has centered around whether it represents a broad grant under the "business of banking" or whether it only represents a narrow grant of specified powers and such incidental powers as are needed to perform them, thus prohibiting national banks from exercising powers other than those specifically granted.

Many laws and regulations since 1864 have defined, refined, limited, and interpreted these powers. The Banking Act of 1933, for example, distinguishes between deposits payable on the demand of the depositor (which may not pay explicit interest) and deposits not payable on demand (which may pay explicit interest). The Depository Institutions Deregulation and Monetary Control Act of 1980 establishes the current percentage ranges for required reserves on the different classes of deposits, and Federal Reserve Regulation D establishes required reserve percentages within the statutory ranges. Other laws contain restrictions on types of loans and amount of lending to directors, officers, and individual borrowers. There are also restrictions on securities underwriting and on the types of securities that banks may hold.

Some activities, including acting in a fiduciary capacity, are permissible for national banks to the same extent that state laws permit them for state-chartered banks.

Historically, state laws have governed the activities of state-chartered banks, although in certain areas they are now restricted by federal law. In some circumstances, state-chartered banks may engage in activities that are not permissible for national banks, yet both types of institutions offer federally insured deposits. Activities authorized by states for their banks have included real estate development as well as insurance agency and underwriting activities. Some states have also permitted limited investment in any nonbank activity, typically subject to a cap on the investment based on a percentage of the institution's assets. Some believe that state-chartered banks, because of these broader powers, may pose a proportionately greater risk of loss to the deposit insurance fund than national banks (such arguments assume that "broader" powers are likely to be "riskier").

The serious difficulties in the thrift industry and the Federal Savings and Loan Insurance Corporation (FSLIC) were viewed by many as showing the dangers of "risky" state powers. Based on the experience of the thrift industry, in which state-chartered institutions accounted for a disproportionate share of the costs to the federal government in resolving failed thrifts, the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) directly limited the activities of federally insured, state-chartered thrifts. FIRREA generally prohibited state-chartered thrifts from engaging in activities not permissible for a federal thrift.

Many observers have concluded that "risky" state powers may also be a problem for commercial banks and therefore propose to limit the powers of state banks to those permissible for national banks, with certain exceptions. As a result of such concerns, effective one year after enactment, FDICIA prohibits an insured state bank and its subsidiaries from engaging as principal in any type of activity not permitted to national banks and their subsidiaries, unless the bank is at least adequately capitalized and the FDIC has determined that the activity poses no significant risk to the appropriate insurance fund.

In addition, FDICIA limits the insurance underwriting activities of state-chartered banks and their subsidiaries. Such banks and subsidiaries--even well-capitalized banks--may underwrite insurance only to the extent that the activity is permissible for national banks or national bank subsidiaries. (There is a limited "grandfather" provision that permits well-capitalized state banks and their subsidiaries to continue to underwrite those insurance lines that they were providing on November 21, 1991. Such services must generally be provided only in-state.) Further, FDICIA generally prohibits insured state banks from acquiring or retaining equity investments beyond those permissible for national banks. Nonpermissible investments must be divested as quickly as possible and in any event within five years.

The Bank Holding Company Act contains prohibitions on activities of organizations that own or control banks. It allows the parent companies of banks to own only shares of nonbank companies whose activities are "so closely related to banking or managing or controlling banks as to be a proper incident thereto." Activities that qualify are determined by the Federal Reserve based on the standard and most are listed in its Regulation Y.[3] Activities not on the list or otherwise approved by Federal Reserve Board order in individual cases are impermissible for subsidiaries of bank holding companies.

Requirements

The list of regulatory requirements is even lengthier than that of prohibitions. Typically, requirements arise from specific mandates in laws or from the applications process, which itself arises from the existence of prohibitions. Requirements are as old as banking regulation. The National Bank Act of 1864 and its state counterparts require any person or group wishing to operate a bank to apply for a charter. These laws also require periodic financial and ownership reporting, various types of recordkeeping for specific transactions, examiner access to books and records, and so forth.

Today requirements are in place for the banking industry associated with all five of the general areas of regulation (see table I and the related discussion in the previous chapter). In the area of structure and competition, for example, agency regulations and practices implementing the Bank Merger Act and the Bank Holding Company Act require applications in a prescribed format in order to permit the agencies to analyze the competitive effects of

---

[3] These include making and servicing loans through such companies as commercial and consumer finance companies, savings associations, credit card companies, and mortgage companies; carrying out trust company functions; providing investment or financial advice; leasing; investing in community development corporations; providing data-processing services for economic, financial, or banking data; underwriting or providing credit-related insurance; management consulting to depository institutions; securities brokerage; providing financial advice; and engaging in several other closely related activities listed in Regulation Y. The Federal Reserve recently expanded the list to include the combination of securities brokerage and investment advice and expanded leasing activities. Further expansion of the list to include other activities such as expanded data processing and armored car services is being considered.

proposed changes in structure. As another example, agency regulations direct any lender that also sells credit life insurance to disclose to the borrower the fact that such insurance, if required, need not be purchased from the lender. This requirement is intended to eliminate illegal tying of products and any conflicts of interest. Banks generally are also required to collateralize extensions of credit to affiliates. Further, state and federal requirements generally provide that access to ATMs be granted openly to competitors.

In the area of bank safety, banks must submit detailed periodic reports and respond at any time to requests from regulators for information about activities and risk. Regulations also require banks to maintain capital at specified levels, to keep within lending limits to a single borrower and to follow extensive accounting rules. In the area of monetary and systemic stability, Federal Reserve regulations require monetary reserves and reporting, and FDIC rules specify deposit insurance requirements and fees. Extensive rules also govern the operation of the payments system.

The consumer protection area has produced many additional requirements for regulated institutions. The Truth in Lending Act, for example, requires banks to make numerous disclosures to consumers in specific forms. The Equal Credit Opportunity Act requires banks to provide equal access to credit and to demonstrate their compliance with this requirement. The Electronic Fund Transfer Act contains a list of additional requirements, including specific disclosures to consumers and instructions for financial institutions concerning procedures for resolving errors. The Expedited Funds Availability Act governs check processing and access to deposits for consumers' transaction accounts, and the Home Mortgage Disclosure Act requires reporting the geographic distribution of mortgage lending. The Community Reinvestment Act requires banks to meet the credit needs of their entire communities, including low- and moderate-income neighborhoods, and requires regulators to assess banks' compliance with this requirement.

"Other" rules include requirements that banks file Form 1099 to report any interest payment in excess of $10. This rule contrasts with reporting of other payments, such as rent or contract payments, which is required only when the payment exceeds $600. To facilitate tax recordkeeping, Internal Revenue Service rules also require that banks ensure that proper taxpayer identification numbers are on file. To aid in controlling money laundering, Treasury Department rules require that financial institutions, broadly defined to include banks and non-bank financial institutions and, in some cases, individuals, file currency transaction and currency and monetary instrument reports and maintain certain records. Banks must also process applications for savings bonds.

Sources of Burden

Regulatory burden thus manifests itself either as an opportunity cost of being unable to undertake preferred activities or as a direct cost when regulated institutions must devote real resources to actions they would not otherwise undertake. Such employment of real resources comes about in several ways. Personnel and equipment must be devoted to regulatory implementation and compliance, and managerial resources must be diverted to understanding, implementing, and complying with regulations. These resources, then, are not available to produce products or to serve customers. Moreover, direct costs include industry and taxpayer support of budgets of the regulatory agencies, deposit insurance premiums, and reserve requirements. These latter costs, in particular, may well be offset by benefits to the public in the form of a safer and more stable banking and monetary system, but they become a burden to the regulated institutions if they become excessive.

Prohibitions and requirements differ fundamentally. A requirement in a particular area that exceeds what a bank would voluntarily do imposes a clearly identifiable cost on each institution to which it applies. In many cases, though, a prohibition may have no easily identifiable cost to individual institutions. Some banks subject to the prohibition may have no desire or need to pursue the prohibited action; the prohibition will not directly burden them. At the same time, it is difficult to identify or measure a specific impact on those banks that might have undertaken the activity; it is difficult to study counterfactual conditions (that is, situations that do not exist).

While the market reaches an (alternative) economic equilibrium without the affected enterprises engaging in the activity, it does not follow that there is no economic effect. There may be sizeable expenditures for understanding, complying with, and enforcing the prohibition as well as negative effects on market competition. Prohibitions on investment banking activities and geographic expansion of banks, for example, do not burden all banks since some of them do not plan to engage in investment banking activities or significant geographic expansion. These prohibitions, though, do affect other banks and, further, may burden the economy by making the financial sector less efficient and the economy less competitive.

The potential for prohibitions to pose a direct burden on individual banks is greatest in two circumstances. First, if a prohibition restricts activities already under way, it will damage those banks that must cease or change these activities. Amendments to the Bank Holding Company Act, for example, have occasionally imposed new prohibitions on institutions already engaged in certain activities. Second, a prohibition may become burdensome to individual institutions if market evolution causes a prohibition to become binding when it previously was not. An example was the ceiling on deposit interest rates. If market rates were below the ceiling, well-run banks were unaffected. When market rates rose, however, the ceiling could become binding and therefore burdensome. Similarly, geographic restrictions on branching may not have been burdensome when distances and poor communications made extensive branch systems difficult to operate. As communications technology has advanced, however, the burden of geographic prohibitions has increased.

A second fundamental difference between prohibitions and requirements is that prohibitions are likely to have an array of possible outcomes for regulated institutions, whereas requirements tend to be more rigid. In response to a prohibition against engaging in an activity, each bank can incorporate the prohibition as a constraint and then determine the optimal remaining product mix to serve its customers. The effect on bank decisions will vary, depending on the bank's market and market conditions. A requirement will usually be more specific and result in identical actions by all affected banks. For example, the response to disclosure requirements will be identical for all banks except in the number of transactions and branches covered.

The laws and regulations that produce prohibitions and requirements are quite varied. In many cases, individual pieces of the regulatory structure are intended to support more than one goal of regulation (for example, the structure and competition goal and the bank safety goal) simultaneously. On occasion, this overlapping of goals may produce conflicts, such as safety requirements that may also protect individual institutions from competition. Such inconsistencies lend legitimacy to requests for relief.

Table III outlines the main areas and kinds of legislative and regulatory activity. Requirements are the more common type of regulation; they are found in all the categories presented in the table and dominate most sections. They include the important Consumer Protection area, Other Operating Requirements, Reporting, Recordkeeping, and Documentation Requirements, and Examination Policies. The list of regulations and policies in each area is extensive. Prohibitions, in contrast, are found chiefly in section I: in Entry

Controls (which includes prohibitions regarding geographic and nonbanking activity) and in Activity Limits (which concerns prohibitions on the range of banking activities).

A review of public comments and testimony on regulatory burden, as well as of available studies, provided the banking regulatory agencies and the FFIEC with some insight into the nature of regulatory burden on large and small financial institutions. First, it appears that prohibitions have become more constraining to the large U.S. banks. As their large corporate customers have increasingly turned to domestic and foreign securities markets for funding, the large banks have been unable to provide for these customers' needs because of restrictions on investment banking and securities market activities. They are also constrained in the consumer area because of prohibitions on branching, on insurance underwriting, and on other retail financial products. Furthermore, these larger institutions comment on the burdens associated with the application process that they generally must undertake when they consider expanding or producing new products through bank or nonbank subsidiaries.

Second, requirements apparently have increased substantially in recent years, and this increase has been especially burdensome to the smaller institutions. Although large institutions are also affected by these requirements, and may complain vociferously when they are enacted, these institutions typically have the legal and compliance staffs to implement them despite their high cost. The smaller banks, however, must often devote the time and attention of high level personnel, including the chief executive officer and the board of directors, to understanding and complying with new and changing requirements. While attention at the highest levels of the institution is undoubtedly useful for ensuring compliance, it also significantly affects operations because a substantial proportion of management's attention has been diverted.

Requirements have increased rapidly and have become more intrusive in recent years because of the growing importance of the "process" approach to regulation--that is, regulation that focuses on bank management and operating processes. In actions of the regulatory agencies and recently in legislation such as FDICIA, requirements have delved deeper and deeper into what had been the responsibility of management. Bankers complain about this intrusiveness, especially in such requirements as formal, written policies in each area of responsibility. FDICIA advances this approach by new requirements in such areas as interbank liabilities, audit standards, real estate lending standards, and safety and soundness standards that include management and compensation standards.

The success of the process approach to regulation depends on the validity of two underlying assumptions: (1) that there is a predictable relation between certain management processes, such as formal written policies, and bank performance; and (2) that bank examiners and their supervisors can properly evaluate these processes. The regulated institutions and the regulators (including the Congress and the agencies) differ in their appraisals of these assumptions. Institutions contend that the emphasis on process requirements is merely burdensome and that it accomplishes little. The agencies have in the past responded that good processes will produce better results.

Appropriate processes, if they can be identified, may improve supervision. However, requiring the same processes for all institutions regardless of size, market, capital, condition, and management ability may well be burdensome. Regulators should maintain a willingness to test the usefulness of the process approach to assure it is producing results. The regulators also should continue to monitor the effectiveness of their own supervision and examination procedures. Well trained examiners and the best possible coordination of examinations should help in the effort to reduce regulatory burden. The regulatory agencies have increasingly focused their attention to issues of coordination, particularly within the past year.

Measuring Burden

Both prohibitions and requirements can be costly to the regulated entity. Although precisely measuring the cost of either type of burden is difficult at best, understanding and measuring the impact of prohibitions typically is even more difficult than quantifying the impact of requirements. Furthermore, often not only the prohibitions and requirements themselves but also <u>changes</u> in these sources of burden can lead to substantial costs. Measurements of total costs, then, should capture both recurring expenses and startup costs. In practice, since requirements seem to change more frequently, prohibitions on engaging in preferred activities are sometimes overlooked in discussions of regulatory burden.

In general, studies of the costs and burdens of regulation are not especially common. Such studies are difficult to undertake, particularly studies of the opportunity costs associated with prohibiting particular activities. The primary difficulty associated with studies of prohibitions is the obvious one--specifying the outcome that would have occurred except for the prohibition--because the counterfactual condition that can be compared with the actual outcome is absent.[4] Also, historically the public has not had much interest in the regulatory burden on banks; most nonbankers have viewed regulatory costs for banks as simply part of the inevitable costs of being in the banking business. This attitude has probably reduced the number of reviews of regulatory costs that otherwise might have been undertaken.

Despite methodological difficulties, researchers have conducted some studies of regulatory burden. Most of the studies attempt to measure the costs of regulatory requirements and have found that total costs attributable to banking regulation are substantial. (Appendix C to this report reviews these studies more fully.) Despite differences in methodology and coverage, findings are reasonably consistent: regulatory costs may be 6-14 percent of noninterest expenses, not including any measurement of the opportunity cost of reserve requirements. If these estimates are correct, given that noninterest expenses of the banking industry were $124.6 billion in 1991, regulatory costs to the industry in that year may have been between $7.5 and $17 billion, before any adjustment for the cos · of reserve requirements.

Another finding from the cost studies is that there appear to be scale economies in compliance costs; in other words, large banks have an advantage in this area. Various econometric studies of costs associated with consumer protection regulations suggest that for a 10 percent increase in output, compliance costs increase only 6-8 percent.

Case studies and surveys suggest that compliance activities for regulations are labor intensive. Labor costs are the major component of compliance costs. Some of these studies also suggest that a large part of the labor cost of complying with regulations is the time bank officers and managers devote to compliance activities.

The available evidence from case studies and surveys suggests that each regulation may contribute only a little to the total, although some regulations clearly contribute a great amount. Truth in Lending, for example, appears in more than one study as a major source of regulatory cost. Deposit insurance premiums and the opportunity cost of reserve requirements also appear to be large components. Taken as a whole, the set of regulations imposed on commercial banks appears to be a significant part of operating expenses and may weigh disproportionately on smaller banks.

---

[4] For discussion of methodological issues associated with undertaking studies of the costs of regulation, see Hahn and Hird [1990].

Reducing Burden

Minimizing unnecessary regulatory burden, within the overriding constraints of other regulatory goals, should be an objective of both the Congress and the agencies. The reduction of unnecessary burden increases economic efficiency by wasting fewer resources in obtaining the desired regulatory goals. Regulations that are more costly than necessary increase the challenges of effectively managing financial institutions. They unnecessarily increase bank operating costs, and thus reduce profitability or raise costs for bank customers or both. Simply stated, some burden may be necessary to achieve public policy goals, but unnecessary regulatory burden represents a dead-weight loss to society.

Review of the materials assembled for this report suggests several recurring themes and common threads that cut across issues. The next section presents several general findings followed by some principles for further consideration in reducing regulatory burden.

General Findings

Cumulative Burden. Comments, testimony, and cost studies suggest that the cumulative regulatory burden may be more than the sum of the parts. Although each regulation by itself may not impose an unmanageable cost, the banking regulations taken together create a burden that may be substantial, if not approaching unmanageable, for many institutions. In recent years, a flood of legislation, regulations, court interpretations, and official and unofficial policy statements has occurred. Regulations in many areas have become more technical and have changed rapidly; as a result, many institutions have been under considerable strain.[5]

Current fiscal pressure on the federal government is likely to continue to encourage the use of regulation as a tool for achieving social objectives through the private sector. Although potential banking legislation may have worthwhile public purposes, attempts to achieve social objectives through regulation will increase regulatory burden on the affected private institutions.

---

[5] The smaller community banks and savings associations, in particular, feel this cumulative burden. These smaller institutions typically do not have the personnel, particularly the managerial resources, to handle so many technical areas. As a result, often a few individuals must address all the regulatory issues that arise in the smaller institutions, ranging from call reports and safety and soundness examinations to consumer compliance.

Balancing of Costs and Benefits. A balancing of costs and benefits is called for in any new proposals, particularly given the level of existing regulation of U.S. banks. While some benefits generally could result from each regulatory proposal, it is important to recognize that those benefits are not free for consumers just because they appear to be paid by institutions. Legislation (and the supporting regulation) often is framed in what amounts to an adversarial proceeding. Supporters typically tout the benefits of the proposal whereas opponents usually concentrate only on the costs. In such an environment, compromises often result. Such solutions tend to overlook the truism that although people enjoy all the benefits of legislation and regulation, they also pay all the costs. Whether the costs are paid by bank customers or by stockholders (including mutual and pension funds on which many people depend for their savings and retirement), they accrue ultimately to people.

Coordination Among Regulatory Agencies. The current regulatory framework can sometimes result in overlapping jurisdiction and inconsistent rules. During 1992, regulators have increased their efforts to coordinate policies and procedures. Some initiatives undertaken by the agencies this year are summarized in Appendix D. Further efforts in this direction will lessen the burden on banking organizations.

Pace of Change. Frequent revisions to laws and regulations contribute substantially to regulatory burden. Cost studies, as well as public comments and testimony, indicate that startup costs are a major component of regulatory burden. Therefore, slowing the pace of legislative and regulatory change could reduce burden substantially.[6] To minimize the burden, rules should be revised as infrequently as possible, changes should be made only if they are significant, and reasonable transition times should be allowed for implementation.

Lack of Flexibility. The current approach to regulation, which relies on mandates and uniform standards, sometimes has led to uniformity and inflexibility that can be costly, rather than burden-reducing. This lack of flexibility is evident in many aspects of the comments received. Compliance requirements necessarily bring specificity and standardization,

[6] Most complaints are about new regulations. The FDICIA is considered especially burdensome because it changed many requirements and mandated rapid implementation in many cases.

especially when the standards or methods of compliance are placed in the law itself and no exceptions are allowed. While uniformity can promote equality of treatment, it also has its costs: It can preclude new approaches, prevent innovation, and even limit access to new technology and new markets. Often there is more than one method of achieving a goal, and institutions responding to market incentives may choose different alternatives or strategies depending on their circumstances.

Market Incentives. The alternative to government regulation is not "no regulation" but, rather, regulation by the market. Economic theory suggests that competitive markets contribute to many of the same goals as public policy--fair dealing with customers, for example. Market regulation may not be satisfactory to everyone in all cases and may be satisfactory to no one in some cases, but regulators should consider existing market incentives.

Sometimes regulatory objectives coincide with market incentives. For example, banks have incentives to protect their stocks of currency and are likely to have significant security devices in place, with or without regulatory requirements. Similarly, banks, particularly publicly-held banks, face market incentives to collect sufficient data to manage the bank and assure the public that they are doing so appropriately.

At times, however, regulatory goals do not coincide with or may exceed market incentives. Some portion of the data that banks are required to generate and file with regulators is not of particular use to the bank's management but, presumably, is of use in achieving a policy goal. For example, few banks would so carefully track cash deposits greater than $10,000 if not for government requirements. In such circumstances, in which market incentives and regulatory objectives diverge, special care should be taken in developing regulations because these are the most likely to produce burden.

Smaller Banks. The regulation of internal processes within banks has become increasingly intrusive, especially for smaller banks. In many ways, this regulation amounts to micromanagment of banks through government agencies. Process requirements, such as mandatory formal written policies for many management functions, may be useful for larger banks (and, indeed most larger banks would have such written policies anyway); but they may have reached the point at which they swamp the smaller institutions. FDICIA expands process requirements further and increases regulatory burden on small banks through such provisions as Section 122 (on reporting of small business and farm loans) and Section 132 (on operation standards).

On occasion, interested parties have suggested exemptions from compliance for small institutions, based on the presumption that burden appears to fall most heavily on them. Many small institutions have stated that they have dropped products or have refused to offer new products because of regulatory complexities. Furthermore, some cite the regulatory burden as one more incentive to sell their institutions to larger organizations.

While exemptions for small institutions may be a good approach on some matters, particularly data collection, they may be more difficult to justify on others, particularly regarding consumer protection. Most of these laws are oriented toward protecting individual consumers in their transactions, and it is not clear that the level of protection for individuals should be governed by the size of the service provider.[7] At the same time, the Congress should realize that regulations affect different institutions differently and that the smaller ones tend to feel the brunt more heavily.

Well-run Banks. Whenever possible, legislation and regulation should distinguish between well-run and other banks.[8] Subjecting well-run banks to the same degree of regulatory oversight that is necessary for problem institutions seems counter-productive. Better-run banks, possibly evidenced by higher capital ratios or supervisory ratings, could be subjected to less frequent examinations and less burdensome reporting and could be permitted to enter new geographic markets and new product markets, including insurance underwriting and more extensive investment banking.

Obsolescence. Uniformity, lack of innovation, and limited access to new technology and markets are especially damaging when part or all of a law or regulation is outmoded. One method of addressing obsolescence is to require sunset provisions--that is, provisions in rules that cause them to expire at the end of a specified period. These sunset provisions, though,

[7] For example, if Congress believes individuals should have Truth in Savings Act disclosures about their deposit accounts, the size of the institution should not matter.

[8] Again, in some regulatory areas, for example consumer protection, the condition of the bank probably should not affect regulation.

present their own difficulties, including uncertainty and the overhanging threat of constant change. Consequently, legislative and regulatory overseers should constantly look for obsolescence and for rules that can be deleted, rendering moot the need for sunset provisions.

Directors. Comments and testimony suggest that regulation and the fear of litigation may have made attracting and retaining competent bank directors more difficult. Because competent directors are one of the first lines of defense against bank difficulties and losses, the important issue of the ways to attract and retain such directors should be addressed.

Civil Liability. Imposing civil liability and permitting punitive damages and class action suits can increase burden because of potential litigation and requests for standardization and legal safe harbors. Administrative enforcement, even with its problems of intrusiveness and possibly inconsistent application on occasion, may in many cases be less burdensome than exposure to large civil penalties.

Exception Authority. Some carefully limited "exception authority" for regulators to resolve anomalies and inconsistencies, such as the exception authority in the Truth in Lending Act, could help resolve possible inconsistencies and ambiguities. The extension of exception authority could reduce burden and should be considered in an expanded number of circumstances.

Regulatory Language. New regulations and changes should be written clearly. Unnecessary regulatory burden results from regulations, policies, and procedures that are difficult to decipher and understand. Unnecessary complexity and confusion arises from the use of different terms with the same basic meaning and from inconsistent definitions of the same term in different requirements.

Statutory Source. Many regulatory requirements are mandated by statute and are not initiated by the agencies. In some cases, the legislation is very detailed in its requirements and, for the most part, the regulations track the statutory provisions.[9] Therefore, the agencies

[9] This is particularly true in the consumer protection area.

have no power to change many of the provisions that impose substantial burdens; substantial alterations require legislation. This situation suggests that, at least in some areas, the reference to "regulatory burden" is a misnomer, and the requirements should rather be referred to as "compliance burden."

Many commenters do not distinguish statute from regulation, and many of the complaints to regulators involve statutory requirements. Thus, if burden is to be significantly reduced, legislative changes are needed. In the final analysis, if there is to be a real reduction in burden, the Congress must revisit its general approach for developing banking laws and establish a more direct process for balancing the benefits of proposals with the burdens they impose.

Commission on Legislative Improvement. Significant reductions in regulatory burden appear to require legislative action; but, because of strongly-held views of advocates of various positions, achieving political consensus for change may be difficult. A particularly difficult area is consumer-protection regulation. Many banks maintain that this area is the most burdensome. On the other hand, many consumer groups perceive these and other protections as important and necessary. For this reason, an independent nonpolitical group or commission charged with exploring possibilities for legislative improvement and possibly for achieving political consensus may be useful. Such a commission could address a broad range of banking issues, offer guidance for legislative and regulatory changes, and help develop the necessary legislative agenda. It could have as a specific goal, among other goals, assessing both the domestic and international competitive position of U.S. banks and the reduction of regulatory burden. With the commission's findings, the Congress might have an easier task in exploring and adopting different approaches to reducing burden.

General Principles for Reducing Regulatory Burden

A number of general principles for reducing regulatory burden emerged from review of the materials assembled for this study. The general principles which follow highlight some major concerns and are intended to serve as preliminary considerations for further analysis of and initiatives to reduce the problem of regulatory burden.

- The problem to be addressed should be clearly defined and articulated before imposing regulation (legislation, regulations, policies, and procedures).

- The expected benefits to society of regulation should clearly outweigh the expected costs imposed on society.

  — Regulation should be fashioned to maximize net benefits to society.

  — The cumulative burden on institutions resulting from the degree of regulation with respect to any particular activity should be considered when imposing it.

  — Regulation should be designed to balance competing policy objectives; narrow focus on a single policy objective should be avoided.

  — A quantitative cost estimate of the proposed regulation should be prepared in advance and as precisely as practicable.

  — The objective of regulation should not be to create zero-risk standards.

- Alternative ways to accomplish the goals of regulation should be evaluated before implementation.

  — Whenever possible, regulations should rely on market mechanisms to achieve public policy objectives. Requirements that complement market incentives should reinforce those incentives wherever possible. Requirements that do not complement market incentives should be scrutinized to ensure that they are efficient means for achieving policy goals.

  — When appropriate, consideration should be given to whether legislation should specify ends rather than means.

- Regulation, when appropriate, should distinguish between different categories of institutions. For example, differences that might be considered, depending upon the circumstances, could include an institution's size or whether it is well or poorly run. Recognizing differences among institutions for regulation may not be appropriate in all instances; in such areas as consumer protection, customers are viewed as entitled to the same protections regardless of the institution with which they are doing business.

- Requirements should be timely, necessary, clear and, when possible, coordinated among the banking regulators. Changes in regulation should be limited to those that are truly necessary. The timing of changes to regulations in related areas should be examined so as to minimize burden.

TABLE III: Areas of Regulatory Concern

I. Supervisory Policies

1. Entry Controls (e.g., Chartering, Change in Control, Branching, Powers)
2. Balance Sheet Requirements (e.g., Capital, Lending Limits, Accounting Rules
3. Activity Limits (e.g., Limits on Domestic, Foreign Products)
4. Enforcement (e.g., C&Ds, Rules of Practice and Procedure)
5. Insider and Affiliate Transactions (e.g., Employee and Director Requirements)

II. Consumer Protection Policies

1. Consumer Disclosure (e.g., TIL, EFT, Leasing)
2. Anti-Discrimination (e.g., ECOA, Fair Housing)
3. Community Reinvestment (e.g., HMDA, CRA Policy)
4. Unfair Practices (e.g., Credit Practices Rule, Check Holds)

III. Other Operating Requirements

1. Operating Procedures (e.g., Payments System, Bank Security, Appraisals)
2. Monetary Policy (e.g., Reserve Requirements)
3. Deposit Insurance Requirements
4. Bank Secrecy Act Requirements (e.g., CTRs)
5. Internal Revenue Requirements (e.g., 1099 Reporting)

IV. Reporting, Recordkeeping, Documentation Requirements

1. Call Reports
2. Other Supervisory Reports
3. Other Supervisory Recordkeeping Requirements
4. Applications
5. Reports for Economic Policy Purposes

V. Examination Policies

1. Examiner Guidance and Training
2. Examination Practices

VI. Other

III. REGULATORY RECOMMENDATIONS

Introduction

In recent years regulatory burden has become an important concern to many regulated institutions and other observers. Representatives of many industries have complained about regulatory burdens, as they see them, and these concerns have, on occasion, become widely discussed. In the banking area, the Congress has shown its interest in the burden issue by including Section 221 in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). This provision requires the agencies to undertake an extensive review of burden arising from their policies, procedures, recordkeeping, and documentation requirements, and to report their findings by December 19, 1992.

Specifically, Section 221 requires the Federal Financial Institutions Examination Council (FFIEC) in consultation with interested parties, including both insured depository institutions and consumer and community groups, to undertake four tasks:[1]

1) To review the policies, procedures, recordkeeping and documentation requirements used to monitor and enforce compliance with all laws under the jurisdiction of the federal banking agencies[2] and the Treasury;[3]

2) To determine whether such policies, procedures, and requirements impose unnecessary burdens on the insured depository institutions;

3) To identify any revisions of such policies, procedures, and requirements that could reduce unnecessary burdens without diminishing compliance with or enforcement of consumer laws or endangering the safety and soundness of insured institutions; and

4) To report on such identified revisions to the Congress within one year.

To meet the requirements of the Act, the four federal banking agencies and the Department of the Treasury undertook extensive reviews of their policies, procedures,recordkeeping and documentation requirements. The five organizations formed an

---

[1] The text of Section 221 is included as Appendix G to this report.

[2] The four federal banking agencies for purposes of Section 221 are the Federal Insurance Deposit Corporation (FDIC), the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

[3] The wording of Section 221 by its terms did not encompass the laws under the jurisdiction of the National Credit Union Administration.

interagency task force on Section 221 under the jurisdiction of the FFIEC. This task force met approximately every other week through 1992 in order to guide the process and shepherd the report through the planning, preparation, and writing stages.

To gather information, the interagency task force assembled the public comments that the Department of theTreasury, FDIC, OCC, and OTS had received in response to their Spring 1992 requests for comments concerning their regulatory review initiatives.[4] In addition, the FFIEC requested public comments specifically on Section 221 and received 449 additional letters. To elicit further views, the FFIEC held "Town Meetings" or hearings in Kansas City, San Francisco, and Washington, D.C. in June 1992. In all, the interagency task force had available for its consideration 1,148 public comments (including comments from more than 100 consumer and community groups) and the testimony of 79 witnesses.[5] Representatives of consumer and community groups also attended the November 1992 meeting of the FFIEC's Consumer Compliance Task Force, and expressed their particular concern that relief from regulatory burden not diminish compliance with or enforcement of consumer laws.

In announcing the public comment period (May 14 through July 10, 1992), the Examination Council indicated its views on the scope of the study. As stated in its May 14, 1992, press release, the Council reported that it had determined that the intended focus of the study was <u>not</u> to examine and develop proposed revisions to the overall statutory scheme governing financial institutions. Rather, according to the Council, it appeared that the Congressional intent was to accept the statutory scheme devised by Congress as a given, and instead examine the manner in which the federal banking agencies and the Treasury Department have implemented that scheme by means of regulations, policy statements, procedures, and recordkeeping requirements.

The Council further indicated that although proposed statutory reforms to ease regulatory burden did not appear to be the intended or primary focus of the study, it

[4] On July 28, 1992 the National Credit Union Administration separately sought public comment on regulatory burden. A summary of the comments the NCUA received is included as Appendix B to this report, in order that the reader would have available public views on regulatory burden pertaining to all insured depositories. The NCUA is currently reviewing those comments, as well as conducting internal reviews, in order to identify and relieve unnecessary regulatory burden.

[5] Summaries of the comment letters and testimony are found in Appendix A to this report.

recognized that suggestions regarding appropriate statutory revisions might well arise. During the course of the study, many valuable suggestions regarding potential statutory revisions did indeed arise. Accordingly, the Council's member agencies have agreed to continue meeting to identify and recommend possible statutory changes to further reduce regulatory burden. The Council hopes to prepare a separate report on those issues in the Spring of 1993.

During 1992, many external public commenters and speakers at "Town Meetings," as well as the agencies themselves, recommended regulatory changes that are within the jurisdiction of the agencies. During the course of the year, the agencies took action on many proposals to relieve regulatory burden. Consequently, those recommendations do not appear here as matters for further action. Instead, a summary of those initiatives appears as Appendix D to this report.

Remaining suggestions identified as under the control of the agencies form the subject matter of this chapter. In some cases related recommendations were grouped together for analysis and discussion. For each recommendation there is a brief introduction to the issue, followed by discussion which typically reviews arguments both in favor of and against the proposal. An evaluation of the recommendation is then provided, with alternative proposals or approaches, where appropriate.

The recommendations in this chapter are divided into three groups. The first group contains recommendations that the FFIEC believes represent effective and efficient steps to reduce regulatory burden. In many cases, the agencies achieved a consensus position supporting the recommendation, while in other cases some agencies support the recommendation in part or prefer an alternative approach to meet the goal of the recommendation. Alternative positions are set forth in the discussion of individual recommendations where appropriate. In most cases, the agencies agreed on the general approach contained in the recommendation, although a few may require some further consideration and possibly some compromise.

The second group contains the recommendations that the agencies felt, after careful consideration, did not meet fully the standards set forth in Section 221. The pros and cons with respect to these recommendations are set forth in the discussion as well. Fewer recommendations fall into this grouping than into the first.

The third group contains recommendations from the public concerning non-Council member agencies. The Department of the Treasury has contributed an analysis of the public recommendations concerning the rules implementing the Bank Secrecy Act (BSA). Recommendations for other agencies are listed without discussion.

Within these groups, the recommendations are generally organized according to the outline in Table III. The following table of contents reflects the organization of the remainder of this chapter and provides page references to major subject headings.

Recommendations Warranting Further Consideration by the Agencies

Recommendations Not Suitable for Implementation by the Agencies at This Time

Other Recommendations

Recommendations Warranting Further Consideration

by the Agencies

BRANCH CLOSINGS

RECOMMENDATION

The federal branch closing provision of FDICIA should not apply to ATM closings or to closings necessitated by leases entered into before FDICIA's enactment.

BACKGROUND

Under FDICIA, depository institutions are required to give federal regulators and customers 90 days advance notice of the closing of a branch. In the fall of 1992, the regulatory agencies issued for public comment proposed guidance to banks on the branch closing requirements. The proposed guidance is consistent with the agencies' current position on the definition of a branch, and accordingly includes ATMs as branches subject to the closing notice requirements. The agencies requested specific comments on the question of definition of a branch for branch closing purposes.

The proposed guidance does not include any exemptions from branch closing requirements for situations where pre-FDICIA leasing arrangements could result in termination of a lease with less than 90 days notice. The agencies did not request specific comments on this issue in their proposed guidance.

Proposed guidance from the OTS for savings associations is similar, although there are some variances resulting from differences in laws and regulations applicable to banks and thrifts. For example, savings institutions may not be required to comply with the branch closings provisions for ATMs because their statutory definition of a branch appears to exclude ATMs.

DISCUSSION

Limiting the definition of a branch for purposes of the branch closing notice to only "brick and mortar" branches would significantly reduce the regulatory burden placed on banks by this statutory closing notice requirement. The closing of an ATM is particularly problematic. For example, customers of the ATM must be notified, but it is very difficult to determine who are an ATM's customers. In some cases, ATMs are part of networks, and the "customers" of an ATM include a significant percentage of individuals who do not hold deposit accounts at the bank that owns or operates the ATM. Similarly, providing some exemptive relief to banks with pre-FDICIA leases that can force closure in less than 90 days would relieve banks of concerns about agency enforcement actions in the event that they cannot comply with closing notice requirements.

On the other hand, exempting ATMs from the closing notice requirements would be contrary to the current position of the banking agencies that ATMs are branches. Some customers of ATMs might be disadvantaged by ATM closings and therefore should be provided with some advance notice of the closing. In some inner city low- and moderate-income areas, for example, ATMs may be the only convenient local banking facilities.

Generally, the agencies support implementation of the branch closing notice requirements in a flexible manner that serves the objectives of the law, but that reasonably accommodates the practical problems facing depository institutions that must comply with the law's requirements. The merits of this recommendation will be assessed after the comment period has ended on each of the agencies' proposals on implementing the branch closing statute. As with all proposed rulemakings, comments from the industry and public on the nature and effect of a proposed agency interpretation of a new law play an essential role in determining the appropriate final action on the proposal.

With regard to the leasing arrangement issue discussed above, the agencies can continue their case-by-case approach of resolving issues as they arise. Because this matter is limited to leases entered into prior to enactment of FDICIA, it is anticipated that the matter will not remain an issue for long.

CAPITAL RULES

RECOMMENDATIONS

Amend OTS capital rules concerning regulatory capital-intangible assets (Part 567).

Amend OCC rules on capital treatment of intangible assets (Part 3) that set forth the rules for treatment of intangible assets for capital purposes.

Core deposit intangibles should be fully counted in Tier 1 capital.

Increase the permissible level of purchased mortgage servicing rights to 50 percent of Tier 1 capital.

BACKGROUND

The regulatory capital treatment of intangible assets differs among the four federal banking agencies. The OCC and FDIC deduct all intangibles except for limited amounts of qualifying intangible assets that meet a three-part test. The Federal Reserve deducts goodwill but does not automatically deduct identifiable intangible assets. The OTS deducts intangible assets except for qualifying supervisory goodwill, purchased mortgage servicing rights, and limited amounts of qualifying intangible assets that meet a three-part test.

All four federal banking agencies have proposed amending their intangible rules to be more uniform. The revisions would: (1) recognize purchased mortgage servicing rights (PMSRs) and purchased credit card relationships (PCCRs) as the two types of qualifying intangible assets; (2) limit the aggregate amount of PMSRs and PCCRs that can be favorably recognized for regulatory capital purposes; and (3) establish accounting and market valuation procedures that would need to be applied to PMSRs and PCCRs. Final rules are expected before year-end 1992. Certain provisions included in the proposed rules (such as the quarterly valuation of PMSRs and the limits on the recognition of PMSRs for capital purposes to no more than 90 percent of fair market value) are required pursuant to section 475 of FDICIA.

The issue of recognizing core deposit intangibles was considered at the time the proposals were drafted. The agencies decided not to recognize core deposit intangibles in the proposal because they do not meet the three-part test.

DISCUSSION

Amendment of the intangible rules, if consistently adopted by each of the four federal banking agencies, will result in the uniform regulatory treatment of intangible assets, regardless of which agency is the primary federal banking regulator for a given institution. This would reduce the regulatory burden that exists for multibank holding companies whose banks are supervised by different regulators and therefore are subject to differing rules on the treatment of intangible assets.

Certain types of intangible assets that have in the past been favorably recognized by at least some of the banking agencies, however, will prospectively have to be deducted in determining regulatory capital if the proposed revisions are adopted.

While revision of the regulatory capital treatment of intangible assets is desirable, recognition of core deposit intangibles would unduly weaken capital standards.

OTS CAPITAL RULES

RECOMMENDATION

Modify OTS capital rules to place those equity investments permissible for national banks in the 100 percent risk-weight category.

BACKGROUND

The current OTS capital rule requires that all investments defined as equity investments under GAAP be deducted from risk-based capital over five years under a transition schedule. There is no parallel treatment in the capital requirements imposed on banks. Some of these equity investments, however, are permissible for national banks and are placed in the 100 percent risk-weight category under the capital regulation of the OCC. The current OTS treatment of these assets results in a more stringent treatment for thrifts than banks. The recommendation is for OTS to treat equity investments held by thrifts that would be permissible investments for national banks to be treated the same for capital purposes as if the investments were held by national banks. The investments most affected by this change would be investments in the stock of the Federal Home Loan Mortgage Corporation and Federal National Mortgage Association and loans with equity characteristics.

DISCUSSION

This proposal would establish uniform capital treatment among the banking agencies for equity investments that are permissible investments for national banks. It would eliminate a capital requirement that may be much more severe than warranted by the assets being held. The OTS published a proposed rule on September 2, 1992, to make this change.

QUALIFIED THRIFT LENDER TEST

RECOMMENDATION

Implement modifications in subtitle G of FDICIA, lowering the QTL test for thrifts from 70 percent to 65 percent and requiring monthly, rather than weekly, reporting.

BACKGROUND

Under FDICIA, the portfolio requirements for the Qualified Thrift Lender Test (QTL) changed. The 1991 statutory revisions lowered the QTL ratio compliance requirement from 70 to 65 percent and revised the measure of compliance from a weekly basis to a monthly average basis for nine out of every twelve months. The FDICIA revisions also permitted Federal Home Loan Bank, Freddie Mac, and Fannie Mae stock to be included as Qualified Thrift Investments (QTI) and doubled the amount of personal, family, household, or educational loans that may count as QTI. FDICIA also increased from 10 percent to 20 percent the amount of liquid assets that may be deducted from total assets in the calculation of portfolio assets.

DISCUSSION

The proposed revisions are required by statute under the Home Owners' Loan Act as amended by FDICIA. On September 9, 1992, the OTS published a proposed rule making the changes. Interim procedures have been in effect since May 1992.

MATURITY OF CORPORATE SECURITIES HELD BY THRIFTS

RECOMMENDATION

Modify the OTS rule on commercial paper and corporate debt securities (12 CFR 545.75) to delete average maturity requirement of six years or less for the portfolio of corporate debt securities.

DISCUSSION

The main difficulty with this recommendation is that it may encourage institutions to buy corporate debt securities with extended maturities, which may lead to additional interest rate risk.

Nevertheless, the basis for the rule appears outmoded given the newer analysis of interest rate risk that the OTS has undertaken. The OTS is in the process of issuing a final rule rescinding Section 545.75.

RULE ON LOANS TO ACQUIRE OR IMPROVE REAL ESTATE

RECOMMENDATION

Modify the OTS rule limiting loans to acquire or to improve real estate to two percent of assets for any one project.

BACKGROUND

Under OTS' regulations at 12 CFR 545.36(d), federal savings associations are limited in the amount they can lend to any one development project to an amount equal to two percent of their assets. This provision conflicts with the loans-to-one-borrower limitation (LTOB) at 12 CFR 563.93.

DISCUSSION

Removal of this regulation will reduce confusion, because the provision conflicts with statutory LTOB limitations. Otherwise, institutions may believe that they can extend funds for one development project in excess of the LTOB restrictions.

This recommendation was included in an OTS notice of proposed rulemaking dated September 3, 1992.

OTS ACCOUNTING RULES FOR MORTGAGE-BACKED SECURITIES

RECOMMENDATION

Revise accounting rules for mortgage-backed securities (MBS) transactions (that is, sales versus financing) to reflect changes in the GAAP accounting literature, particularly those involving contracts to sell and repurchase a MBS of the same issuer that is not the identical original security ("dollar roll").

BACKGROUND

OTS issued a rule (12 CFR 571.16) to curb abuses in the accounting for exchanges of mortgage-backed securities at a time when no other guidance existed. Since issuance of the rule, the American Institute of Certified Public Accountants (AICPA) has issued three statements of policy and has significantly revised the audit and accounting guide for savings institutions to address the issue of sales versus financing treatment of transactions involving mortgage-backed securities.

DISCUSSION

Currently the OTS rule provides an objective measure for determining compliance for financing treatment of dollar rolls. It requires that dollar rolls be funded and taken back into portfolio on an annual basis and prohibits funding with repurchase agreements. The GAAP literature does not provide similar objective measures for determining compliance. Arguably, the current OTS policy is a more stringent interpretation of GAAP.

Revision of the rule to recognize developments in reporting MBS transactions, particularly dollar rolls, is consistent with the OTS' stated objective of establishing accounting standards that are consistent with the practices of the other federal banking agencies and GAAP.

The OTS is in the process of issuing a final rule rescinding Section 571.16.

RISK-BASED CAPITAL WEIGHTINGS

RECOMMENDATIONS

1) Lower the risk weight on home equity loans to 50 percent if the combined loan-to-value ratio of the first and second mortgages is below 80 percent.

2) Lower the risk weight on all manufactured housing and mobile home communities.

3) Apply a 0 percent risk weight to Federal Home Loan Bank stock.

4) Lower the risk weight for warehouse lines of credit secured by residential single family loans from 100 percent to 50 percent for conventional loans and to 20 percent for government guaranteed loans.

5) Place FHA loans and the portion of VA loans guaranteed by the government in the 0 percent risk-weight class.

BACKGROUND

These recommendations all ask for revisions to risk-weight categories under the risk-based capital rules. Discussion of each follows.

DISCUSSION

1) The first recommendation seeks to change the present risk weighting of some home equity loans from the 100 percent risk-weight to the 50 percent risk-weight category. The agencies already permit loans secured by junior liens on residential properties to be assigned to the 50 percent risk-weight category if the total of all loans on the property results in a conservative loan-to-value ratio, provided that all liens are held by the same institution.

This suggestion makes sense in those cases where the bank holds all of the liens on the property. However, a 50 percent risk weight should not be extended to junior liens where the same bank does not hold the first lien.

2) The commercial bank call report indicates that mobile homes are considered to be 1-4 family residential properties if the applicable state law defines the purchase or holding of a mobile home as the purchase or holding of real property and the loan to purchase the mobile home is secured by that mobile home. Thus, mobile homes are eligible for assignment to the 50 percent risk-weight category if all the criteria are met.

Under existing OTS capital rules, loans to manufactured home communities may also be included in the 50 percent risk-weight category if they meet the criteria for multifamily mortgage loans. The three banking agencies currently have proposals outstanding that would allow certain multifamily housing loans to be assigned to the 50 percent risk-weight category if the applicable criteria were met. The proposed treatment for multifamily housing loans may include loans for manufactured home communities.

The agencies do not believe that the 50 percent risk weight for manufactured housing should be extended beyond what is currently covered plus what is being contemplated in the proposal on multifamily housing.

3) The risk-based capital rules explicitly assign equity securities to the 100 percent risk-weight category. However, when developing the risk-based capital rules, the agencies decided to assign Federal Home Loan Bank stock to the 20 percent risk-weight category because it is a condition of membership in the system. Bonds issued by the Federal Home Loan Bank system are also risk weighted at 20 percent (rather than 0) because they are not backed by the full faith and credit of the United States. It would not make sense to assign a lower risk weight for Federal Home Loan Bank stock than for its bonds.

4) The interagency risk-based capital working group and each of the agencies individually have considered this issue within the past year and have reaffirmed their view that warehousing lines of credit are collateralized loans to mortgage banks, which are considered private obligors. Since mortgage banks are private obligors, any exposures to them are risk weighted at 100 percent. In addition, since mortgage loans are not eligible collateral under the Basle Accord or the agencies' risk-based capital rules, the mortgage collateral does not result in a reduced risk weight.

5) As a part of an interagency study on recourse arrangements, the banking agencies currently are reviewing the guarantees extended by the FHA and VA to determine whether they are unconditional. In order for FHA and VA loans to be assigned to the 0 percent risk-weight category, their guarantees must be unconditional; otherwise they are assigned to the 20 percent risk-weight category along with other claims that are conditionally guaranteed. This recommendation, therefore, could be implemented if a review finds that the guarantees extended by the FHA and VA are the equivalent of unconditional guarantees.

ACCOUNTING FOR OTHER REAL ESTATE OWNED BY NATIONAL BANKS

RECOMMENDATION

Amend accounting requirements (covered transaction rule) for other real estate owned (OREO) and replace with GAAP. Also clarify certain supervisory issues relating to OREO and add a section dealing with in-substance foreclosure (ISF).

BACKGROUND

The requirements for OREO are set forth in the call report instructions and OCC Interpretative Ruling (IR) 7.3025. IR 7.3025 requires an initial investment of 10 percent before receivables arising from the sale can be removed from OREO. Agency practice is to follow GAAP with respect to ISFs.

DISCUSSION

Updating and clarifying IR 7.3025 may reduce misunderstandings about current regulatory requirements for OREO. The OCC is currently in the process of revising IR 7.3025 to make it more consistent with GAAP and the appraisal regulation. Additionally, the accounting profession has provided guidance on the determination of ISFs and the accounting for OREO.

The AICPA issued Practice Bulletin No. 7 regarding the determination of ISFs. The AICPA has also issued Statement of Position (SOP) 92.3, "Accounting for Foreclosed Assets." The banking agencies intend to incorporate appropriate provisions of the SOP in the call report.

ALLOWANCE FOR LOAN AND LEASE LOSSES

RECOMMENDATION

Clarify standards for the Allowance for Loan and Lease Losses.

BACKGROUND

The primary objective of the allowance process is to establish a level of allowances adequate to cover anticipated loan and lease losses. To accomplish this objective, institutions should apply a methodology that ensures that appropriate consideration is given to all significant factors that can affect the collectability of the loan portfolio. These factors include the character, overall financial condition, and payment record of the borrower, the prospects for support from any guarantors, and the nature and degree of protection provided by the cash flow and value of the underlying collateral. Since many factors affect the collectability of loans and these factors differ among banking organizations, it is neither possible nor desirable to remove all judgment and management discretion from this process.

This comment was specifically directed at the OCC and requests that the agency issue more definitive standards on how the agency judges the adequacy of the allowance. The OCC has published a Banking Circular on this topic, the purpose of which was to provide more guidance. The OCC examiner handbook issuance is in process to provide more internal guidance on this issue.

DISCUSSION

Each of the federal banking agencies recognizes that more specific guidance in assessing the reliability of loan loss allowances would be desirable. Accordingly, there is an interagency effort currently underway through a subcommittee of the FFIEC Task Force on Supervision to explore ways to develop more structured and consistent operational guidance for bankers to follow in determining their allowance needs and for examiners to use in assessing whether an institution's allowance policies and practices are leading to adequate reserve coverage. However, it is necessary that the guidance preserve sufficient flexibility to accommodate all relevant factors affecting the realization of losses and the legitimate differences that exist among banking organizations.

REGULATORY ACCOUNTING FOR SALES OF ASSETS

RECOMMENDATIONS

Regulatory accounting should conform to GAAP for sales of assets.

Recourse recognition for all regulatory reporting and compliance purposes should be confined to explicit quantifiable risk retention.

BACKGROUND

The existing accounting rules for the treatment of certain recourse arrangements on sales of assets by banks differs from the treatment permitted under GAAP. Under FASB 77, many assets sold with recourse can be recognized as sales with the transferred assets removed from the balance sheet and any gain immediately recognized as income. OTS-regulated savings associations follow FASB 77 for Thrift Financial Reporting purposes. For bank reporting purposes, however, many asset sales with recourse (other than certain mortgage transactions) are treated in a manner whereby the assets remain on the balance sheet, the proceeds received from the sale are reflected as borrowings, and any gain on the asset transfer is deferred. This regulatory reporting treatment therefore may have an adverse effect on a bank's capital ratios relative to the treatment that would otherwise be allowed if the banking agencies followed the FASB 77 accounting standard.

An FFIEC Recourse Working Group has been coordinating an interagency effort to revise existing reporting and capital rules for the treatment of recourse arrangements. In June 1990, the FFIEC issued a discussion paper on recourse arrangements prepared by the working group. The working group has developed a series of recommended changes to the agencies' regulatory capital standards and is analyzing their impact. Once that is completed, the FFIEC will consider those suggestions and determine whether to recommend that the agencies propose for public comment amendments to their capital standards.

DISCUSSION

An advantage of adopting the FASB 77 accounting treatment for bank regulatory reporting purposes is that one of the major remaining differences for banks between GAAP and regulatory reporting rules would finally be resolved. This would reduce the regulatory burden that arises from having to treat asset sales with recourse differently for regulatory reporting rules and capital rules than they are treated for GAAP accounting rules.

Notwithstanding the GAAP guidance permitted by FASB 77, however, asset sales with recourse can entail the retention by the selling institution of significant risk of loss for the assets transferred. In such cases, the regulatory capital and reporting rules need to capture this risk and compelling supervisory reasons may therefore remain for treating these recourse transactions differently than what is permitted under GAAP standards.

The FFIEC Recourse Working Group is dealing with the broad topic of recourse with the goal of a uniform interagency policy. When this review is finished, further appropriate changes may be in order.

ASSET-BASED LENDING TO SMALL BUSINESSES

RECOMMENDATION

Increase emphasis by examiners on collateral value in their examination review of small business lending.

BACKGROUND

This recommendation relates to OCC's examination and review of an institution's small business lending practices; it requests that the agency place greater emphasis on the value of collateral (as well as cash flow) in the assessment of small business loans.

Often the only source of funds for small businesses is bank lending which, to this customer base, is essentially asset based. A practical view of asset-based lending is necessary with emphasis on collateral and cash flow and less emphasis on traditional balance sheet ratios. Some bankers contend that OCC examiners do not adequately value collateral in assessing the credit rating of these loans, even though such loans are largely predicated upon the value of the collateral. They argue that the examination process penalizes banks because new asset-based loans are often immediately considered a criticized credit, which discourages banks from making these loans.

DISCUSSION

The OCC does not agree that asset-based loans are automatically considered a criticized credit. Credits are criticized based on a review of all relevant financial and collateral factors relating to that particular loan. Banks, through their industry trade associations, have recommended revising OCC guidance concerning the review of asset-based loans, and OCC is currently undertaking a review of the recommendations to determine what changes, if any, are warranted. Should the OCC determine that the guidelines warrant amendment to provide a fairer assessment of asset-based loans, the OCC will develop a banking circular with new guidance for field examiners and banks and will update the Comptroller's Handbook for National Bank Examiners.

This issue is an important area of policy that should be common among the agencies. The agencies support the need to review and consider underlying collateral values and all other factors affecting collectability of these loans.

COORDINATION OF DETERMINATIONS OF VALUATION ALLOWANCES

RECOMMENDATION

Increase coordination between the OTS and the FDIC on the adequacy of valuation allowances.

BACKGROUND

Commenters have requested greater coordination between the OTS and FDIC on the determination of an adequate valuation allowance and have expressed concern that examiners take the most conservative of two views of assets. In addition, some commenters have requested that the OTS clarify the interaction between valuation allowances and capital requirements. On the latter point, the OTS issued a clarification on the interaction of valuation allowances and capital requirements in Thrift Bulletin 38-4, dated April 13, 1992.

The FDIC and OTS entered into a joint agreement on October 12, 1989, designed to promote coordination between the two agencies. On May 18, 1992, the FDIC and OTS adopted specific guidelines to define each agency's responsibilities with regard to conducting examinations, processing examination reports, supervisory correspondence, enforcement actions and capital plans. The agencies have also established a resolution process for material differences in the FDIC and OTS examination findings and proposed corrective actions. These guidelines should result in greater communication and coordination between the two agencies, including the issue raised by the recommendation.

DISCUSSION

The FDIC/OTS agreement dated May 18, 1992, delineating the examination and supervisory responsibilities for each agency should result in increased coordination between the agencies in all phases of examination. Since this involves one of the most contentious issues during examinations, however, the agencies should continue to monitor and discuss possible improvements in this area.

REVIEW OF OPERATING SUBSIDIARY NOTIFICATIONS

RECOMMENDATION

Reduce the types of national bank operating subsidiary notifications that must be submitted to the OCC for prior review.

BACKGROUND

Under 12 CFR 5.30, national banks must receive prior OCC approval to establish or acquire an operating subsidiary. The notice may be submitted in letter form and must describe the activities of the proposed subsidiary in sufficient detail to permit the OCC to determine whether the proposed activity is legally permissible for a national bank. Generally, if an activity is determined to be legally permissible, the establishment or acquisition of the subsidiary will be approved. In certain cases, the activities of the subsidiary may raise supervisory or regulatory concerns, and approval of the activity therefore may be subject to specified conditions or limitations. In addition, the safety and soundness of the bank proposing the subsidiary may be a consideration in some cases.

DISCUSSION

By limiting the review required for certain types of subsidiaries, the OCC could streamline the filing process and reduce the regulatory burden on national banks. To effect this proposal, the OCC probably would have to publish a list of previously approved operating subsidiary activities. The publication of such a list would improve the information available to national banks seeking to establish or acquire common types of subsidiaries. This would reduce filing burdens and provide greater certainty to many banks seeking to establish or acquire subsidiaries.

The legality of operating subsidiary proposals is a fact- specific determination. Therefore, it can be difficult to determine if an operating subsidiary proposal would comport with the activities appearing in a list of preapproved activities. In addition, while some activities may be legally permissible, supervisory considerations may still arise due to the nature of the activity or due to the condition of the bank applying for the subsidiary.

Some streamlining of operating subsidiary filing requirements should be established for banks in good condition. This will require a publication of a listing of activities that are clearly legally permissible and some definition of banks eligible for the streamlined process. To the extent state chartered banks may not engage in activities not permitted to national banks unless they obtain FDIC consent, such a clarification of OCC standards will also give relief to state banks.

FORWARD COMMITMENTS, OPTIONS, AND FUTURES ACTIVITIES FOR SAVINGS ASSOCIATIONS

RECOMMENDATION

Revise savings association rules governing forward commitments, options and futures to allow institutions that meet fully phased-in capital requirements to participate in a greater array of activities.

BACKGROUND

This proposal recommends that the OTS' rules on forward commitments, options and futures be relaxed to allow greater use of these instruments to manage interest rate risk. The banking agencies do not similarly prohibit the use of these instruments but instead require that all of these activities be reported at market value or at the lower of cost or market value (limited to the lower of cost or market value for standby option contracts). The banking agencies permit banks to use GAAP for futures and forward activities that are associated with bona fide hedging of mortgage banking operations.

DISCUSSION

The use of these instruments is currently under discussion by an interagency working group. The goal of this working group is to establish standards that are uniform among the agencies and consistent with GAAP.

SECURITIES OF NATIONAL BANKS

RECOMMENDATION

Repeal the OCC's rules setting forth the disclosure requirements for offers and sales of national bank securities and incorporate by reference the SEC's regulations.

BACKGROUND

Bank-issued securities are exempt from registration pursuant to the Securities Act of 1933. The OCC has issued 12 CFR Part 16, which sets forth the disclosure requirements for offers and sales of national bank securities. This proposal would result in repeal of Part 16 in its current form and incorporation by cross reference of certain rules of the SEC implementing the 1933 Act.

DISCUSSION

In August 1992, the OCC requested comment on a proposed rule to incorporate by reference the SEC's regulations promulgated under the 1933 Act. Because the SEC's regulations are not directly applicable to banks, the OCC's proposed rule has certain minor differences from the SEC's regulations to take into account the special nature of banks. The OCC's proposal to incorporate by reference the SEC's rules will ensure that the same set of regulations that apply to publicly-traded companies will also apply to national banks. It will ease reporting and filing requirements and simplify compliance because investors and securities counsel for banks and investors are more familiar with the SEC's rules. Further, uniform rules would promote consistency of disclosure in the market and eliminate waste associated with two sets of regulations that are intended to accomplish the same goals.

SENIOR EXECUTIVE OFFICERS

RECOMMENDATION

Modify the FDIC's regulation at 12 CFR 303.14 on changes in senior executive officers and directors to narrow the definition of "troubled condition."

BACKGROUND

Section 32 of the FDI Act requires prior notice to the appropriate federal banking agency before adding a director or employing an individual as a senior executive officer of an institution which has been chartered less than two years, has undergone a change in control in the last two years, has less than the minimum required capital, or is otherwise in a troubled condition.

"Troubled condition" has been defined to include an institution that "is subject to a written agreement that requires action to improve or maintain the safety and soundness of the institution." The FDIC has interpreted "written agreement" to include informal actions such as a memorandum of understanding. The other agencies do not have such an interpretation.

The law is designed to ensure that directors and senior executive officers have sufficient expertise and ability. It imposes a burden to the extent that the affected institutions must file a notice with the federal banking agencies 30 days in advance of adding or replacing a director or employing or changing the responsibilities of an individual to those of a senior executive officer.

DISCUSSION

The burden of this regulation lies in the 30-day delay in employing a senior executive officer or director, representing lost productivity, and the time and expense of filing a notice. Additional expense would be incurred if the position's proposed addition or change were disapproved and the institution appealed the decision; however, the simplified hearing process should minimize legal costs. While no formal estimates are available, costs are probably modest if not nominal, although the process can be distracting. Fewer than two percent of the 4,190 notices processed by the FDIC between January 1990 and August 1992 were denied.

The agencies do not favor narrowing the definition of "troubled condition" to exclude banks that are subject to formal written agreements that require action to improve or maintain the safety and soundness of an institution. The agencies feel that the minimal reduction in burden for institutions would not outweigh the potential for deleterious effects on the banking industry and the deposit insurance fund. However, there should be agency uniformity on informal actions not being included.

I. Supervisory Policies: Insider and Affiliate Transactions

GENERAL BACKGROUND

Section 22(h) of the Federal Reserve Act (12 U.S.C. 375b) imposes restrictions on loans to insiders and their related interests. These restrictions include a prohibition on loans to insiders on preferential terms, a lending limit on loans to individual insiders, and an aggregate lending limit on loans to all insiders. Regulation O, promulgated by the Federal Reserve, implements section 22(h) and was recently amended to incorporate a number of changes made by FDICIA.

Many commenters criticized section 22(h), as amended by FDICIA, on the basis that it impairs the ability of banks to attract good officers and directors, and requires banks to send their officers and directors, who are frequently their best customers, to competitors. Many of the general comments concerning burdens that section 22(h) and Regulation O impose on institutions in attracting and retaining qualified officers and directors arise from FDICIA and can be addressed only through statutory revisions.

AGGREGATE LENDING LIMIT FOR SMALL BANKS

RECOMMENDATION

The Federal Reserve should make permanent the aggregate lending limit of 200 percent of unimpaired capital and unimpaired surplus for small banks.

BACKGROUND

FDICIA amendments to section 22(h) of the Federal Reserve Act give the Federal Reserve authority to grant relief to small banks from the aggregate lending limit applicable to insiders. In general, a bank cannot lend to its insiders, in aggregate, more than 100 percent of its unimpaired capital and unimpaired surplus. The Federal Reserve, however, is permitted to raise that limit to not more than 200 percent for banks with deposits of less than $100 million if it determines that the exception would be "important to avoid constricting the availability of credit in small communities or to attract directors to such banks."

In the final rule amending Regulation O to reflect the changes made to section 22(h) by FDICIA, the Federal Reserve granted an exception to permit small banks to establish a higher aggregate lending limit for loans to insiders which may not exceed more than 200 percent of their unimpaired capital and unimpaired surplus. This exception expires on May 18, 1993. The Federal Reserve has already indicated that it will revisit the issue of an appropriate aggregate lending limit for small banks prior to May 18, 1993, and it is in the process of collecting further evidence to determine whether 200 percent of unimpaired capital and unimpaired surplus is the appropriate limit.

A bill supported by the Administration in 1992 would have raised the limit on aggregate loans to officers, directors, and shareholders of small banks (under $100 million in assets) to 200 percent of capital.

DISCUSSION

The advantage of making permanent the exception permitting small banks to establish an aggregate lending limit of up to 200 percent of unimpaired capital and surplus is that it would permit these banks to continue serving the credit needs of their insiders rather than forcing insiders to terminate their relationship with the bank or seek credit elsewhere.

The disadvantage is that it would increase the exposure of these banks to a concentrated credit risk from insiders. On balance, it appears that further review of the temporary lending limit of up to 200 percent of unimpaired capital and surplus should be undertaken.

GENERAL REVIEW OF REGULATION O

RECOMMENDATION

The Federal Reserve should undertake a general review of Regulation O.

DISCUSSION

The Federal Reserve has indicated that it will review Regulation O in its entirety and the effect of the regulation on bank operations. The Federal Reserve has also indicated that it will consider modifications that are shown to be necessary or appropriate.

CORPORATE GOVERNANCE REQUIREMENTS

RECOMMENDATION

Address corporate governance requirements in ways that would modernize the governance of national banks.

BACKGROUND

Many states permit directors and shareholders to take actions in writing instead of holding meetings. The OCC has no express authority to permit the boards of directors of national banks to take actions in writing. Similarly, national bank directors are not specifically authorized to follow the now-common practice of permitting one or more board members to attend board meetings by telephone. Permitting written actions and conference call attendance would increase flexibility for directors and enable boards to take action more quickly and with the participation of more board members than would be possible if the board had to wait until members could attend in person.

DISCUSSION

In the past the OCC developed a precedent letter which permitted some changes on a limited basis in certain circumstances. Given technological advances, the OCC agrees that this recommendation has merit and should be explored further.

The OTS also has corporate governance regulations that should be reviewed and updated.

ADVERSE CONTRACTS

RECOMMENDATION

Adoption of the FDIC's rule regarding adverse contracts, as proposed, would be a disincentive to data service providers to offer such services to depository institutions.

BACKGROUND

In accordance with section 30 of the FDI Act, the FDIC's proposed regulation (56 FR 13291, April 1, 1991) provides that no person may enter into an adverse contract with an insured depository institution. This recommendation suggests that adoption of the proposed regulation on contracts deemed adverse by the FDIC would be a disincentive to data service providers to provide such services to weaker financial institutions. According to the argument, if the FDIC were to establish a number of disincentives for vendors to do business with troubled financial institutions, such institutions may not be able to obtain key services at such rates as to enable them to control or reduce their costs.

DISCUSSION

The FDIC's proposed rule received much criticism from interested parties because of (1) alleged inadequacies in the definition of "contract," and (2) the belief that third party vendors might be joined to FDIC cease-and-desist actions against insured institutions. A rule that creates extra burdens for service providers would add to the cost of providing services to institutions, especially troubled institutions.

Legitimate, beneficial contracts should not be adversely affected by this rule, however. The final rule, if one is adopted, will clearly define what is an adverse contract. The proposed rule would implement section 30 of the Federal Deposit Insurance Act, which permits but does not require a regulation. However, section 30 is broad and it does not set any standards or require that notification be provided to contracting parties of actions that are prohibited. It is believed that an implementing regulation would alleviate some of this uncertainty and could in fact be less burdensome than not having a regulation. Additionally, only vendors that are judged to be "institution-affiliated parties" would be subject to administrative action under the rule.

Action on the proposal should be taken in order to remove uncertainty. The issue in question deals with a proposed regulation, and the issues raised by commenters will be fully considered as part of the rulemaking process.

II. Consumer Protection Policies: Disclosures and Practices

ELECTRONIC FUND TRANSFER (REGULATION E)

RECOMMENDATION

Increase the exemption from coverage for small institutions with $25 million or less in assets to $50 million or less.

BACKGROUND

Currently Regulation E exempts from its coverage preauthorized transfers to or from accounts at institutions with $25 million or less in assets. (The exemption does not extend to section 913 of the EFT Act regarding compulsory use of electronic funds transfer.)

DISCUSSION

Because the asset size of financial institutions has increased since the small institution exemption was originally adopted in 1982, a standard for "small institution" with a comparable scope today should use a higher asset level. Increasing the asset cutoff would reduce regulatory burden to some extent, because additional institutions would not have to comply with Regulation E with regard to preauthorized transfers.

At the same time, it is not clear how much benefit would result from increasing the exemption. Institutions that offer EFT services other than preauthorized transfers must comply with Regulation E with regard to these other services; complying with regard to preauthorized transfers as well may not represent a major difference in burden.

Federal Reserve staff is planning to recommend that this change be included in the proposed revision of Regulation E to be published for comment early next year.

TRUTH IN LENDING (REGULATION Z)

RECOMMENDATIONS

Revise and improve the disclosure requirements for adjustable-rate mortgages (ARMs) to reduce burden.

Consider exempting small banks that offer a limited number of ARMs from some or all of the disclosure requirements.

Permit the period in the ARM historical table to be 20 years so that new rates can be added at the bottom of the forms without annual revisions.

BACKGROUND

The ARM disclosures are provided when a consumer receives an application for an ARM. They include primarily generic information about ARMs generally, but also describe some features of the lender's own product. The disclosure contains a payment example based on the preceding 15 years' history of values of the index used to show how historical rate fluctuations affect a hypothetical loan with the features the lender offers ("historical table"). These uniform disclosure requirements were developed by the FFIEC over the course of several years to address the burdens lenders faced from the four overlapping and inconsistent agency requirements for ARMs that existed prior to 1988 -- those of the OCC, the Federal Home Loan Bank Board, the Federal Reserve, and the Department of Housing and Urban Development.

DISCUSSION

Some financial institutions (particularly smaller ones) have said that they are unwilling to offer ARM products because of the disclosure requirements, that the historical table is difficult to update each year and is not valuable to consumers, and that, overall, the disclosures are too burdensome.

The disclosures were developed to ensure that consumers received adequate information about a complex and potentially risky loan product, while not requiring lenders to provide detailed information about individual transactions. Therefore, compared to the previous requirements, the uniform ARM regulations achieved a burden reduction and lenders have a single set of requirements applicable to all ARM products.

The FFIEC Task Force on Consumer Compliance could investigate the complaints, especially by small banks, that the ARM disclosure requirements are unnecessarily burdensome. The Task Force could also look into whether there is a need to develop a compliance aid to help small banks; such a compliance aid might include a complete disclosure for a standard or typical ARM product.

OTS CONSUMER REGULATIONS

RECOMMENDATION

Eliminate the OTS restriction on prepayment penalties on adjustable-rate loans.

BACKGROUND

OTS regulations prohibit federal savings associations from imposing a prepayment penalty on an adjustable-rate mortgage for the 90-day period that follows a notice to the borrower that the mortgage payment will be adjusted (12 CFR 545.34).

DISCUSSION

This restriction has been reevaluated recently by the OTS to consider whether it is generally consistent with safety and soundness considerations because it might discourage institutions from taking steps to prudently manage interest rate risk exposure. Because of these concerns, the OTS is in the process of issuing a final rule to eliminate the restriction.

OTS CONSUMER REGULATIONS

AGENCY RECOMMENDATION

Eliminate the requirement in OTS regulations for disclosing additional information in fixed-rate and adjustable-rate mortgages relating to due-on-sale clauses, late charges, prepayment penalties, escrow payments, and the notice of maturity for non-amortizing or partially-amortizing loans.

BACKGROUND

OTS regulations require savings associations to provide applicants for fixed-rate or adjustable-rate mortgages with disclosures in addition to those required under the Truth in Lending Act (12 CFR 563.99).

DISCUSSION

The purpose of the OTS disclosure requirements is to explain in greater detail the operation and consequences of the loan for which the borrower is applying.

In many cases, however, the information duplicates information in Truth in Lending disclosures or typically contained in home loan contracts. Because of this duplication, the OTS is in the process of issuing a final rule to eliminate these requirements.

FAIR HOUSING HOME LOAN DATA SYSTEMS

RECOMMENDATION

Eliminate the requirement that national banks and thrifts keep loan application registers ("Fair Housing Home Loan Data Systems") more comprehensive than that required by Regulation C (Home Mortgage Disclosure Act).

BACKGROUND

In the 1970's, the FDIC, OCC and OTS (then the Federal Home Loan Bank Board) adopted requirements that regulated institutions maintain information about the characteristics of applicants for home loans. The agencies' requirements differed somewhat one from the other and duplicated some of the information required by HMDA (as amended in 1989). The FDIC has dropped its requirements that insured institutions maintain this additional loan application register. The OTS is deleting its requirement that savings institutions maintain loan application information in addition to that required by HMDA. To eliminate duplicative recordkeeping requirements, the OCC is proposing that its monthly Fair Housing Home Loan Data System recordkeeping requirements be rescinded, but that HMDA-covered institutions be required to maintain their HMDA information on a current (monthly) basis.

DISCUSSION

Eliminating the additional loan application requirements would reduce the paperwork and recordkeeping burden for banks and thrifts. Since HMDA imposes a uniform standard for reporting this information, it has become less necessary for the agencies to impose requirements for collection of additional data outside of HMDA.

On the other hand, additional data could assist examiners in scrutinizing lending patterns and characteristics that would suggest discriminatory practices. Therefore, the OCC is studying whether HMDA data may need to be augmented to conduct valid statistical analysis of home loan data.

While there is merit in conforming the data collection rules, some flexibility should be retained by the agencies to resolve the issue differently if they find substantial benefits from collecting the additional information.

COMMUNITY REINVESTMENT ACT

RECOMMENDATIONS

Review documentation standards required to demonstrate compliance, clarify them, and eliminate any unnecessary requirements, particularly for small institutions in rural areas.

Use a two-tiered approach to evaluating performance, with an in-depth examination of CRA performance only being conducted if the examiner is not satisfied that credit is being extended throughout the entire community in a nondiscriminatory manner.

Reward institutions with satisfactory ratings such as by simplifying examinations and reducing their frequency, or by providing a safe harbor on applications.

Review CRA examination procedures and examiner training to ensure uniformity and consistency.

Establish procedures for appealing CRA ratings.

Create exemptions from the law if a similar state law applies or if an institution is small, located in a rural community, or operates as a wholesale or credit card bank.

BACKGROUND

The Community Reinvestment Act of 1977 (CRA) states that regulated financial institutions have a continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered. It requires financial institutions to demonstrate that their deposit facilities serve the convenience and needs of their delineated communities.

CRA also requires the federal financial supervisory agencies to use their authority when examining institutions to encourage institutions to help meet the credit needs of the local communities in which they are chartered, consistent with safe and sound operation. Since July 1990, the ratings that the agencies assign to CRA performance at individual institutions are available to the public. In addition, the agencies prepare a CRA Performance Evaluation of the institution, which is also available to the public.

DISCUSSION

With the advent of public disclosure in July 1990, there has been considerably more attention paid to CRA and whether it is achieving its purposes. Much of the discussion has been directed at how the agencies handle their responsibilities under CRA.

This debate is understandable given the lack of specificity and guidance in the statute. The statute does not direct the financial institutions to do anything in particular, but rather directs the agencies to encourage the institutions they regulate to lend throughout their communities, to examine them to assess their record of meeting the credit needs of their entire community, and to take the institutions' records into account when considering certain applications. The agencies have been very careful in their public pronouncements to avoid any semblance of credit allocation as part of their CRA programs. Instead, the agencies have put their major efforts into making clear to the industry that CRA lending can be profitable and that it can include all kinds of lending, not just home mortgages. The agencies also have expected their institutions to do outreach and marketing throughout their communities, and to have in place a process for managing their responsibilities. These include some level of documentation of their efforts consistent with their need to manage the process (since the agencies believe that some level of documentation is necessary in virtually any good management effort). However, the debate over CRA continues.

Community organizations frequently argue that the ratings assigned by the agencies are too high; the financial industry often complains that the ratings are too low and do not place enough emphasis on actual lending. Financial institutions and community organizations complain that the CRA rating system is too subjective. There are also criticisms that the CRA does not provide any incentives to financial institutions to want to achieve an "outstanding" rating or even a "satisfactory" rating if they have no plans for filing CRA-covered applications. Some small institutions argue that CRA is superfluous for them and that they would not be profitable if they were not serving the credit needs of their local communities. Many institutions have argued that CRA is too costly because it places a significant burden on them to document activities to prove performance. Community organizations argue that CRA is not too burdensome and that some of the smaller institutions are poor CRA performers.

In essence, the major recommendations highlighted above demonstrate that there are widespread differences in perception about what CRA is intended to accomplish and the way it is being administered by the agencies. The agencies agree that uniformity in the administration of the Act in the form of examination procedures, examiner training and policies promotes consistency and the agencies have attempted to achieve this goal. However, given the very subjective nature of CRA, and given that the agencies examine thousands of institutions with different business goals and strengths in thousands of cities and towns of different sizes, characters and needs, that goal is not easily achieved. The agencies also believe that focusing evaluations more on lending performance than on documentation and recordkeeping should reduce paperwork burden, emphasize the utility of public disclosure, and increase lending in low- and moderate-income areas.

On the other hand, making major adjustments to CRA might give the impression that the agencies are not treating CRA with the amount of attention it deserves and the public has come to expect. Community groups have cautioned that CRA should not be weakened in any way.

The agencies have taken several steps recently to respond to some of the criticisms and evaluate the recommendations. Specifically, in June 1992 the agencies issued revised, uniform CRA examination procedures to clarify the role that documentation should play in assessing CRA performance and the type of documentation that is expected and to focus the examiner's attention on performance rather than process. This should help relieve any misunderstandings about the extent of expected documentation, especially for small institutions. Furthermore, examiners are encouraged to keep the institution informed about the recommended CRA rating during the examination. There is also a significant amount of time during the actual examination and before the final performance evaluation is issued for discussion with the examiners and agency officials about the recommended rating.

The agencies also are addressing other issues raised by the recommendations by having the FFIEC's Task Force on Consumer Compliance look at other CRA enforcement procedures such as tiering the examination process, clarifying aspects of the interagency CRA rating system, reviewing the need for all of the assessment factors in the CRA implementing regulations, and the possibility of exemptions for limited-purpose banks. (Other exemptions such as those for small or rural institutions would require statutory change.) The Task Force expects to make recommendations in these areas by March 1993.

In addition, the agencies plan to hold a joint compliance training session for examiners in March 1993. CRA will be a featured topic at this session.

INTERACTION of REGULATION CC and UCC

RECOMMENDATION

Review the interaction of Regulation CC and revised Articles 3 and 4 of the Uniform Commercial Code in light of recent UCC revisions.

BACKGROUND

In 1990, the National Conference of Commissioners on Uniform State Laws and the American Law Institute approved revisions to Articles 3 and 4 of the UCC, governing negotiable instruments and bank deposits and collections, respectively. Several states have adopted or are in the process of adopting the revised UCC.

Subpart C of Regulation CC, governing the collection of checks, supersedes any inconsistent provisions of the UCC or any other state law, to the extent of the inconsistency. Many instances where Regulation CC supersedes the UCC are identified in the commentary to Subpart C of the regulation.

DISCUSSION

The revisions to Articles 3 and 4 generally were designed to make the UCC more consistent with the provisions of Regulation CC, and thus no changes to the substance of Regulation CC or its commentary are necessary. However, there are a variety of technical changes that need to be made to the regulation and commentary, largely due to the renumbering of the UCC. Federal Reserve staff is in the process of developing these technical amendments.

APPRAISAL ISSUES--DEPARTURE PROVISION

RECOMMENDATION

Allow use of the departure provision in the appraisal regulations.

BACKGROUND

The departure provision allows an appraiser to omit certain procedures, designated as specific guidelines, contained within the Uniform Standards of Professional Appraisal Practice (USPAP). Other procedures of USPAP, designated as binding requirements, cannot be omitted. When the agencies proposed their appraisal regulations, they determined that the then existing departure provision allowed the appraiser wide discretion to omit certain items, without adequate disclosure or documentation requirements and, as a result, the agencies did not adopt the departure provision as part of their regulations.

However, a revised USPAP was issued at approximately the same time as the final appraisal regulations. The revision places the burden on an appraiser to substantiate use of the departure provision and to disclose any limitation in the scope of the appraisal to ensure that the reader of the appraisal is not misled.

DISCUSSION

The appraiser's discretionary latitude, which was subsequently reduced by the revised departure provision, now requires disclosure and documentation of any limitation on the appraisal report that could be misleading. Moreover, the revised departure provision no longer permits an appraiser to depart from USPAP Standards Rule 2-2, which details the requirements for the content of an appraisal. Departure from other critical items in developing an appraisal also is not allowed.

By allowing appraisers to use the revised departure provision, appraisers could use streamlined methods to produce appraisals that meet regulatory standards, thus permitting institutions and customers to save on appraisal fees without sacrificing quality.

The agencies are preparing revised appraisal regulations that will accomplish this objective.

APPRAISAL ISSUES--BORROWERS' APPRAISALS

RECOMMENDATION

Allow institutions to use appraisals prepared for borrowers under certain circumstances and certain constraints.

BACKGROUND

Borrowers historically provided financial institutions with appraisals. Title XI of FIRREA, its legislative history, and the resulting regulations focused on the need for appraisals to be "independently and impartially prepared." This was intended to ensure that the independence and impartiality of the appraiser remained insulated from potential borrower influence. The current regulations require the institution or its agent to order the appraisal.

DISCUSSION

While appraisals provided by a borrower could be acceptable in some situations, identifying the particular circumstances when this might be appropriate and specifying proper controls and constraints would be difficult. Appraiser independence, one of the primary objectives of Title XI of FIRREA, could be jeopardized and the potential for borrower influence over the appraiser would always be present. Any change to current regulatory requirements would have to be carefully balanced to avoid jeopardizing appraiser independence. Nevertheless, in certain limited circumstances, the recommendation could benefit small borrowers, possibly located in rural locations.

APPRAISAL ISSUES--RECIPROCITY AND TEMPORARY PRACTICE

RECOMMENDATION

Encourage states to establish reciprocity and to enhance temporary practice for appraisers.

BACKGROUND

Title XI of FIRREA provides for "temporary practice" between states. This allows appraisers licensed or certified in one state to perform an appraisal in another state where they are not licensed or certified by obtaining the permission of the other state's appraisal licensing authorities. Reciprocity, on the other hand, entails an agreement between or among states to allow appraisers to perform appraisals across state lines so long as they remain licensed or certified in their home state. Reciprocity is not provided for in Title XI of FIRREA, but many states have entered into reciprocity agreements with other states.

DISCUSSION

Both reciprocity and temporary practice can benefit consumers and financial institutions by helping to ensure an adequate supply of competent and qualified licensed and certified appraisers throughout all areas of the country. However, not all states have embraced this concept. Some have established what seem to be excessive fees for temporary practice--fees that could discourage appraisers from seeking temporary practice in another state or make it uneconomical to do so.

The Appraisal Subcommittee could strive to eliminate artificial barriers (such as unreasonable fees) to temporary practice and encourage states to develop reciprocity agreements among themselves. (Mandatory reciprocity would require a statutory amendment to Title XI of FIRREA, however.)

APPRAISAL ISSUES--EMERGENCY WAIVERS

RECOMMENDATION

Establish emergency waiver provisions of federal regulations (appraisal) during national emergencies or local disasters.

BACKGROUND

The Depository Institution Disaster Relief Act of 1992 recently authorized the agencies to waive the appraisal rules in disaster areas. The agencies in November 1992 adopted certain waiver provisions in an interagency rulemaking.

APPRAISAL ISSUES--THRESHOLD LEVELS

RECOMMENDATION

Consider modifying the threshold.

BACKGROUND

Commenters suggested various changes to the threshold for the size of the transaction to which the appraisal regulations apply. Suggestions included: increasing the amount; having a higher threshold for commercial transactions; and varying the threshold by bank size or capital levels.

DISCUSSION

All agencies now have thresholds at $100,000, except the NCUA and RTC, which have thresholds of $50,000. The agencies can study the issue after gaining more experience from the current threshold.

The Office of Management and Budget (OMB) completed a study on whether there should be a separate, higher threshold for commercial real estate transactions. OMB concluded that there is inadequate information to formulate a recommendation, and referred the issue to the agencies for future consideration.

Changes to the threshold should be considered only after further experience with the current thresholds permits the development of more information concerning this matter.

APPRAISAL ISSUES--EXEMPTIONS

RECOMMENDATION

Provide more exemptions from the appraisal regulations.

BACKGROUND

The agencies' appraisal regulations apply to all real estate-related financial transactions that require the services of a licensed or certified appraiser. Regulated institutions have reported that there are situations where appraisals are currently required but which the institutions believe should not require the services of a licensed or certified appraiser. The agencies have indicated in interpretive letters that additional transactions may not require the services of an appraiser and have reviewed these situations on a case-by-case basis.

DISCUSSION

Examples of recommended exemptions are: a modification to the existing "abundance of caution" exemption; acceptance of FNMA and FHLMC appraisals; changes to the threshold; permitting use of the USPAP departure provision; and other changes that could provide more latitude to financial institutions and appraisers and reduce costs to borrowers. Some of these changes are currently being considered by the agencies as amendments to their appraisal regulations.

APPRAISAL ISSUES -- DEFINITIONS

RECOMMENDATION

Provide more refined definitions of certain terms used in the agencies' appraisal regulations.

BACKGROUND

The agencies' appraisal regulations and guidelines contain certain terms that were not previously used in the banking industry. Some confusion exists among the regulated institutions and examiners regarding the application of these terms to the agencies' appraisal requirements.

DISCUSSION

Some terms are taken directly from the statute. Certain terms are also defined in the appraisal guidelines or through interpretive letters for specific situations. Moreover, certain definitions have already been clarified, as necessary, in recent amendments to the appraisal regulations of the OCC, OTS, and FDIC. The Federal Reserve as well plans to seek notice and comment on these definitions.

APPRAISAL ISSUES--ENGAGEMENT LETTERS

RECOMMENDATION

Mandatory engagement letters should not be necessary to meet the requirements of the agencies' appraisal regulations.

BACKGROUND

The agencies' appraisal regulations require that regulated institutions or their agents hire the appraiser. Some regulated institutions have questioned whether an engagement letter is required to establish that the appraiser was hired by the regulated institution.

DISCUSSION

Engagement letters are not mandated by the regulation. However, financial institutions should have evidence that they engaged the appraiser.

No action is necessary to accommodate this recommendation since mandatory engagement letters are not required.

DEPOSIT INSURANCE ASSESSMENT METHOD

RECOMMENDATION

Implement a tiered deposit insurance assessment system, limiting the deposit insurance premiums assessed on "good" banks to pay for costs to the insurance funds arising from "risky" banks.

BACKGROUND

Section 302 of FDICIA requires the FDIC to establish by regulation a risk-based assessment system to become effective no later than January 1, 1994. In October 1992 the FDIC published a final rule (effective on November 2, 1992), which provides an interim system for transition from a flat-rate to a risk-related system. Rates will be affected for the assessment period beginning January 1, 1993. The FDIC will be proposing a permanent risk-related system by year-end 1992.

There is no express statutory cap on the premium to be assessed on any risk classification. If the reserve ratio of the Bank Insurance Fund (BIF) is less than the designated reserve ratio, the FDIC Board of Directors must set the semiannual assessment rates at a level sufficient to increase the reserve ratio to the designated reserve ratio either: (1) not later than 1 year after such rates are set; or (2) in accordance with a recapitalization schedule that specifies target reserve ratios culminating in a reserve ratio that is equal to the designated reserve ratio no later than 15 years after the effective date of the schedule. (12 U.S.C. 1817(b)(1)(C).) In addition, premiums must be used to repay the U.S. Treasury for any funds borrowed to cover payments of insured deposits.

DISCUSSION

While individual agencies and members of the public might prefer other assessment methods, FDICIA explicitly requires risk-based premiums. The most basic concern presented by the combination of sections 104 and 302 of FDICIA is that premiums should not be so high as either to weaken the competitive position of the U.S. insured depository institution industry, or to limit the potential for individual risk classes of institutions to succeed. No matter the channel, higher premiums generally result in a smaller share of the aggregate credit flow going through insured depository intermediaries, and to the credit markets in which they specialize.

Thus, while there is a consensus that, insofar as possible, the cost of insurance fund losses should be paid for by the industry, there is reason to be cautious about the level of premiums assessed. Deposit insurance has provided some measure of economic stability. In addition, other parts of FDICIA, by requiring higher capital standards and greater prudential supervision and regulation, will reduce the draws on the deposit insurance funds, limiting the need to raise premiums.

The statutory mandate to establish a risk-related assessment system provides an incentive for depository institutions to balance the risk they incur and the gains they expect, and it may reduce the degree to which well-managed banks and thrifts bear the cost of insured deposit losses. However, economic concerns limit both the average level of deposit insurance premiums and the costs to be borne by individual risk classes.

Implementation of the assessment system required by the statute essentially accomplishes the goal of the recommendation. The risk-related system establishes a range of rates based first on capital ratios and then on risk to the insurance fund.

IV. Reporting, Recordkeeping, Documentation Requirements: Call Reports

CALL REPORT CONTENTS -- GENERAL

RECOMMENDATION

Unify call reports so that all regulatory agencies request the same information.

BACKGROUND

At present, three out of the four bank regulatory agencies, the Federal Reserve, the FDIC, and the OCC, utilize a unified report, the Consolidated Reports of Condition and Income (Call Report). The Federal Reserve is responsible for collecting and processing the data for state member banks and the FDIC collects and processes the data for the rest of the commercial banking industry. The OTS currently collects data from the savings association industry using its own report format referred to as the Thrift Financial Report.

DISCUSSION

The FFIEC has directed its Reports Task Force to begin developing a proposed core financial report that would permit a uniform performance report for banks and thrifts. The OTS is currently considering the possibility of converting to the bank call report and is in the process of identifying the issues raised by such a conversion.

Because there are some differences between banks and savings and loan associations, however, both in their charters and in governing legislation, a common report format may not be feasible without supplementary schedules that, unless well designed, may be burdensome and confusing. Consequently, the matter is under study with the goal of developing uniform reporting requirements.

CALL REPORT INSTRUCTIONS

RECOMMENDATION

Provide an index for the call report instructions.

DISCUSSION

The banking agencies have considered providing a more detailed index for the call report instructions. While an instruction index has not yet been developed, the agencies believe that such an index would be helpful to filers and users of the call report.

IV. Reporting, Recordkeeping, Documentation Requirements: Other Supervisory Reports

OTHER SUPERVISORY REPORTS

RECOMMENDATIONS

Limit changes in financial and supervisory reports to once a year, unless more frequent changes are necessary to meet statutory requirements or essential policy needs.

Provide at least 60-day lead time for all changes.

BACKGROUND

Aside from the Reports of Condition, the agencies collect certain other financial and supervisory reports from financial institutions under the auspices of the FFIEC. The FFIEC (or its Reports Task Force under delegated authority) approves the form and content of these reports. These other recurring reports are the Annual Report of Trust Assets (FFIEC 001) and International Trust Report (FFIEC 006), which are submitted annually; the FFIEC's Country Exposure Reports (FFIEC 009, 009a, and 019), which are filed quarterly; and the FFIEC's Monthly Foreign Currency Report (FFIEC 035).

The agencies, under the auspices of the FFIEC, have adopted a formal policy governing the frequency of changes to Reports of Condition and the amount of advance notification about these changes. Although the FFIEC policy as written is not applicable to other FFIEC reports, the Reports Task Force has informally agreed to apply this policy to the other agency reports under its jurisdiction.

DISCUSSION

Changes in reporting requirements impose a burden on financial institutions because institutions must make modifications to their recordkeeping and reporting systems (whether manual or automated) 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.

The FFIEC is considering expanding its existing policy regarding the frequency of changes to Reports of Condition to encompass the other interagency reports under its jurisdiction.

MUNICIPAL SECURITIES DEALERS FORM MSD-4

RECOMMENDATION

Eliminate some of the information required on Form MSD-4 for Municipal Securities Dealers.

BACKGROUND

Regulations adopted by the FDIC, OCC, and Federal Reserve (12 CFR 343, 12 CFR 10, and 12 CFR 208.8(i), respectively) pursuant to Sections 15(B)(c)(5), 17, and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78o-4(c)(5), 78q, and 78w) prohibit a bank (or a subsidiary, department, or division thereof) that is a municipal securities dealer from allowing a person to be associated with it as a municipal securities principal or representative unless the institution has filed the prescribed application (Form MSD-4) with its primary federal regulatory agency. The agency reviews the information reported on the form to determine the applicant's compliance with the professional qualifications requirements for municipal securities principals and representatives set forth in the General Rules of the Municipal Securities Rulemaking Board (MSRB).

Rule G-7 of the MSRB directs every bank and nonbank municipal securities broker and dealer to obtain from each "associated person," as defined in the rule, a completed questionnaire which, at a minimum, contains certain information specified in the rule. The specified information includes a statement of employment and personal history for at least the past ten years and a record of all residential addresses for at least the past five years. Rule G-7 also states that, for banks, a completed Form MSD-4 containing the information specified in the rule satisfies the requirements of Rule G-7.

DISCUSSION

A review of the Forms MSD-4 used by the agencies reveals that questions regarding place of birth, educational background (to the extent the education took place prior to the past ten years and is therefore not required to be included in employment and personal history), and whether the applicant is currently bonded are not part of the minimum information required by Rule G-7. In addition, the Form MSD-4 used by the FDIC requires residential addresses for the past ten years even though only five years' worth of addresses are required by Rule G-7. Moreover, although the applicant is required to include his/her employment history for the past ten years on the Form MSD-4, a bank municipal securities dealer is required to verify only the past three years' employment history.

The agencies could reduce some of the burden of completing Form MSD-4 by eliminating the information included on the form that is not required by Rule G-7. Additionally, employment history beyond five years, as well as residential addresses for any period, may not be relevant to the purposes for which applications on Form MSD-4 are filed. In order to eliminate any of this information from the Form MSD-4 to reduce the reporting burden on applicants, the MSRB would have to revise its Rule G-7.

Although eliminating information on the form would reduce burden somewhat, bank municipal securities brokers and dealers may find some or all of the information on the Form MSD-4 that is being suggested for possible deletion useful in determining whether the background, past experience, and reputation of the applicant will meet their needs as an employer. In particular, even though a broker or dealer is required to verify employment for only three years, the requirement that an applicant provide ten years' history may reveal whether the applicant has been employed, for example, with securities firms that have been found to have engaged in fraudulent practices. The comparable registration form for municipal and government securities principals and representatives requires employment history for the past ten years and residential addresses for the past five years.

It makes sense for the banking agencies to eliminate from the Form MSD-4 questions that are not required by the MSRB's Rule G-7. As for employment history and residential addresses, discussions could be initiated with the MSRB (and any other appropriate government agencies) as well as municipal securities brokers and dealers to determine whether any of the information currently required by Rule G-7 should be eliminated.

SECURITIES DEALERS FORMS

RECOMMENDATION

Combine the forms required under the regulation of municipal securities dealers and government securities dealers into one form (12 CFR 10; 17 CFR 400.1, 400.4, 400.5, 400.6, 449.1, 449.2, 449.3, and 449.4).

BACKGROUND

In general, bank municipal securities brokers and dealers and persons associated with these firms are required to file forms with the banking agencies when they begin this type of business and when they terminate their involvement.

Regulations adopted by the Treasury Department (17 CFR 400.4, 449.3, and 449.4) pursuant to Section 15C of the Securities Exchange Act of 1934 (15 U.S.C. 78o-5) generally require a financial institution that is a government securities broker or dealer (unless it is exempt) to obtain from every associated person a completed disclosure form (Form G-FIN-4) and file it with its primary federal regulatory agency. The agency reviews the information reported on the form to determine whether the applicant might be subject to disciplinary action pursuant to Section 15C(c)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-5(c)(2)). The Form G-FIN-4 requires less information about an applicant than Form MSD-4.

Under 17 CFR 400.4 of the Treasury's regulations, a person who has filed Form MSD-4 with a financial institution does not need to file a Form G-FIN-4 also. In this situation, the financial institution must provide to its primary federal regulator a list of all associated persons who have filed Forms MSD-4 in lieu of filing additional copies of previously filed Forms MSD-4. After the termination of an individual's status as an associated person of a financial institution government securities broker or dealer, the institution is required to file a Form G-FIN-5 with its primary federal regulator unless the institution has filed a Form MSD-5 (Termination Notice) with respect to that individual.

The banking agencies' regulations, however, do not permit the previous filing of Forms G-FIN-4 and G-FIN-5 to satisfy the requirement to file Forms MSD-4 and MSD-5. In contrast, individuals who are registering their participation in the securities industry are able to file a single form (Form U-4, "Uniform Application for Securities Industry Registration and Transfer") covering all applicable categories of positions in the securities industry. A single form (Form U-5, "Uniform Termination Notice for Securities Industry Registration") is also available to terminate an individual's registration.

A bank that conducts municipal securities dealer activities must file a registration form (Form MSD) with the SEC and its primary federal regulator pursuant to Section 15B(a)(1) of the Securities Exchange Act of 1934. A financial institution that is a government securities broker or dealer must file two copies of a notification form (Form G-FIN) with its primary federal regulator (unless the institution is exempt) pursuant to Section 15C(a)(1)(B)(i) of the Securities Exchange Act of 1934. The information contained in Forms MSD and G-FIN is of a continuing nature and must be updated periodically in the event any of the information previously submitted becomes inaccurate or incomplete. Amended versions of these forms are to be filed "promptly" and within 30 calendar days, respectively. When a bank discontinues being a municipal securities dealer, it is required to file a withdrawal notice (Form MSDW) with the SEC and its primary federal regulator. When a financial institution ceases to act as a government securities broker or dealer, it is required by 17 CFR 400.6(a) of the Treasury's regulations to file two copies of a notification form (Form G-FINW) with its primary federal regulator. In the case of the Forms G-FIN and G-FINW, which are promulgated by the Federal Reserve, the primary federal regulator forwards one of the two copies it receives from the financial institution to the SEC.

Brokers and dealers other than financial institutions can file a single form (Form BD, "Uniform Application for Broker-Dealer Registration") to register as, among other types of businesses, a municipal securities dealer and/or government securities broker or dealer and to amend previous submissions. A single form (Form BDW) is also available for brokers and dealers who are withdrawing from the securities business.

DISCUSSION

Combining the forms should reduce some of the burden on both individuals and financial institutions. Thus, municipal securities and government securities forms that separately perform the same function for financial institutions and individuals associated with these institutions (that is, Forms MSD and G-FIN, MSDW and G-FINW, MSD-4 and G-FIN-4, and MSD-5 and G-FIN-5) should be combined in the same manner as those applicable to other individuals and firms in the securities business.

Because the regulations under which these various forms were created are those of other government agencies, however, the banking agencies do not have the authority to carry out the recommendation on their own. Any changes will require the agencies with primary authority to administer the provisions of the Securities Exchange Act of 1934 for municipal securities dealers and government securities brokers and dealers to reconcile the statutory language with respect to the "registration" of municipal securities dealers and the "notification" by government securities brokers and dealers.

Therefore, the agencies should initiate discussions with the other government agencies involved in the administration of the securities laws relating to municipal and government securities brokers and dealers about combining the various forms applicable to such brokers and dealers and persons associated with them.

RECORDKEEPING ON SECURITIES TRANSACTIONS

RECOMMENDATIONS

Increase the number of securities transactions for customers before recordkeeping and customer disclosure requirements apply (12 CFR 344).

Revise recordkeeping and customer disclosure requirements for banks purchasing or selling securities for customers (12 CFR 12).

BACKGROUND

Regulations adopted in 1979 by the FDIC, OCC, and the Federal Reserve (12 CFR 344, 12 CFR 12, and 12 CFR 208.8(k), respectively) pursuant to their general rulemaking authority provide recordkeeping and notice requirements for securities transactions effected by banks for their customers. Banks are required to maintain certain records for these securities transactions and to furnish to their customers a notice containing specified information. Banks are also required to establish policies and procedures governing securities transactions for customers; these must include, among other things, provisions designed to detect and prevent the misuse of nonpublic information by bank employees for their personal enrichment.

The regulations provide a partial exemption from the recordkeeping and written policy requirements for banks having an average of fewer than 200 securities transactions for customers per year, exclusive of transactions in U.S. Government and federal agency obligations. Financial institutions that are required to file notice as government securities broker-dealers are also subject to Treasury's recordkeeping rules issued pursuant to the Government Securities Act of 1986 (GSA), which incorporates the recordkeeping requirements of the federal banking agencies. (In addition, bank activities subject to the rules of the Municipal Securities Rulemaking Board are not subject to the agencies' recordkeeping and customer disclosure requirements.) Institutions with fewer than 200 securities transactions must keep certain records and provide notices to customers, but are relieved of some of the burdens of the regulations. More specifically, those banks below the threshold are exempt from maintaining: (1) a customer account record; (2) an order ticket for each transaction; and (3) a record of the brokers used during the year. In addition, banks below the threshold are not required to establish written policies and procedures providing supervisory responsibility over bank personnel and fair treatment of simultaneous transactions involving the same security.

DISCUSSION

This modification in recordkeeping requirements would primarily benefit small banks and banks with small securities brokerage operations by reducing their recordkeeping burden and attendant expense. There has been no evidence of abuse by banks in the areas covered by the exemption. Raising the threshold is not expected to have a negative impact on internal controls or safety and soundness, although lessening the regulation's requirements on certain institutions would be a weakening of the protections provided securities customers of banks. The low activity threshold could be raised from an average of 200 to 1,000 transactions per year.

One concern in increasing the transaction exemption threshold is that it not result in inconsistent application and enforcement of the bank regulatory agencies' recordkeeping rules and the GSA recordkeeping rules applicable to financial institution government securities broker-dealers or create a loophole whereby financial institution government securities broker-dealers would be exempt from compliance with most of the recordkeeping requirements. Coordination by the banking agencies of these recordkeeping revisions should help to ensure uniformity and consistency.

PROXY REVIEW

RECOMMENDATION

Adopt requirements for proxy review identical to those of the SEC.

BACKGROUND

Commenters stated that the proxy solicitation process would be more efficient if the banking regulatory agencies would adopt requirements for proxy review identical to those of the SEC and not impose fees for reviewing material filed with another agency.

A bank that is not part of a holding company filing proxy material is required only to file the material with its supervisory agency. The situation described is unique to holding company reorganizations. In those situations, the holding company must register with the SEC and the depository institution must submit its proxy material to the appropriate federal banking agency.

DISCUSSION

The OCC agrees with the suggestion that it adopt requirements for proxy review identical to those of the SEC. In fact, as the OCC updates its regulations, it references the SEC regulations instead of writing its own. The OCC disagrees with the comment about not imposing any fees, however, because review of proxy materials takes time and resources. Additionally, the OCC review is different from that performed by the SEC.

The Federal Reserve currently uses the same rules, regulations and forms, including proxy materials, as the SEC. Under Section 12(i) of the Securities Exchange Act of 1934, the Board has the powers, functions and duties vested in the SEC to administer and enforce the reporting requirements for state member banks of the Federal Reserve System. To implement this statutory requirement, the Board adopted Section 208.16 of Regulation H, which requires state member banks to follow the SEC rules, regulations and forms. The Board, however, charges no fees for any of the required filings.

The FDIC's disclosure requirements for proxy statements are, as required by Section 12(i) of the Securities Exchange Act of 1934, substantially similar to those of the SEC. Whenever the SEC revises its proxy rules, the FDIC updates its proxy disclosure requirements accordingly. The SEC is in the process of revising its rules at the present time and the FDIC plans to consider changing its proxy rules to simply reference those of the SEC at the FDIC's next revision of these rules. In a holding company reorganization by a registered bank, the holding company would file a registration statement with the SEC and the bank would file a proxy statement with the federal regulator. The disclosures contained in these documents would be essentially the same. Because the scope of the review by the SEC of the registration statement can vary from none to a full review, the FDIC undertakes a full review of the bank's proxy materials to ensure that the bank is satisfying the disclosure requirement applicable to it. The FDIC has no plans to change the scope of its review of proxy statements. The FDIC does not charge fees in connection with the filing or review of securities registration and disclosure documents.

The OTS has adopted the SEC rules and regulations. The OTS charges a fee structure similar to the SEC for reviewing proxy material.

The banking regulatory agencies thus are already working toward reducing differences in regulatory requirements among themselves and between themselves and the SEC, although they believe that the issue of fees should be left to the discretion of the agencies.

APPLICATIONS

RECOMMENDATION

Permit appending applications made to chartering agencies to satisfy some FDIC application requirements; also, eliminate requirement for so much detail, particularly on premises and fixtures.

BACKGROUND

This recommendation arises from recent legislation which requires FDIC consent before deposit insurance is granted, no matter which agency is the primary federal regulator. The FDIC has cooperated for many years with state chartering authorities in applications for proposed new depository institutions. In order for the process not to be overly burdensome, the FDIC has also previously established procedures with OTS for applications for proposed new savings associations. The FDIC, OCC and Federal Reserve are discussing methods of cooperation in connection with applications for proposed new national banks and state member banks.

In April 1992 the FDIC published a statement of policy on insurance applications in which the agency stated its policy to minimize applicants' burden of filing. Information that is provided to the chartering authority that is also needed as part of the deposit insurance application may be provided to the FDIC by appending a copy of it to the FDIC application. The policy statement further stated that applications that are filed simultaneously will also permit joint publication of public notice rather than two separate publications.

DISCUSSION

The recommendation would eliminate the need for organizers of proposed new depository institutions to submit duplicate information to the FDIC and another federal financial institution regulator. The portion of the recommendation to eliminate detail in the FDIC application would relieve burden on all applicants for proposed new financial institutions by eliminating detailed requests for information that seldom were used in the substantive decision-making process.

The FDIC has instructed its staff to use as much of the application to the chartering agency as possible in determining eligibility for federal deposit insurance. Additional information needed by the FDIC will be appended to this application.

APPLICATIONS FOR REMOTE SERVICE FACILITIES

RECOMMENDATION

Revise application procedures to establish a domestic branch to exclude remote service facilities.

BACKGROUND

The recommendation for the FDIC to exclude remote service facilities (RSFs) from applications for branch requirements is grounded in the experiences of processing these requests. During 1991, 326 such requests were processed and none was denied. The FDIC currently requires an application only for the establishment of an initial RSF. This application is in letter form and only six items of information are required. An institution that wishes to establish an additional RSF or to relocate an existing RSF is required to notify the FDIC and comply with publication requirements. The notice requires the same six items of information contained in the regular application. In the case of an additional RSF, unless notified within 15 days of publication or receipt of the notice, whichever is later, the additional RSF is considered approved. In the case of the relocation of an existing RSF, unless notified within 21 days of publication or receipt of the notice, whichever is later, the relocation is considered approved.

DISCUSSION

Excluding RSFs from the branch application requirements would eliminate the burden of reviewing transactions to which the FDIC has found little objection in the past. The transactions do not require additional management, do not significantly change the competitive environment, and are not as susceptible to insider involvement with ownership of the facilities as traditional branches.

On the other hand, current procedures require only minimal information, and in many cases do not require an affirmative FDIC approval. By reviewing these transactions, the public is allowed an opportunity to comment and the FDIC has an ability to object to expansion if planned. Section 18(d)(1) of the Federal Deposit Insurance Act states that no state nonmember insured bank shall establish and operate any new domestic branch unless it shall have the prior written consent of the FDIC, and no state nonmember insured bank shall move its main office or any such branch from one location to another without such consent.

FDIC staff has studied this question and concluded that the recommendation should not be supported, but the FDIC Legal Division is reviewing the issue. The statutory definition of branch appears to include RSFs owned or leased by a bank because they are facilities at which deposits are received or checks are paid or money lent.

The FDIC is currently reviewing a proposal which would allow RSFs to be established after notifying the FDIC of the proposed facility's location. No publication would be required. Such a proposal would eliminate most of the burden of applications for RSFs while the FDIC would continue to fulfill its statutory requirement to review these transactions.

APPLICATIONS PROCESSING

RECOMMENDATIONS

Simplify the application and regulatory approval process, including simplifying the information requirements for applications.

Handle applications in a single process without duplication of effort and make the ultimate decision maker responsible for identifying and raising policy issues with the applicant at an early stage.

The agencies should adopt and follow a published schedule for the processing of applications.

Replace the application procedures for mergers or consolidations of affiliates with a notice procedure.

Eliminate applications for ATMs.

The OCC should permit emergency purchase and assumption transactions to be made on a letter application basis similar to the other agencies.

DISCUSSION

The agencies generally support all efforts to streamline application information requirements and processes. In addition, the agencies agree that requirements and timing should be as clear as possible to facilitate planning by applicants. Streamlining and clarification of application requirements save time and expense in application preparation. Information on typical processing times facilitates planning of business activities related to an application.

The agencies are participating in an interagency effort to promote consistency and reduce regulatory burdens and costs without lessening the effectiveness of regulation and supervision. As part of this project, the agencies are working to (1) develop common approaches to dealing with application forms for mergers, corporate reorganizations, branching, and deposit insurance applications; (2) establish procedures and application requirements for granting depository institution charters and deposit insurance approval that avoid duplication and delay; and (3) develop uniform procedures to expedite the processing of applications and notices by banking organizations that are in strong financial condition.

Opportunities for streamlining or clarification are limited, however, by the need to address prudential supervisory interests and by statutory considerations. Extensive streamlining may expose the system to unacceptable supervisory or litigation risks.

The agencies' positions on the specific recommendations are as follows:

- The agencies agree that it is beneficial to identify policy issues as early as possible in the application process.
- The agencies are involved in an ongoing process to streamline information requirements for applications whenever possible.

- The agencies support providing applicants with an indication of the time required to process their filings. In many instances statutes such as the Bank Holding Company Act and the Competitive Equality Banking Act require the agencies to process certain applications within prescribed time periods. In other instances, the agencies may prefer to provide probable processing time guidance on a case-by-case basis rather than publishing a fixed schedule and repeatedly advising individual applicants whether or not their filing will be processed in accordance with the published schedule.
- The agencies support the simplification of the process for mergers of affiliated banks to the extent feasible within the statutory framework of the Bank Merger Act.
- The ability of the Federal Reserve, FDIC, and OCC to eliminate applications for ATMs may be restricted by the statutory definition of branch which appears to include ATMs. However, the OTS, pursuant to a different statutory provision relating to branching, does not require institutions to submit an application or a notice form to establish ATMs.
- The OCC supports the simplest filing requirement possible for applications required to acquire a failed or failing depository institution. The OCC will consider either a letter format or an abbreviated application form.
- The OCC agrees that it should review its application process for operating subsidiaries to devise a more streamlined process for healthy banks proposing to engage in previously legally authorized activities for national banks.

IV. Reporting, Recordkeeping, Documentation Requirements: Reports for Economic Policy Purposes

WEEKLY CONDITION REPORTS

RECOMMENDATION

Change the reporting frequency of the FR 2416 and the FR 2644.

BACKGROUND

One commenter recommended a reduction in the reporting frequency of the Weekly Report of Assets and Liabilities for Large Banks (FR 2416) and the Weekly Report of Selected Assets (FR 2644). The commenter noted that preparation of the reports requires significant staff time and computer resources, "a high price to pay for the preparation of reports that historically show little volatility from week to week." The commenter also raised concerns about having to respond to edit questions from the Federal Reserve, both on a weekly basis and once a quarter when the data are compared to the call report, noting that generally the data fluctuations questioned by the Federal Reserve are the result of normal daily activity. The commenter noted that any change in the frequency of these reports would be a welcome relief--to biweekly at a minimum but preferably to monthly, with reporting as of the last day of the month.

A second commenter suggested that the FR 2644 either be justified or eliminated.

FR 2416 and FR 2644 are two of three reports commonly referred to as the "weekly condition report/bank credit series," which are mainstays of the Federal Reserve's reporting system and from which data for analysis of current banking developments are derived. These three reports are:

- Weekly Report of Assets and Liabilities for Large Banks (FR 2416), a detailed balance sheet report that is collected as of each Wednesday from a sample of about 160 very large commercial banks.
- Weekly Report of Selected Assets (FR 2644), a considerably less detailed report that is collected as of each Wednesday from a stratified sample of about 1,000 smaller commercial banks.
- Weekly Report of Assets and Liabilities for Large U.S.Branches and Agencies of Foreign Banks (FR 2069), a balance-sheet report that is collected as of each Wednesday from a sample of about 68 institutions.

Reporting is voluntary for all three surveys. Under the Federal Reserve's regular triennial review schedule, FR 2416 and FR 2644 were last reviewed in late 1990 and FR 2069 in the fall of 1991. Under those reviews, both the overall need for the series and the need for individual report items, the size and composition of the reporting panel, and the reporting frequency were reaffirmed for each report.

FR 2416 and FR 2069 are used on a stand-alone basis to construct weekly aggregates of large banks. In addition, all three reports, together with data from other sources, are used for constructing weekly estimates of bank credit, of sources and uses of bank funds, and of a balance sheet for the banking system as a whole.[6] These estimates also are used in constructing the domestic nonfinancial debt aggregate monitored by the Federal Open Market Committee (FOMC). The various series constructed from these three reports are included in the weekly briefing tables and periodic analyses provided to the Board and the FOMC. The data are published in aggregate form in various Federal Reserve statistical releases, which are followed closely by other government agencies, the banking industry, the financial press, and other users.

DISCUSSION

The Federal Reserve recognizes that institutions filing these reports view reporting as costly, in particular having to generate detailed balance sheet data every week. The Federal Reserve needs the weekly data, however, for accurate and timely construction of the key series used to analyze current banking developments. (For example, the weekly data have been watched closely as a result of concerns about the availability of credit during the last economic downturn and current recovery.) None of these series could be constructed on a sufficiently accurate or timely basis if the frequency of reporting were reduced.

With respect to the question about data fluctuations, the overall purpose of the weekly, intra-series editing process is to flag unusual data fluctuations and consult with the respondent to help ensure that the data were reported correctly. When the respondent confirms that the item in question is indeed correct, it is quite helpful to the Federal Reserve in its analysis of the data to receive an explanation for the fluctuation. The editing process is designed with the intent of identifying significant or unusual data movements, not normal day-to-day activity. This distinction is often difficult to make, however, without consultation with the respondent.

Similarly, the inter-series edits are intended to flag major differences between comparable data items reported on one of the sample reports and the call report. The Federal Reserve recognizes that the greater the number of days between the call date and the date of the sample report, the larger the differences in the data on the two reports. The Federal Reserve also recognizes that even when both report dates are the same, differences will occur in the reported data owing both to definitional differences and to the additional time that the respondent has to complete the call report. The intent of the inter-series edits is to focus on possible reporting errors, not differences resulting from timing or definitions. As in the case of the intra-series edits, however, this distinction also is often quite difficult to make without consultation with the respondent.

Although the Federal Reserve does not favor reducing the frequency of these reports, it does plan to reassess both the design and the execution of the intra-series and inter-series edits applied to these data series in an attempt to reduce the number of call-backs to respondents about their reported data without jeopardizing overall data quality.

---

[6] For construction of the balance sheet, deposits data for smaller commercial banks are obtained from the deposits reports addressed earlier.

Quarterly call report data are used to blow up all sample data to universe levels.

EXAMINER UNDERSTANDING AND CONSISTENCY

RECOMMENDATIONS

Each agency should assure that its field examiners have a timely understanding and acceptance of administrative directives regarding general and specific regulatory issues.

Examiner instructions and approach should be consistent from one examination to another.

Examiners should not be allowed the freedom of changing the way banks comply when banks have been instructed previously by other examiners.

BACKGROUND

The agencies have been criticized for inconsistencies between field examiners' understanding of regulations and regulatory perspective, as well as inconsistencies in the application and enforcement of regulations by individual examiners. It has been suggested that each regulatory agency needs to assure that field examiners have a timely understanding and acceptance of administrative directives regarding general and specific regulatory issues.

DISCUSSION

The agencies use a variety of communication devices to relay information to field examiners. Such devices include: examiner handbooks that include examination procedures, bulletins and notices that are sent to industry as well as examinations staff, internal memoranda to field staff, staff meetings, and examiner training. Increased interagency efforts have resulted in timely and consistent messages of policy and regulatory changes.

The agencies agree that constant communication between management and field examiners is vital to the regulatory process to ensure that timely and consistent actions are taken. Consequently, each agency agrees to continue to refine its current methods of communications to field examiners and to correct any communication defects in a timely manner. The agencies are engaged in several initiatives that address the development of common examination procedures and reports, standardized training on an interagency basis and coordination of significant agency interpretations of statutes.

Continuous communications help ensure that examiners receive timely information on policy and regulatory changes. Interagency pronouncements should help alleviate conflicting messages. Development of common examination procedures and reports, along with the coordination of statutory interpretations, result in more uniform application and enforcement of regulations. No method of communication, of course, can be entirely without occasional problems. The agencies are committed to review their methods of communication on a continuous basis, however, to ensure that problems are identified and corrected.

EXAMINER GUIDANCE

RECOMMENDATION

Remind examiners and agency staff that the examination is not supposed to be a painful process. The examination is not a punishment but a supervisory tool.

BACKGROUND

There has been some criticism of examiners' attitude and demeanor. Quoting further from the letter making this specific recommendation, "The bank's examination is the single most important contact that the bank has with its supervisor. In the past, most bankers have welcomed the examiners into the banks for an opportunity for an expert review of the bankers actions finishing with a constructive critique that often bankers found very helpful in their management activities. However, recently, the relationship between bank and examiner has deteriorated into one of an adversarial nature bordering on the destructive."

DISCUSSION

The majority of the examining force in all the regulatory agencies conduct their examinations with professionalism. However, occasionally there are complaints about a minority who are not professional in their relationships with bankers. Inexperienced examiners, inconsistent instructions from one examination and/or examiner to the next, and differences in regulatory interpretations all can contribute to an adversarial relationship, particularly in recent years when there have been so many regulatory changes arising from legislation. The need to understand, implement, and monitor compliance with changed initiatives affects both examiners and bankers. Examiners also need to emphasize correction of problems and not dwell excessively on penalties and sanctions.

The agencies agree that the examination is not supposed to be a painful process. Through additional internal review of examiners and examination results, meetings with agency examiners, agency policy statements sent to examiners, newsletters, telephone calls, and other forms of communication, each agency instructs its examiners to conduct their examinations in a professional manner. Repeatedly offending examiners are subject to discipline under the agency's performance appraisal process, and they are counseled or removed as necessary.

EXAMINATION COORDINATION

RECOMMENDATIONS

Coordinate examination policies with other bank regulatory agencies so that each institution or holding company will not be subject to duplicative examinations or inspections by different bank regulatory agencies (absent a problem situation).

Combine or restructure bank regulatory agencies so that one agency has primary responsibility for each bank.

Modify OTS rules concerning examination management questionnaire. Limit the number or types of individuals included in an examination management questionnaire (which requires the names and number of shares of the institution's common stock held by all directors, officers and employees of the institution).

BACKGROUND

Currently the federal banking regulatory agencies and the state banking authorities are responsible for conducting examinations of insured depository institutions. In some instances, and for a variety of reasons, the agencies have undertaken duplicative examinations. Although this is not a widespread practice, there has been sufficient concern expressed by the banking industry to warrant clarifications.

DISCUSSION

When regulatory agencies conduct separate examinations of the same entity resulting in duplication, the burden on the institution increases and efficiency decreases. In an effort to address these concerns the agencies are discussing an interagency examination coordination program. The program focuses on the planning, staffing, and timing of inspections and examinations; it involves conducting concurrent reviews of functions and entities where appropriate, and conducting joint management meetings, as needed. The proposed program emphasizes full cooperation and coordination of the supervisory activities.

The program also includes coordination of pre-examination efforts by the federal regulatory agencies. Under the program, representatives from the appropriate supervisory offices will meet to review examination and inspection schedules and discuss supervisory strategies. The scheduling/strategy meetings will include:

- sharing the strategy and scope of each examination;
- determining which agencies have a supervisory need to participate on the examination/inspection;
- determining what, if any, areas should be formally reviewed by an interagency team of examiners;
- determining whether a consolidated request letter should be prepared to avoid duplicative information requests;

- assessing the feasibility of scheduling and conducting coordinated specialty and international examinations; and
- sharing examination/inspection work papers and resulting findings and conclusions from prior examination efforts.

Nothing in the proposed program will alter the ongoing cooperative efforts with state banking authorities. Whenever possible and appropriate, the objectives of the program will apply to coordination efforts with state authorities.

OTS AND FDIC COORDINATION

RECOMMENDATION

Coordinate OTS examination procedures with the FDIC.

BACKGROUND

Commenters cite the overlap in examination and regulation by the OTS and the FDIC as being inefficient and costly. They have expressed concern about separate examinations and conflicts between the two agencies.

The OTS and FDIC signed a joint memorandum on May 18, 1992, that governs the conduct of examinations, supervisory and enforcement actions, and capital plan reviews in which the FDIC has an interest. The Joint Agreement clarifies the respective roles of the OTS and the FDIC. The memorandum also defines communications and responsibilities, and establishes a process to resolve differences between the two agencies. OTS has initiated action to schedule joint examinations. It is expected that in most situations, the OTS will be the only federal regulator to contact savings associations. The implementation of the guidelines of the joint memorandum will decrease the amount of time and resources expended in dual examination tasks and the resolution of agency differences about exam conclusions.

DISCUSSION

The OTS/FDIC arrangement promotes a more efficient use of agency resources. It defines the roles and responsibilities of each agency with respect to conducting examinations as well as the processing of the resulting examination reports, supervisory correspondence, enforcement actions, and capital plans. Implementation is already underway through interagency action.

OTS EXAMINATION PROCEDURES

RECOMMENDATION

Streamline the OTS examination process.

BACKGROUND

OTS has implemented new streamlined examination procedures that continue to allow the agency to achieve its goals with less review in most institutions. OTS has also implemented risk-focused compliance examinations that look at the adequacy and oversight of management's programs rather than concentrating on technical violations. As OTS continues to downsize its staff (and reduce assessments), it remains committed to finding additional ways to streamline its examination process without jeopardizing the health of the thrift industry.

DISCUSSION

Streamlined examinations result in a more efficient use of examination resources. More time is spent reviewing the adequacy of policies and practices and the impact on risk.

A disadvantage is that risk-focused examinations may not identify each and every regulatory violation. OTS accepts this drawback to its program in order to concentrate on major risks to the health of thrifts.

The streamlining process is well under way and OTS is committed to continuing this process.

SEMINARS

RECOMMENDATION

The agencies should hold seminars for regulated institutions updating them on agency procedures, like the training sessions for examiners. They could be regional in nature with fees to attend.

BACKGROUND

When the banking agencies identify situations that require guidance or interpretation of regulations or statutes, they seek to provide guidance to institutions in a number of ways. Each banking agency provides regulatory information to the institutions it regulates in the form of Thrift Bulletins, Banking Circulars, the Federal Reserve Regulatory Service, or Financial Institutions Letters. In addition, the agencies participate in professional seminars in order to present new regulatory materials and help keep members of the banking and thrift industries abreast of new statutory and regulatory developments. At the regional level, the agencies hold call-report and community-outreach seminars. When statutory or regulatory revisions are enacted, the agencies make an effort to promptly review, update, or delete outdated guidance.

DISCUSSION

Participation in professional seminars and training sessions, distribution of guidance to institutions, and creation of public outreach programs help the banking agencies to disseminate the latest regulatory standards to regulated institutions. By assuring that all institutions are informed about the regulations and standards they must meet, there can be a reduction both in regulatory burden and in bank agency supervisory and enforcement resources.

The agencies will continually assess needs and opportunities to improve communications and participate in industry training.

EXAMINATION CONSISTENCY AMONG AGENCIES

RECOMMENDATIONS

Improve consistency of examination report forms and examination procedures among agencies.

The three federal bank regulatory agencies and the states should develop a coordinated approach.

Try to reduce inconsistency and subjectivity in the examination process.

BACKGROUND

There has been criticism of inconsistencies in the examination process. Such inconsistencies have led to inefficiencies in the examination process and confusion on the part of regulated financial institutions.

DISCUSSION

Recognizing the benefits of more consistency, the agencies have agreed to work toward this goal by:

- Developing and utilizing common core examination reports and uniform procedures. The regulatory agencies have developed a draft core examination report for use by each agency.
- Adopting agreements with state regulators to achieve optimal efficiency by coordinating examinations and information sharing.
- Developing common definitions, policies and standards for classification and valuation of assets, accounting issues and minimum levels of general valuation allowance when differences exist.
- Coordinating significant interpretations of statutes commonly applied by the agencies. The chief legal officers of the four federal agencies have agreed to guidelines to ensure appropriate consultation prior to the issuance of significant statutory interpretations.

VI. Other

TECHNOLOGY

RECOMMENDATION

Seek opinions of technology vendors as to the feasibility of implementing proposed regulations.

BACKGROUND

A commenter stated that the regulatory process could be considerably more effective if the technology implications of regulations are considered before the regulations are finalized. According to this commenter, the agencies should consider establishing a technology task force to discuss these issues formally when appropriate. The commenter noted that last year the Internal Revenue Service formed an Information Reporting Advisory Committee to serve a similar purpose.

DISCUSSION

Although this recommendation could improve communication between banking regulators and the technology industry, and thus produce more efficient regulations, it might also cause delays in the regulatory process. Agency rulemaking is governed by the Administrative Procedures and Government in the Sunshine Acts. These statutes outline steps the agencies must take during the process of rulemaking. The agencies first must publish a general notice of proposed rulemaking in the Federal Register. After notice, the agency must give interested persons an opportunity to participate in the process through submission of written data, views, or arguments. The rule must be published not fewer than 30 days before its effective date and the agencies must provide interested parties the right to petition for the issuance, amendment, or repeal of a rule. During the course of the process, the agencies find it beneficial to obtain input from interested parties.

In addition to its impact on statutory deadlines, there are other problems with implementing the recommendation, including determining appropriate membership.

Despite the problems with implementing this recommendation, it has merit and is worth further exploration. It may be that the affected industry should form a task force, for example, to discuss how to ensure that the appropriate comments regarding technological issues are submitted during the agencies' rulemakings.

Recommendations Not Suitable for Implementation by the Agencies at This Time

CONCENTRATION DEFINITION

RECOMMENDATION

The OCC should use Federal Reserve definitions of markets in analyzing market concentration.

BACKGROUND

The Bank Merger Act and the Bank Holding Company Act require the agencies to assess the effects of mergers of banks and bank holding companies on competition. Which agency is responsible for analyzing competitive effects depends on the structure of the transaction and the charters of the acquiring and target banks.

Analysis of competition requires the agencies to define relevant geographic and product markets. Each agency has adopted similar approaches to the definition of product markets for banking, but different approaches to defining geographic markets. The Federal Reserve uses predefined market areas for most significant geographic markets in the U.S. These predefined market areas for banks and bank holding companies may be readily obtained from the Federal Reserve Banks.

DISCUSSION

Uniform use of Federal Reserve market areas would be convenient for merger applicants. The definitions are readily available and uniformity would simplify the merger application process somewhat by standardizing the geographic market used by the agencies.

On the other hand, no definition of geographic markets is absolutely precise and the predefined Federal Reserve market definition may not be the best geographic market definition for a specific transaction. Agencies have prevailed in antitrust challenges to their competitive analyses using markets other than those predefined by the Federal Reserve.

Applicants should have the option to define geographic markets that may be appropriate for particular transactions. In some cases, this may be the Federal Reserve market; in other cases it may not. It is possible to take advantage of the easy access to the predefined Federal Reserve markets and to use them as part of a standardized method for quickly identifying mergers that will clearly raise no significant competitive concerns. The OCC has implemented such a process with its "Quick Check Merger Screen."

PURCHASE AND ASSUMPTION TRANSACTIONS FOR NATIONAL BANKS

RECOMMENDATION

Permit a national bank to assume less than all of the liabilities of another bank in a purchase and assumption transaction.

BACKGROUND

The OCC requires that in purchase and assumption transactions, the acquiring bank assume all the liabilities of the target, including known and unknown contingent claims. This policy has caused difficulties in some problem bank acquisitions. For example, an acquirer may be concerned about unknown FDIC contingent claims against a problem target bank and may not wish to assume such contingent liabilities.

DISCUSSION

The policy ensures that creditors of the target bank will have some party with which they can file a claim. Furthermore, the OCC applies the policy flexibly. In some cases, the OCC has approved transactions where the acquiring bank agreed to satisfy all potential creditor claims but did not assume all liabilities. (For example, the acquired bank's holding company or affiliate agreed to assume the liabilities not transferred to the acquirer.) The primary benefit of this policy is that all creditors of a target bank have a viable party against which to pursue their claims in a transaction approved by a federal regulator.

The difficulty with the policy is that potential acquirers are wary of unknown contingent claims and may bid less, potentially increasing the exposure of the deposit insurance fund in some cases.

The OCC does not support a change in this policy. The policy provides a reasonable safeguard to creditors of target banks. In addition, on a case-by-case basis, the OCC has elected to apply the policy flexibly or not to enforce the policy if to do so would increase the exposure of the deposit insurance fund.

RISK-BASED CAPITAL STANDARDS

RECOMMENDATION

Eliminate risk-based capital requirement (except for internationally-active banks).

BACKGROUND

The risk-based capital framework was devised under the Basle Accord, which expressly governs only internationally-active banks. The OCC, FDIC, and Federal Reserve have imposed the Basle framework on all the banks they regulate, regardless of whether they are internationally active or are solely domestic institutions. The OTS has adopted the same framework in the interest of safety and soundness and also pursuant to the mandate of FIRREA that the capital requirements imposed by the OTS on savings associations be no less stringent than the capital requirements imposed on national banks. Risk-based capital standards are now required for all insured depository institutions. The statutory mandate for risk-based capital standards can be found at FDI Act Section 38 (Prompt Corrective Action) for all insured depository institutions, and HOLA Section 5(t) specifically for OTS-regulated savings associations.

DISCUSSION

This recommendation would eliminate the risk-based capital requirement for all but internationally active banking organizations. Even though the Basle Accord explicitly applies only to internationally-active banks, the concept of measuring capital in relation to risk is fundamental and is as applicable to small banks as it is to large banks. The agencies are required by law to ensure that all institutions have adequate capital. The risk-based capital concept has been incorporated in a number of statutory mandates, for example, the risk-related insurance premium rules and the prompt corrective actions rules.

Implementation of this recommendation potentially raises a concern that applying different capital standards to smaller institutions would create inequities in regulatory treatment. The agencies will continue to pursue appropriate avenues to reduce unnecessary supervisory burden on smaller banking organizations.

REGULATORY ACCOUNTING AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

RECOMMENDATION

Adopt GAAP for regulatory accounting purposes.

BACKGROUND

This comment, directed primarily at the OTS, recommends that the agency unify its regulatory accounting with GAAP. The OTS published its final accounting and reporting standards rule on September 2, 1992. The standard establishes GAAP as the minimum regulatory reporting standard in the Thrift Financial Reporting (TFR) unless there are safety and soundness considerations that require an accounting treatment that is more stringent than GAAP. At the moment, there are no regulatory accounting principles. Adjustments are being made to GAAP equity to compute regulatory capital on schedule CCR. The banking agencies also use GAAP except in situations involving safety and soundness where the agency may choose to use more conservative reporting treatment methods.

DISCUSSION

Exclusive use of GAAP provides for complete consistency among the four agencies. Using reporting standards that solely utilize GAAP would allow the recognition of certain economies and minimize reporting burden by eliminating the current need to maintain two sets of books.

GAAP does not give the agencies the flexibility, however, to use more conservative standards for safety and soundness considerations when needed. Section 121 of FDICIA generally requires accounting principles used for regulatory reports that accurately reflect capital, facilitate effective supervision, and allow for prompt corrective action. Accounting principles that are consistent with GAAP may not always achieve these objectives.

The banking agencies' reporting requirements are generally consistent with GAAP while requiring more stringent treatment than GAAP when warranted by safety and soundness concerns. The OTS now also requires GAAP as the minimum regulatory reporting standard in its TFR (unless safety and soundness considerations require more stringent treatment).

ACCOUNTING STATUS OF TROUBLED DEBT RESTRUCTURINGS

RECOMMENDATION

Permit troubled debt restructurings (TDRs) to be returned to performing status if the debt is at market rate, chargeoffs are taken, and the debt is fully collectible.

BACKGROUND

The issue is whether TDRs can be accounted for on an accrual basis (and thus be deemed a "performing" asset) once certain criteria have been met, without a performance period. The uniform policies of the banking agencies indicate that a loan that has been formally restructured may be returned to accrual status if it is reasonably assured of repayment and performance according to its modified terms. A period of sustained performance, whether prior to or subsequent to the date of the restructuring, is an important factor, although not the only factor, in determining whether there is reasonable assurance of repayment and performance according to the loan's modified terms. These policies indicate that a preponderance of evidence may be sufficient to warrant returning a restructured loan to accrual status, provided the loan under its restructured terms is reasonably assured of performance and full collectability. These policies are consistent with GAAP.

The uniform interagency policies also indicate that restructured assets that yield a market rate need not be reported as TDRs in years following the restructuring, although the asset must be disclosed as restructured in the year that the restructuring took place. These policies are consistent with SEC reporting requirements and GAAP. Disclosure of restructured assets in the year of restructuring is useful to readers of financial statements in explaining the impact of these assets on the earnings and financial condition of financial institutions.

DISCUSSION

Adoption of the recommendation would allow institutions to reflect these assets as performing loans, which in some cases may more accurately reflect the economic value of the assets.

However, adoption of the recommendation may lead to more liberal accounting methods that are not consistent with GAAP. The agencies believe that generally loans need a period of performance before returning to accrual status after having been on nonperforming status and restructured. The agencies essentially have consistent policies and recently established prudent criteria, consistent with GAAP.

MARKET VALUE ACCOUNTING

RECOMMENDATION

Market value accounting for bank investment portfolios should not be adopted.

BACKGROUND

The SEC has urged the Financial Accounting Standards Board (FASB) to consider adopting accounting standards that would require certain assets to be marked to market for financial reporting and disclosure purposes. The FASB has proposed that marketable debt and equity securities be reported at market value when the institution does not have a positive intent and ability to hold to maturity. This is an attempt to be partially responsive to the SEC and to address abusive accounting practices. Some believe market value accounting could increase volatility in earnings and impair credit availability. Others believe that market value accounting for marketable securities is consistent with an operating strategy that includes selling securities to manage income and interest rate risk.

DISCUSSION

The federal banking agencies and the Treasury Department agree that market value accounting raises a substantial number of significant issues that need to be studied thoroughly before moving toward this accounting approach. They have been working with FASB to discuss these issues. Reliable market values are not available for a large portion of a banking organization's assets, liabilities, and off-balance sheet commitments, and reasonably specific standards have not been developed for the estimation of market values. Thus, any market value estimates would be subjective and subject to error. The overall cost and reporting burden associated with developing reliable market value estimates could also be considerable. Furthermore, market value accounting could increase the volatility in reported earnings and capital. A piecemeal application of market value accounting for a significant portion of the bank balance sheet (such as all or a substantial component of investment securities) and not for <u>all</u> balance sheet and off-balance sheet items could result in volatility in reported earnings and capital that may not be indicative of the bank's true financial condition.

In addition, a change in market value accounting could have a major impact on the investing, lending, and other activities of banking organizations. For example, extending market value accounting to long-term holdings of investment securities (but not to loans) may reduce the amount of securities banking organizations are willing to hold and thus may adversely affect bank liquidity.

MORTGAGE SERVICING RIGHTS

RECOMMENDATION

OTS should adopt the GAAP interpretation that excess mortgage servicing rights bought in a whole-institution transfer continue to be considered excess servicing rights.

BACKGROUND

This recommendation suggests that OTS consider excess servicing rights acquired in a purchase of an entire institution as excess servicing rights as opposed to the current practice of recording the assets as purchased mortgage servicing rights (PMSR). OTS capital rules require certain deductions of PMSR from GAAP equity capital in the determination of regulatory capital. The OTS' interpretation of GAAP for acquired excess servicing rights is consistent with that of the banking agencies.

DISCUSSION

This proposal could have a favorable impact on the amount of regulatory capital in an acquisition, since excess servicing is viewed for GAAP purposes as a "tangible" asset and thus is not subject to the regulatory capital deductions that apply to PMSRs and other intangible assets.

Any changes by OTS, however, would be inconsistent with positions of the other agencies and might be inconsistent with GAAP. Currently, the initial reporting of acquired excess servicing and the capital treatment of PMSRs are being addressed on an interagency basis. Any revision of these rules outside of the interagency context would be contrary to OTS' stated objective of establishing accounting standards that are consistent with the other federal banking agencies and GAAP.

The existing reporting treatment is consistent with GAAP and the agencies plan to address the capital treatment of PMSR and excess servicing on a uniform interagency basis.

WRITTEN POLICIES

RECOMMENDATION

Reconsider the need for written policies in all areas for small banks with few or no branches and limited geographic spread.

BACKGROUND

The federal financial regulatory agencies require as a matter of supervisory practice that insured institutions maintain written policies in various areas such as investments, loans, asset-liability management, and capital planning. Commenters contend that uniform requirements for written policies in many areas seem unnecessary in many small banks where all the officers work in one office or a very few offices.

DISCUSSION

Community bankers feel that preparing written policies takes a considerable amount of officer time away from more important responsibilities. They argue that examiners often criticize their written policies for being too short, inappropriately worded, or lacking in other trivial ways. They contend that in a small bank written policies are not important anyway, because employees and examiners can question the bank president or senior officials directly. In this view there is little utility to written policies that must be updated or corrected frequently.

The regulatory agencies, on the other hand, feel that written policies demonstrate that the directors provide a clear framework of objectives and policies within which executive officers must operate and administer the insured institution's affairs. When deficiencies are noted on one or more aspects of an institution's operations, in the agencies' experience it is nearly always the case that absence of written and clearly defined objectives, goals, performance standards, and limits of authority is an important contributing factor. (The existence of written policies also saves examination time because examiners do not then have to examine the insured institution in detail to ascertain what policies the institution follows.)

The need for written policies is an important element of examination policy for all of the regulatory agencies. There is no better means of ensuring that directors are properly supervising the institution's affairs than by their direct participation in devising, modifying, and enforcing the institution's written guidelines. The agencies recognize that the depth and detail of written policies may properly vary among institutions, depending on the nature, scope, and complexity of their operations.

I. Supervisory Policies: Insider and Affiliate Transactions

GENERAL BACKGROUND

Section 22(h) of the Federal Reserve Act (12 U.S.C. 375b) imposes restrictions on loans to insiders and their related interests. These restrictions include a prohibition on loans to insiders on preferential terms, a lending limit on loans to individual insiders, and an aggregate lending limit on loans to all insiders. Regulation O, promulgated by the Federal Reserve, implements section 22(h) and was recently amended to incorporate a number of changes made by FDICIA.

Many commenters criticized section 22(h), as amended by FDICIA, on the basis that it impairs the ability of banks to attract good officers and directors, and requires banks to send their officers and directors, who are frequently their best customers, to competitors. Many of the general comments concerning burdens that section 22(h) and Regulation O impose on institutions in attracting and retaining qualified officers and directors arise from FDICIA and can be addressed only through statutory revisions.

TRACKING OF CORRESPONDENT BANK INSIDERS

RECOMMENDATION

Amend Regulation O so as not to require banking organizations to track the list of executive officers and directors of their correspondent banks.

BACKGROUND

Section 106(b) of the Bank Holding Company Act Amendments of 1970 prohibits banks that maintain correspondent accounts with each other from extending credit to each other's executive officers, directors, or principal shareholders unless the extension of credit (1) is made on substantially the same terms as those prevailing at the time for comparable transactions with other persons, and (2) does not involve more than a normal risk of repayment or present other unfavorable features. Banks whose executive officers, directors, or principal stockholders have received preferential extensions of credit from other banks are prohibited from opening correspondent relationships with those banks. Section 306 of FDICIA applies the restrictions in section 106(b) to savings associations and savings banks as well.

DISCUSSION

Regulation O does not require banks to track the executive officers, directors, and principal shareholders of their correspondent banks. It leaves to each bank the discretion regarding the most appropriate manner for complying with the requirements of section 106(b) regarding loans to officers, directors, and principal shareholders.

It appears that this recommendation arises from a misunderstanding of the requirements of the Bank Holding Company Act Amendments of 1970 and Regulation O.

OPERATION OF BOARDS OF DIRECTORS

RECOMMENDATION

Review all current requirements for boards of directors and eliminate all matters that are not sufficiently important to require board attention.

DISCUSSION

A commenter indicated that, because of the variety of regulations, a significant portion of a board's agenda consists of matters that the directors should quite properly delegate to management.

The agencies understand that routine actions of management need not require board action. Nevertheless, the board of directors assumes full responsibility for the operations of the bank. The agencies have not instituted any reporting requirements that are not properly performed at the board of director level. A board of directors does have the option of delegating tasks to a board subcommittee. While an agency checklist of matters that should be delegated to management may shorten board meeting time, it also strengthens the argument that regulatory agencies are micro-managing the institutions. Furthermore, this recommendation would not contribute to a reduction in regulatory burden because failure of a bank board of directors to be aware of information could expose them to liability.

II. Consumer Protection Policies: Disclosures and Practices

ELECTRONIC FUND TRANSFER (REGULATION E)

RECOMMENDATION

Permit financial institutions to treat "negative notice" (that is, continued use by the consumer after notification) as a request for access to additional accounts.

BACKGROUND

Regulation E prohibits the issuance of "access devices" (such as debit cards) to consumers without a request or application from the consumer. The Official Staff Commentary to Regulation E states that if an access device has already been issued to a consumer (to access a checking account, for example), making an additional account (such as a savings account) accessible by means of the same access device is equivalent to issuing an access device for that account and may not be done, therefore, without a request from the consumer. The recommendation would allow a lender to make a new account accessible by a preexisting access device without a specific advance request. It would treat use of the access device by the consumer after being told about the new feature as a "request" for access to the new account.

DISCUSSION

To the extent that financial institutions wish to connect as many accounts as possible to debit cards that are already in their customers' possession, the recommended change would make it easier to do because it would eliminate the need first to obtain a request from the customer. It represents a limited change to the existing requirements insofar as it would allow use of an existing device on a new account to be deemed a request for the new access. (A more extreme recommendation would allow the consumer's continued use of the device to access an existing account to be deemed acceptance of that access device on the new account.)

On the other hand, the result of this recommendation could be to expose a savings account to the risk of unauthorized withdrawals that might occur if the debit card is lost or stolen before the consumer has used the card on that account or otherwise agreed to allow the card to access that account. In addition, this change might not result in any significant reduction in burden because requests for access devices most often arise when an account is opened, rather than later. An institution that wishes to ensure that as many of its customers' accounts as possible are accessible by debit cards can routinely have customers request such access at the time new accounts are opened.

ELECTRONIC FUND TRANSFER (REGULATION E)

RECOMMENDATION

Standardize the time periods for investigating error claims, eliminating the difference between point-of-sale or foreign-originated transactions and all other transactions.

BACKGROUND

Regulation E requires a financial institution to investigate and resolve error claims generally within 10 business days, or else provisionally credit the account for the disputed amount and resolve the claim within 45 calendar days. For transactions initiated by debit card at point of sale (POS), and for transactions initiated outside the United States, the regulation allows 20 business days in place of 10, and 90 calendar days in place of 45.

DISCUSSION

If the time periods were made uniform (presumably using the shorter time periods, because adopting the longer periods as the general rule would require amendment of the Electronic Fund Transfer Act), financial institutions might find the error resolution provisions of Regulation E easier to understand, and this section of the regulation would be simpler and shorter.

However, making the error resolution time periods uniform by adopting the shorter periods in all cases would mean that error claims involving POS debit and foreign-initiated transactions would have to be investigated and resolved within tighter deadlines than those now applicable. There clearly would be additional burdens imposed on institutions with regard to these two categories of transactions. Therefore, the recommendation does not appear to result in an overall burden reduction.

TRUTH IN LENDING (REGULATION Z)

RECOMMENDATION

Allow the borrower's statement of business purpose to be conclusive about whether a loan is subject to Truth in Lending.

BACKGROUND

Regulation Z requires Truth in Lending disclosures for consumer-purpose loans and not for business-purpose loans. A lender needs to ascertain the purpose of the loan in deciding whether to give disclosures and considers several factors, including the borrower's statement of purpose, the size of the loan, and the relationship of the borrower's primary occupation to the purpose of the loan.

DISCUSSION

Although it is not clear whether a significant problem exists, the recommendation would reduce burden in the sense that a creditor would no longer need to exercise independent judgment about the purpose of the loan and would not risk liability for not providing disclosures when the consumer stated that the loan was for a business purpose. The number of cases in which it is unclear whether a loan is for business (rather than for consumer) purposes probably is very limited; therefore assuming the recommendation is limited to those few cases in which there is some question about the purpose of the loan, there is little risk that it would result in disclosures not being provided in what are clearly consumer purpose loans.

However, this recommendation may be too sweeping. Without any limitation on its applicability, it would allow consumer-purpose loans to be made without Truth in Lending disclosures as long as the borrower stated that the loan was for a business purpose. The policy envisioned by the recommendation also could be abused, especially if "business purpose" statements became preprinted "boilerplate" on every loan application and consumers were routinely encouraged to sign them.

TRUTH IN LENDING (REGULATION Z)

RECOMMENDATION

Provide that a loan on non-owner-occupied rental property is deemed to be for business purposes.

BACKGROUND

Regulation Z already provides that most loans secured by non-owner-occupied rental property are business purpose and exempt from disclosure requirements (namely, loans to acquire, improve or maintain the property). This recommendation would extend the exemption to any loan secured by such rental property.

DISCUSSION

The recommendation would eliminate the need to give disclosures in a limited number of transactions.

The recommendation appears to address a very narrow issue--loans for a consumer purpose for which rental property is used as collateral. The recommendation would be counter to the approach taken by the law, that the purpose of the loan should govern whether disclosures are given and not the type of collateral.

OTS AND OCC CONSUMER REGULATIONS

RECOMMENDATION

Permit use of internal indices on adjustable-rate mortgage (ARM) loans by federally-chartered institutions.

BACKGROUND

OTS regulations (12 CFR 545.33(e)(1)) and OCC regulations (12 CFR 34.7) for ARMs require that federal savings associations and national banks specify an index to which changes in the interest rate on an ARM shall be linked. The index must be beyond the control of the lender and be readily available to, and verifiable by, the borrower. Therefore, internal indices may not be used.

DISCUSSION

Elimination of some interest rate risk to the lender would eventually lessen required capital associated with ARM lending and could allow for interest rates and terms more favorable to the consumer.

On the other hand, elimination of the prohibition on use of internal indices would mean that borrowers would no longer be protected from manipulation of interest rates by federally-chartered institutions, since they control internal indices. Furthermore, the Home Equity Loan Consumer Protection Act of 1988 included similar prohibitions on the use of internal indices for open-end home equity credit lines by any lender, indicating Congressional preferences in this area. In addition, use of indices outside the lender's control facilitated the development of the secondary market for ARMs. Those ARMs indexed to internal cost of funds or prime rates could have little or no marketability. Use of an index within the lender's control provides no verifiable historical basis for consideration by the consumer in evaluating the risks of ARMs.

II. Consumer Protection Policies: Anti-discrimination

EQUAL CREDIT OPPORTUNITY (REGULATION B)

RECOMMENDATION

Conform the monitoring requirements of Regulation B to those of Regulation C (Home Mortgage Disclosure Act).

BACKGROUND

Regulation B requires collection of data about an applicant's race or national origin, sex, marital status, and age in an application for a loan to purchase or refinance a one-to-four family dwelling that is to be occupied by the applicant as a principal residence. The Regulation C data collection requirements differ in that (1) more types of loans (such as home improvement and multifamily loans) are covered than under Regulation B monitoring requirements, and (2) information on marital status and age is not required under Regulation C, but information on the applicant's income is required.

DISCUSSION

If the monitoring requirements of Regulations B and C were identical, lenders might find them somewhat easier to understand and comply with.

In practice, however, there is almost no difference in monitoring requirements, since the types of loans covered by Regulation C are broader and Regulation B permits collection of data for monitoring purposes if required under another regulation. Thus, Regulation C is the controlling regulation for all practical purposes. The model monitoring forms themselves are virtually identical, containing questions about only race/national origin and sex. The other items (age, marital status, and income) are expected to appear elsewhere on the application form as part of the lender's own credit evaluation. Finally, some lenders are subject to Regulation B but not to Regulation C; for this group, conforming to Regulation C monitoring requirements would represent an increase in burden.

EQUAL CREDIT OPPORTUNITY (REGULATION B)

RECOMMENDATION

Reduce the period for required record retention to 12 months.

BACKGROUND

Regulation B requires record retention on consumer credit transactions for 25 months. For extensions of credit to small businesses (those with gross revenues of $1 million or less), the record retention period is 12 months; for transactions involving larger businesses or trade credit, the period is 60 days.

DISCUSSION

A shorter required record retention period would clearly reduce burden on creditors in general. A particular benefit for creditors offering both business and consumer credit would be that the record retention periods for the two types of credit would become more uniform.

On the other hand, the statute of limitations under the Equal Credit Opportunity Act is two years; reducing the record retention period to one year might leave plaintiffs without access to records necessary to pursue their rights effectively. Also, depository institutions are generally examined less frequently than once per year; thus, if records could be destroyed after a year, significant portions of an institution's records might escape examiner review. This would impair the agencies' ability to carry out their assigned enforcement duties.

GOVERNMENT SECURITIES ACT of 1986

RECOMMENDATION

Permit banks to provide monthly account statements of overnight hold-in-custody repurchase transactions at the customer's option rather than daily confirmations.

BACKGROUND

The regulations implementing the Government Securities Act of 1986 (GSA) contain rules applicable to financial institutions that engage in hold-in-custody repurchase transactions. These rules essentially parallel other GSA requirements which apply to brokers and dealers that are not financial institutions. Among other things, the regulations require daily confirmation of overnight repurchase agreement transactions; thus, confirmation of the specific securities that are the subject of a hold-in-custody repurchase transaction must be issued by the end of the day on which a transaction is initiated and on any day on which substitution of securities occurs.

The Treasury Department has periodically received comments on the impact of the daily confirmation requirements, particularly for hold-in-custody sweep repurchase transactions. Commenters have cited the cost of producing confirmations and their limited usefulness. These comments have been received only from banks, even though the confirmation requirements apply equally to both registered broker-dealers and financial institutions.

Treasury has consistently taken the position that securities transactions should be confirmed promptly and that such treatment is particularly appropriate for hold-in-custody repurchase transactions. The frequency or short duration of certain repurchase transactions does not obviate the benefits to a customer of receiving prompt confirmation of each transaction. Moreover, the legislative process giving rise to the GSA focused on hold-in-custody repurchase transactions as an area of major concern in the context of customer protection.

Treasury has also repeatedly stated that confirmations have significant value, especially in transactions with an insolvent entity. Until a confirmation is received, a customer may have no knowledge of the specific securities that are the subject of the repurchase transaction. Prompt confirmations help underscore the importance of allocating specific securities to customers in the repurchase market, thus enabling the customers to identify the securities should they need to initiate a claim. Confirmations also provide an easy means for customers to assure that the securities allocated to them on a repurchase transaction are both acceptable and of adequate value.

Furthermore, confirmations appear to be required under state commercial law (Article 8 of the Uniform Commercial Code) to achieve an effective transfer of an interest in securities. Treasury is reviewing the current development of proposed revisions to Article 8 of the Uniform Commercial Code to determine if the proposals might permit a less burdensome manner for achieving customer protection in this area. However, the need for disclosure and the need to maintain a level playing field among market participants (financial institutions and non-financial institutions) may limit potential modifications of this provision.

Treasury recently issued an interpretation of the GSA regulations permitting confirmations to be sent by facsimile, which should be less costly and more efficient.

Finally, Treasury's authority to modify or amend these regulations lapsed on October 1, 1991, and it is unknown when it will be reauthorized. Accordingly, Treasury currently has no authority to modify this regulation.

DISCUSSION

Changing the requirements to permit monthly account statements in lieu of the daily confirmations would reduce the cost of producing and sending the confirmations. Furthermore, confirmations have a short period of usefulness since they are received after the transaction has been effected and a new transaction is done daily. Finally, some customers view confirmations as unnecessary and bothersome.

On the other hand, prompt confirmation of securities transactions (including repurchase agreement transactions) strengthens customer protection. Confirmations benefit customers by providing information -- specific securities involved in the transaction, appropriateness of securities, whether securities are of adequate value -- which allows the customer to act or react knowledgeably and promptly in current and future transactions with a given counterparty. Confirmations have significant value in establishing a customer's interest in securities. Furthermore, all government securities broker-dealers -- both financial institutions and non-financial institution entities -- are subject to the same confirmation rules. Any changes to the rule would require coordination and consultation with the SEC so that no class of government securities broker-dealers would be subject to more stringent regulatory requirements than another class.

Treasury does not support the recommendation to make changes to the confirmation requirements at this time. Treasury will continue to review developments in commercial law to determine if there are less burdensome ways to provide for customer protection in this area.

EXPEDITED FUNDS AVAILABILITY (REGULATION CC)

RECOMMENDATION

Delay enactment of the same-day settlement rule until the Federal Reserve has addressed and mitigated the credit risk to paying banks that must accept a direct presentment (and settle for it the same day) from any bank, including a bank that may potentially fail.

BACKGROUND

In September 1992, the Federal Reserve adopted a final amendment to its Regulation CC to require a bank to make same-day settlement for checks presented under certain conditions, effective January 3, 1994. Under the same-day settlement rule, a paying bank must accept presentment from and settle with any presenting bank, even if the paying bank had no previous relationship with the presenting bank, such as holding a settlement account for that bank.

Commenters to the initial proposal stated that other statutes and regulations would have to be amended to assure the recognition of either a preferred claim for or a security interest in adjustments owed to the paying bank. They also commented that lack of advance notice of presentment would make it difficult for paying banks to anticipate staffing needs and related operational costs and that the lack of quality standards for cash letters could result in costly litigation as banks attempt to develop their own standards without guidance.

DISCUSSION

The same-day settlement rule could create risks for paying banks. Because the paying bank often will not have the time to verify the contents of a cash letter before the settlement deadline, the settlement generally will be made on the basis of the stated cash letter total. This total may be overstated due to an error by the presenting bank. Failure to settle for the full amount of the cash letter raises the risk that the paying bank will lose the right to return the checks it has received in the cash letter. Consequently, by settling for the stated amount of the cash letter, the paying bank would bear a risk, not of its own choice, that the presenting bank would be unable or unwilling to process adjustments for excess payments for same-day settlement cash letters.

In an effort to provide further protection to paying banks, the Federal Reserve included certain warranties in the same-day settlement rule. The rule requires all banks in the forward collection and return chain to warrant that the settlement total demanded or indicated on the cash letter equals the total amount of checks or returned checks presented or transferred. The rule establishes a warranty by all banks in the forward collection or return chain that the MICR encoding on a check or returned check is correct. The rule also provides that the paying bank may set off any excess settlement made against settlement owed to the presenting bank for checks presented subsequently. In addition, the rule gives the paying bank a preferred claim against a failed presenting bank that breaches an amount or encoding warranty.

The Federal Reserve determined that giving the paying bank a security interest in the settlement amount would, in practical terms, have the same effect as the preference provision, and thus did not include a security interest in the final rule. Although the warranty and preference provisions may be limited in their effectiveness, there are many situations in which they could alleviate risk to the paying bank.

The rule states that a bank may present checks for same-day settlement "in accordance with reasonable delivery requirements established by the paying bank." A presenting bank generally will find it necessary to contact the paying bank to determine the appropriate presentment location and delivery instructions. In addition, presentments are subject to the regulation's good faith standard. The practical effects of allowing the paying bank to establish reasonable delivery requirements and requiring presenting banks to present checks in a manner consistent with reasonable commercial standards of fair dealing will be that presenting banks generally will contact paying banks to determine the delivery requirements and/or for other purposes, and this contact will serve to notify paying banks of future check presentments. It is in the presenting bank's interest to provide advance notice so that it can furnish necessary information for settlement and thereby facilitate timely settlement by the paying bank.

The rule does not contain cash letter quality standards. The appropriate technical requirements and standards with respect to presentments made under the same-day settlement rule are likely to evolve over time as check collection practices change. Therefore, incorporating such requirements and standards in the regulation may be unnecessarily inflexible. Rather, these requirements and standards can be more efficiently worked out between presenting banks and paying banks within the context of the good faith standard. The banking industry could develop guidelines, which, if widely embraced, may be used as a benchmark against which violations of the good faith standard could be judged.

DAYLIGHT OVERDRAFTS (REGULATION J)

RECOMMENDATION

Do not impose a fee for intraday ("daylight") overdrafts in accounts at the Federal Reserve.

BACKGROUND

The Federal Reserve has developed a payments system risk reduction program to reduce both Federal Reserve risk and systemic risk should payments system participants fail to meet their payments obligations. As part of this program, the Federal Reserve has taken several steps to induce risk-reducing behavior by payments system participants on both Fedwire and private large-dollar networks that settle through the Federal Reserve on a net basis. In September 1992, the agency approved a pricing system under which Reserve Banks will charge a fee for average daily daylight overdrafts in reserve and clearing accounts that exceed a deductible of 10 percent of qualifying capital. Fees of $25 or less in any two-week period will be waived.

Commenters stated that depository institutions would have to build expensive systems to monitor daylight overdrafts on a customer-by-customer basis and to charge customers for daylight overdrafts. The commenters believed that, absent such systems, customers would continue to incur daylight overdrafts and depository institutions would continue to incur overdrafts at the Federal Reserve. Thus, institutions' costs would increase and risk would not be reduced. One commenter estimated the cost of a monitoring system to be $620,000-$720,000, with total incremental costs of $200,000-$380,000 and additional Federal Reserve payor bank service fees of $180,000.

Commenters were also concerned that participants in the New York Clearing House Interbank Payments System (CHIPS) may shift payments from Fedwire to CHIPS to avoid daylight overdraft charges. The commenters believed that the accessibility of CHIPS to New York institutions gives them a competitive advantage over other institutions and that either CHIPS should be more accessible to all institutions or daylight overdraft pricing should be delayed until all institutions have a private settlement option.

DISCUSSION

Depository institutions can make adjustments to avoid daylight overdraft fees that will cost considerably less than the fees themselves, for example, by shifting to CHIPS, through netting and rollovers, and through delay of less time-sensitive payments. Each of these adjustments would reduce both overdrafts subject to fees and Federal Reserve risk. A relatively small number of institutions that now receive the subsidy of free overdrafts will nonetheless have remaining overdrafts subject to fees. The costs of modifying customer monitoring systems and developing systems to charge customers for daylight overdrafts could be substantial for these institutions. However, as noted, the Board estimates that only a relatively small number of institutions would choose to make these modifications. Institutions are unlikely to install expensive systems if those systems would cost more than paying the overdraft fees.

The cost burden of the overdraft fees themselves should be relatively low and are outweighed by the benefits. The great majority of depository institutions will be exempt from pricing given the 10 percent deductible and the de minimis $25 exemption. The Board estimates that approximately 80 percent of the fees will be paid by the top ten overdrafting institutions, now benefiting from a large volume of free Federal Reserve daylight credit. The benefits of pricing include significant reductions in direct Federal Reserve risk and, in the context of the Federal Reserve's evolving payments system risk reduction program of recent years, total payments system risk. Pricing will harness market forces to induce behavioral changes by market participants that will reduce risk and contribute to economic efficiency.

As noted, shifts of payments from Fedwire to CHIPS is a likely market response to daylight overdraft pricing. However, the extent to which payments are shifted to CHIPS may be limited by a variety of factors. For example, other market responses to pricing, such as delayed sends and netting, will likely siphon off some of the payments that might otherwise shift to CHIPS. Also, because CHIPS has implemented settlement finality, CHIPS participants are unlikely to be willing to raise their bilateral credit limits for all other participants. In addition, some users of payment services may insist that payments be made to them over Fedwire to assure immediate access to final funds.

To the extent that payments shift away from Fedwire, private payments networks such as CHIPS could benefit. Additional demand for an alternative payments network could provide an incentive for CHIPS to broaden its membership or for banks to form other private payments networks. Market responses to daylight overdraft pricing could result in short-term competitive advantages to established private payments networks, but, in the long run, pricing should result in decreased risk and increased competition in the payments system. The Federal Reserve adopted pricing with the view that these market developments would occur as a result of, rather than a prerequisite to, daylight overdraft pricing.

APPRAISAL ISSUES -- FORMS AND FORMATS

RECOMMENDATION

Provide specifics for report formats and allow the use of appraisal forms.

BACKGROUND

Some regulated institutions have questioned whether a certain appraisal form or format meets the requirements of the agencies' appraisal regulations. One commenter requested that the agencies develop their own residential appraisal form.

DISCUSSION

The regulations issued by the agencies allow for the use of any form so long as it contains the information necessary to comply with the regulations. The flexibility allowed by the regulations now in place is less burdensome than would be the case if greater specificity were required. Designing a standard form would in fact create regulatory burden by forcing uniformity.

MONETARY POLICY

RECOMMENDATION

Increase the number of limited transfers that may be made before a savings account is reclassified as a transaction account.

BACKGROUND

The Federal Reserve Act mandates that the Federal Reserve Board establish required reserve ratios for transaction accounts and for nonpersonal time deposits. The Board may vary these reserve requirements, solely for the purpose of implementing monetary policy, within statutory ranges of 8 to 14 percent for transaction accounts and 0 to 3 percent for nonpersonal time deposits.[7] The Board implements the statutory provisions for reserve requirements through its Regulation D. At present, Regulation D specifies that the required reserve ratio for transaction accounts is 10 percent and that for nonpersonal time deposits is zero. (As explained below, over the past two years the Board has reduced reserve ratios considerably to lower the regulatory burden on depository institutions and improve the availability of credit.) The law also permits the Board to define terms pertinent to reserve requirements.

The issue in this recommendation involves the definition of savings account. Regulation D defines the term savings account to mean, roughly, a deposit without a specific maturity date, on which the depository institution may require a seven-day notice of withdrawal by the depositor, and under the terms of which the depositor is permitted to make no more than six withdrawals per month, no more than three of which may be by check or similar order.

DISCUSSION

The reasons given for the recommendation are (1) that increasing the number of transactions permitted while imposing clear standards about what must be done when the limits are exceeded would put all banks on a level playing field, and (2) that banks with strict monitoring procedures would need to send fewer customer notifications.

---

[7] Net transactions accounts up to $42.2 million are subject to a 3 percent limit. This "low reserve tranche" amount is indexed annually by 80 percent of the percentage change in transaction accounts held by all depository institutions, measured as of June 30.

The first $3.6 million of reservable liabilities of each depository institution are subject to a zero percent reserve requirement. This reserve exemption amount is adjusted each year for the succeeding calendar year by 80 percent of the percentage increase in the total reservable liabilities of all depository institutions, measured on an annual basis as of June 30.

As to the first reason, at present, all depository institutions already are subject to the same transaction limits and requirements for preventing excessive transactions.[8] With regard to the second reason, an increase in the transaction limit may result initially in a decline in the number of limit violations and thus in lower costs of enforcing transaction limits on savings accounts. However, customers eventually would take advantage of higher limits by transferring funds more frequently out of savings accounts. As customers increased the number of transfers, it is likely that the number of limit violations also would increase. Thus, it is questionable whether a permanent reduction in notification costs would accrue to depository institutions as a result of implementing this recommendation.

Raising transaction limits for savings accounts could have adverse effects for the conduct of monetary policy. Monetary policy needs a sufficiently large base of required reserves so that total reserves demand is reasonably predictable. To the extent that reserves demand is predictable, monetary policy can adjust reserves supply to achieve money market conditions that are judged by the Federal Reserve to be consistent with attainment of broader economic objectives. If transaction limits on savings deposits were increased, it is likely that funds would be shifted from transactions deposits, such as NOW accounts, to savings deposits. Given the zero reserve requirement on savings deposits, such a shift would erode the reserve base. If the shift were sufficiently large, the predictability of total reserves demand could be diminished, adversely affecting the conduct of monetary policy.

An alternative approach to reducing the burden of reserve requirements on depository institutions is to lower required reserve ratios. The Federal Reserve has made two such reductions recently. In December 1990 and January 1991, the required reserve ratio on nonpersonal time deposits was cut in two steps to zero from 3 percent, and in April 1992, the required reserve ratio on transaction accounts was lowered from 12 percent to 10 percent. These reductions are estimated to have reduced required reserve balances in the aggregate by roughly $20 billion. At current interest rate levels, this reduction has lowered funding costs of depository institutions by approximately $600 million annually.

---

[8] Regulation D makes the following provisions for enforcement of transaction limits on savings accounts:

In order to ensure that no more than the permitted number of withdrawals or transfers are made, for an account to come within the definition in section 204.2(d)(2), a depository institution must either (a) prevent withdrawals or transfers of funds from this account that are in excess of the limits established by section 204.2(d)(2), or (b) adopt procedures to monitor those transfers on an ex post basis and contact customers who exceed the established limits on more than an occasional basis.

For customers who continue to violate those limits after they have been contacted by the depository institution, the depository institution must either close the account and place the funds in another account that the depositor is eligible to maintain, or take away the transfer and draft capacities of the account. An account that authorizes withdrawals or transfers in excess of the permitted number is a transaction account regardless of whether the authorized number of transactions are actually made. For accounts described in section 204.2(d)(2), the institution at its option may use, on a consistent basis, either the date on the check, draft, or similar item, or the date the item is paid in applying the limits imposed by that section.

DEPOSIT INSURANCE BILLING

RECOMMENDATION

Delete call report Schedule RC-0 as it is duplicative of the FDIC certified statement of insurance assessment.

BACKGROUND

Call report Schedule RC-0, "Other Data for Deposit Insurance Assessments," each quarter collects data on various adjustments to the reported amounts of a bank's demand deposits and time and savings deposits in domestic offices for calculating semiannual deposit insurance premiums. A bank calculates its insurance premium by completing a certified statement with the adjustments from the two most recent quarter-end report dates. The schedule is necessary to adjust for reporting differences between the FDIC and other agencies. This information is not duplicated on the certified statements.

DISCUSSION

The certified statement requires deposit and adjustment data from the two most recent quarter-end dates. For example, the certified statement completed in July contains March 31 and June 30 data. The starting point for the certified statement is the deposit totals reported in the call reports for those two dates. Normally, a bank will prepare the June 30 adjusting items for the June 30 call report and the July certified statement simultaneously. Consequently, it can take the March 31 adjusting items directly from the completed March 31 call report without researching source documents. If Schedule RC-0 were deleted, the bank would have to go research its March 31 records to find the adjustment data, unless it had instituted a procedure to capture the March 31 data on or around that date for the July certified statement. Any FDIC inquiries would also necessitate review of March 31 data. If the adjusting items are instead reported in Schedule RC-0 (as they are at present), any questions about the validity of the reported amounts would be raised as part of the call report editing process. This would mean questions about a bank's March 31 deposit and adjustment data (as well as questions about other aspects of its call report for that date) would be resolved with the bank all at one time shortly after the bank had completed the March 31 call report.

Adoption of the recommendation would essentially substitute a new burden for an existing burden. The FDIC needs the schedule to adjust for reporting differences.

CALL REPORT FREQUENCY

RECOMMENDATION

Reconsider the frequency of all call report schedules.

BACKGROUND

Section 7 of the FDI Act requires each insured depository institution to make four "reports of condition" (call reports) annually to the appropriate federal banking agency.[9] This means that, at the very least, Schedule RC (Balance Sheet) and data needed for deposit insurance assessments must be submitted four times a year.

DISCUSSION

The additional information collected on the supporting schedules is necessary for the additional detail it provides on securities, loans, off-balance sheet activities, and other specific transactions. The detail provided in these schedules allows the agencies to monitor the involvement and the potential risk exposure of individual banks and the industry as a whole.

Currently, one schedule, Schedule RI-C (Applicable Income Taxes by Taxing Authority), and numerous individual items on selected other schedules are collected only once a year. To limit reporting burden, Schedules RI-A and RI-B, part II, which contain year-to-date reconcilements of equity capital and the allowance for loan and lease losses, are collected only annually as of December 31st from banks with assets of less than $100 million. In addition, other schedules and a number of individual items are completed only by banks that meet specific criteria. For example, Schedule RC-D (Assets Held in Trading Accounts in Domestic Offices Only) is completed only by banks with $1 billion or more in total assets.

[9] Banks that are members of the Federal Reserve System are required by Section 9 of the Federal Reserve Act to file "reports of condition and the payment of dividends" with the Board not less than three times a year.

CALL REPORT CONTENTS -- GENERAL

RECOMMENDATIONS

Restrict reporting requirements to information strictly needed to assess safety and soundness and do not require information that is not needed.

Review all schedules, determine usage of each item and delete requirements for data that are not used.

Make changes in call report information and format only after evaluating costs of software and outside professional services that will be necessary.

BACKGROUND

The call report is a document that serves many functions. While a significant part of the call report is geared toward gathering information for safety and soundness purposes, the call report data also are used by the Federal Reserve in the generation of statistics needed for monetary policy purposes including 1) benchmarking key financial series constructed from sample data and 2) constructing data series not available from any other source, including sample surveys. In addition, data reported on the call report are used by the FDIC in determining deposit insurance assessments and for developing related deposit information. The Federal Reserve, the OCC, and the FDIC also use the data for analyzing applications filed by banking organizations. All the agencies use the call report data for research purposes.

DISCUSSION

If the non-safety and soundness data were eliminated from the call report, it would still need to be collected from banks in some other separate report or reports. Separate reports for these purposes would add a certain amount of duplication and would increase the overall reporting burden on banks.

The Reports Task Force of the FFIEC periodically reviews the usage of all items on the call report as well as their collection frequency. Recently, the agencies decided to eliminate an entire schedule, the highly leveraged transactions schedule, because it was felt that it was no longer necessary. In addition, the Task Force adds only items that it believes are absolutely necessary. Moreover, once every three years the federal banking agencies are required to conduct a zero-based review of the content of the call report in accordance with the Paperwork Reduction Act.

CALL REPORT CONTENTS -- SPECIFIC SCHEDULES

RECOMMENDATION

Eliminate Schedules RC-D (Assets Held in Trading Accounts) and RC-H (Selected Balance Sheet Items for Domestic Offices), as they are duplicative of Weekly Report of Assets and Liabilities for Large Banks.

DISCUSSION

Schedules RC-D (Assets Held in Trading Accounts) and RC-H (Selected Balance Sheet Items for Domestic Offices) of the commercial bank call report are not duplicative of the Weekly Report of Assets and Liabilities for Large Banks (FR 2416). Differences exist in respondent coverage, in item coverage, and in methods used to prepare the reports.

The FR 2416 is a balance sheet report that the Federal Reserve collects from a sample of approximately 165 large banks, generally with total domestic assets greater than $3.5 billion.[10] In contrast, the trading account schedule (RC-D) of the call report is completed by all banks with total assets (domestic and foreign) of $1 billion or more, while Schedule RC-H is completed by all banks that have foreign offices. Thus, the respondent coverage for Schedules RC-D and RC-H is broader than that of the FR 2416.

The trading account schedule (RC-D) collects more item detail than does the weekly FR 2416. Item coverage also differs between Schedule RC-H and FR 2416. Thus, use of FR 2416 as a substitute for Schedules RC-D and RC-H of the call report would require expansion of both the reporting panel and the item coverage of the weekly series, adding considerably to reporting burden.

In addition, for preparation of the FR 2416, respondents are provided leeway both for consolidating accounts of domestic subsidiaries and for excluding transactions with foreign offices. Because the information in the call report schedules likely is not available on the weekly reporting schedule, respondents may either incorporate the data with a lag or use estimates. Neither approach would be appropriate for the call report. Conversely, imposing call report consolidation standards on the FR 2416 would add significantly to weekly reporting burden.

[10] Additional details on the FR 2416, including its usage, are provided in the section on Reports for Economic Policy Purposes.

CALL REPORT CONTENTS -- SPECIFIC SCHEDULES

RECOMMENDATION

Delete Schedule RC-M (Memoranda), memorandum item 7, on mandatory convertible debt because it is outdated.

DISCUSSION

While it is true that the terms "primary" and "secondary" capital that appear in the caption to this item are no longer in use for supervisory purposes, the information on mandatory convertible debt is still necessary since the banking agencies' risk-based capital guidelines include the net amount of mandatory convertible debt in Tier 2 capital. Thus, if this information were not collected, the agencies would be unable to calculate accurately the risk-based capital for those institutions that hold these types of instruments.

CALL REPORT CONTENTS -- SPECIFIC SCHEDULES

RECOMMENDATION

Delete Schedule RI-D (Income from International Operations) as it is disclosed in annual reports.

DISCUSSION

The vast majority of banks are owned by bank holding companies and it is the holding companies, not the subsidiary banks, that submit annual reports to the SEC.[11] The SEC's Guide 3 requires that bank holding companies provide information on the income generated from international operations in their annual reports. The bank information collected on the call report's Schedule RI-D does not duplicate the information that is provided in bank holding company annual reports since the holding company data include international operational income earned by the bank subsidiary as well as other subsidiaries.

Schedule RI-D is only completed by those banks that have foreign offices where the international operations account for more than 10 percent of total revenue, total assets, or net income. This means that only banks that file the call report for banks with foreign offices (FFIEC 031) could possibly be required to complete Schedule RI-D. As of the March 31, 1992, call report date, less than 2 percent of the banking industry filed the FFIEC 031 and even fewer institutions would complete Schedule RI-D.

Furthermore, Part II of Schedule RI-D is collected by the banking agencies solely to satisfy the data needs of the Departments of Commerce and Treasury for purposes of measuring the U.S. international accounts and the U.S. national income and product accounts. The supplementary data in Part II are not disclosed in annual reports.

[11] There are publicly-owned banks that are required by the Securities Exchange Act of 1934 to submit their annual reports to their primary federal bank regulator. There are very few of these institutions, however, and an even smaller number have international operations.

IV. Reporting, Recordkeeping, Documentation Requirements: Other Supervisory Reports

BANK HOLDING COMPANY REPORTS

RECOMMENDATION

Return the reporting frequency of the FR Y-6A to quarterly reporting.

BACKGROUND

The Bank Holding Company Report of Changes in Investments and Activities (FR Y-6A) collects information on the changes in investments and activities of bank holding companies and their subsidiaries. The report is filed by the largest bank holding companies when certain changes in investments and activities occur. This report is the only source of information on bank holding company structure other than an organization chart, which is filed annually as part of the FR Y-6 report. If no changes occur, no FR Y-6A report is filed. The FR Y-6A was changed from a quarterly reporting cycle to a flow-basis cycle as of April 1992. Prior to implementing the change in reporting cycle, notification was published in the Federal Register, providing a 30 day comment period. No comments were received.

DISCUSSION

The only apparent advantage of reverting to the quarterly reporting cycle is that it would allow bank holding companies between 45 and 135 days to gather minimal information on investment and activities transactions that occur during a specific quarter. The new cycle does not require the reporting of any additional information.

There are a number of disadvantages of quarterly reporting. First, each organization will incur an added burden at the end of each quarter in that staff will have to research transactions that happened throughout the quarter and reacquaint itself with the details of each. For this reason, the quality of information reported may decline since reporters may forget to report certain transactions, or report them incorrectly due to the time lapse or due to the volume of reports filed at the end of each quarter. Before the change in the reporting cycle, information quality was low and this was a contributing factor in the decision to change the cycle. (The new cycle has been in place less than six months and, as yet, there has not been a study to assess differences in quality.) A telephone survey of Reserve Bank staff has shown that most reporters prefer the new reporting cycle because it is easier and reduces their quarter-end burden.

Second, information is more timely under the new approach. Under the quarterly reporting cycle, the Federal Reserve received information much later. Transactions could be reported up to 135 days after they occurred, and this delay was not acceptable. Information regarding the organizational structure and activities of bank holding companies could be five months out of date and not very useful. Often, current information is critical for supervision and applications as well as for evaluation of emergencies.

Third, information requests from Congress, the public, and other regulatory agencies would suffer from the same reporting delay.

BANK HOLDING COMPANY REPORTS

RECOMMENDATION

Eliminate the FR Y-11I report.

BACKGROUND

The Annual Report of Selected Financial Data for Nonbank Subsidiaries of Bank Holding Companies (FR Y-11I) is filed annually by a bank holding company for its nonbank subsidiaries. The report, which is the only source of standardized financial data for nonbank subsidiaries, contains ten financial data items. This information is used by supervision staff to monitor compliance and the condition of nonbanks and holding companies between inspections; it is also used for industry and financial analysis and to satisfy information requests from Congress and the public.

DISCUSSION

Elimination of the FR Y-11I report would mean that there would be no standardized financial information available on individual nonbank subsidiaries of bank holding companies. The availability of standardized financial information is critical to assess the potential impact nonbank subsidiaries may have on the condition of the bank holding company and its subsidiary bank's condition. The trend toward increasing numbers of activities that are permissible for nonbank subsidiaries and the potential for nonbank companies to have an adverse impact on affiliated banks through intercompany transactions and complex inter-relationships make this information important. Without standardized financial information for nonbank subsidiaries, potential problems, which may be masked in consolidated bank holding company reporting, could go undetected between examinations of an institution.

BANK HOLDING COMPANY REPORTS

RECOMMENDATION

Streamline the FR Y-9C filing to be consistent with GAAP and SEC reporting standards.

DISCUSSION

The FR Y-9C is filed on a GAAP basis and the Balance Sheet and Income Statement are generally consistent with information that is required by the SEC. Additional detail that is generally similar to SEC disclosures is captured on supporting schedules contained within the report. Further detail provides the Federal Reserve necessary information to assess the safety and soundness of banking organizations. Moreover, these schedules provide the Federal Reserve with information needed to establish statistical support for supervisory decisions. Schedule HC-I (Risk-Based Capital) is the only schedule in the FR Y-9C that is filed on a RAP basis. These data are required to determine risk-based capital ratios.

PUBLIC REPORTS OF INSIDER LENDING

RECOMMENDATION

Eliminate public report of lending to executive officers and principal shareholders (12 CFR 31), in light of duplication in 12 CFR 215.23 (Regulation O).

BACKGROUND

12 CFR 31 is the OCC's regulation implementing the reporting requirements of section 22(g) of the Federal Reserve Act and Federal Reserve Regulation O. The reporting requirements of 12 CFR 31 and Regulation O are not duplicative of each other, since 12 CFR 31 applies to national banks, while Regulation O applies to state member banks. Comparable requirements apply to state nonmember banks.

The agencies require banks, upon receipt of a written request, to disclose the name of each executive officer and principal shareholder whose aggregate indebtedness at the bank itself as of the last quarter-end and at the bank's correspondent banks at any time during the previous year exceeded a certain amount. Thus, although disclosure to the public is required only when requested, some of the information must be updated quarterly. The quarterly information must also be reported as a single total in the call report each quarter.

DISCUSSION

While the public report is not required by statute, the information contained in the report is authorized by section 7 of the FDI Act and the recordkeeping requirements of Regulation O. Because there are indications from banks that the public does not request the disclosures very often, there is some question whether the benefits of the disclosure requirement exceed the cost to banks of having to stand ready to make these disclosures.

The recommendation is not favored by the Federal Reserve, OCC, or OTS. Because the banking agencies routinely scrutinize insider lending, however, FDIC believes that there should be further consideration of eliminating or modifying the public disclosure requirement.

IV. Reporting, Recordkeeping, Documentation Requirements: Applications

UNIFORM APPLICATION FORMS

RECOMMENDATION

Adopt uniform application forms among the agencies for mergers and acquisitions, as well as for other purposes.

BACKGROUND

In many cases, approval of more than one agency is required and there could be savings if duplicate filings could be eliminated.

The Federal Reserve, OCC, FDIC, and OTS have drafted and reviewed a uniform interagency application form for mergers, consolidations, acquisitions of assets and/or assumptions of liabilities involving insured depository institutions and a uniform application form for the processing of de novo charters.

DISCUSSION

In the effort to develop standardized application forms, the agencies reviewed the information needed to meet statutory requirements at each agency. The agencies attempted to draft application forms that could be used by all the agencies.

The use of standardized application forms would reduce the institutions' burden of preparing several applications forms for the same transaction. However, differing agency statutory and regulatory requirements complicate the prospects for uniformity. While increased coordination and cooperation are possible, uniform application forms may not be feasible.

IV. Reporting, Recordkeeping, Documentation Requirements: Reports for Economic Policy Purposes

DEPOSIT REPORTS

RECOMMENDATION

Reduce the frequency of the Report of Transaction Accounts, Other Deposits, and Vault Cash (FR 2900) for banks subject to the 3 percent reserve requirement.

BACKGROUND

Two commenters suggested that the Federal Reserve reduce the reporting frequency of the Report of Transaction Accounts, Other Deposits and Vault Cash (FR 2900) from weekly to quarterly for depository institutions whose transaction accounts are less than the low reserve tranche (now $42.2 million) and are, therefore, subject only to the 3 percent reserve requirement. (Net transaction accounts greater than the low reserve tranche are subject to a 10 percent reserve requirement.) One of the commenters suggested that "quarterly reporting would not harm the economy and would provide substantial cost savings for affected banks."

The FR 2900 is one of the principal "deposits reports" that the Federal Reserve collects for administering Regulation D (Reserve Requirements of Depository Institutions) and for constructing, analyzing, and controlling the monetary and reserves aggregates. In general, the report is collected from all depository institutions that are not fully exempt from reserve requirements ("nonexempt institutions").[12] FR 2900 reporting frequency is governed by a "deposit cutoff" that is determined by the Federal Reserve Board. Nonexempt institutions with total deposits equal to or greater than the deposit cutoff file the report once a week, while smaller nonexempt institutions -- that is, those with total deposits less than the deposit cutoff -- file the report one week each quarter.[13]

The accuracy of measurements of the monetary aggregates is tied directly to the frequency with which deposits data are collected from depository institutions. When the current deposits reporting system was established in 1983, the Federal Reserve set the deposit cutoff at $15 million. Since then, analyses of the cutoff have been made under the regular triennial reviews of the deposits reports in order to determine whether the cutoff could be

---

[12]The Monetary Control Act of 1980 imposed reserve requirements on all depository institutions that maintain transaction accounts or nonpersonal time deposits. The Garn-St Germain Depository Institutions Act of 1982 subsequently imposed a zero percent reserve requirement on the first $2 million of a depository institution's reservable liabilities, in effect exempting from reserve requirements all depository institutions whose total reservable liabilities are less than or equal to the exemption amount ("fully exempt institutions"). The exemption amount is indexed annually by 80 percent of the annual growth rate of reservable liabilities at all depository institutions. For 1992, the exemption amount is $3.6 million.

[13]A separate reporting structure, commonly referred to as "reduced reporting," is in place for "fully exempt institutions."

raised, thus reducing respondent burden, without material adverse consequences for the measurement and control of money. In 1985, the cutoff was raised to $25 million and thereafter was to be indexed annually to allow for deposit growth, consistent with the indexing of the exemption amount. In 1988, the Board raised the deposit cutoff to $40 million (from the $30 million called for by the indexation formula). During the 1991 review, there was no increase in the cutoff beyond normal indexation. Many depository institutions were still in the process of adjusting their operations to the lower levels of required reserves that resulted from the late 1990 reduction in reserve requirements on nontransaction accounts to zero percent. It was believed that until that period of adjustment ended and sufficient time had elapsed for an assessment to be made of the efficacy of the current reporting structure in the new reserve ratio environment, any increase in the cutoff beyond normal indexing, or indeed any change in the overall category structure, would be premature.[14]

In the spring of 1992, under the Federal Reserve's review of all its regulations, policies, and reports that was undertaken in conjunction with the President's regulatory moratorium, the issue of the deposit cutoff was again revisited. However, the reserves environment was about to undergo even further change under the reduction from 12 to 10 percent in the reserve requirement on net transaction accounts in excess of the low reserve tranche (effective on April 2, 1992). Thus, it was concluded that a reassessment of both the deposit cutoff and the overall reporting framework would still be premature.

DISCUSSION

Apart from the question of the appropriate time to consider another increase in the deposit cutoff that determines FR 2900 reporting frequency, the recommendation would change the measure used for that determination. Instead of total deposits, which encompasses both transaction accounts and time and savings deposits, transaction accounts alone would be used. This more limited measure would disregard an institution's time and savings deposits, which also are basic components of the monetary aggregates.[15] In the view of the Federal Reserve, elimination from the weekly FR 2900 reporting panel of those reporters with transaction accounts less than the low reserve tranche (now $42.2 million) would have substantial adverse effects on the availability of accurate, timely monetary data. About 6,750 reporters would be affected, leaving fewer than 2,000 reporters in the weekly panel. Deposits of those institutions that would shift from weekly to quarterly FR 2900 reporting amount to about $840 billion, or one-fourth of weekly deposit data and nearly one fourth of total

[14] Under the regular triennial reviews, the item content of the FR 2900 also has been scaled back over the years as a result both of Regulation D changes and of market developments that reduced the need to analyze individually certain deposit categories. The most significant reduction took place under the 1991 review, when the number of data items was cut from 21 to 14.

[15] Transaction accounts are introduced at the Ml level of the monetary aggregates, savings and small time deposits at the M2 level, and large time deposits at the M3 level. All three aggregates are constructed and published weekly.

deposits.[16] Shifting these reporters to the quarterly reporting panel would impair the Federal Reserve's ability to measure deposit growth within quarters. The weekly data from smaller weekly reporters are needed not only for their direct contribution to the monetary aggregates, but also because they are used to estimate and interpolate data from quarterly FR 2900 reporters and from fully exempt institutions that are subject to "reduced" deposits reporting.

The regular triennial review of the deposits reports is scheduled to commence in the latter part of 1993. That review will include a reassessment of the overall reporting framework and of the specific measures used to determine deposits reporting frequency and detail. As in past years, the goal will be to minimize reporting burden to the extent possible without adverse consequences for the measurement and control of money.

---

[16] The gross deposit holdings of the 6,750 institutions that would be shifted include about \$110 billion in net transaction accounts, \$225 billion in savings deposits, and \$385 billion in time deposits.

DEPOSIT REPORTS

RECOMMENDATION

Justify or eliminate FR 2001 and daily telephone calls to report to Federal Reserve Banks.

BACKGROUND

A commenter recommended that the FR 2001, "which duplicates the FR 2900 but is submitted one day prior to the FR 2900," and "daily telephone calls to report data to Federal Reserve Banks" be justified or eliminated.

DISCUSSION

Data on deposits and vault cash are collected in advance of the weekly FR 2900 on two reports, one daily and one weekly. The daily advance report (FR 2000) collects 10 data items from 173 very large commercial banks; FR 2000 respondents file the data every business day, generally by telephone. The weekly advance report collects six-day (Tuesday through Sunday) totals for the same 10 items from a sample of 540 smaller banks; FR 2001 data typically are filed on Monday.[17]

These data are needed for constructing preliminary estimates of the monetary aggregates for the statement week just ending and for estimating required reserves and applied vault cash as the current reserve maintenance period proceeds, all before universe FR 2900 data for weekly reporters become available. In the view of the Federal Reserve, elimination of the advance reports would lead to a substantial deterioration in internal money stock estimates and in internal and published estimates of reserves aggregates, with adverse implications for the implementation of monetary policy.

---

[17] The weekly FR 2900 covers a seven-day reporting week, starting on Tuesday and ending the following Monday. Relatively few FR 2900 reports are actually filed with the Federal Reserve on the following day (Tuesday).

Some FR 2000 and FR 2001 respondents, at their own choosing, report all 14 FR 2900 data items daily, thus satisfying both the advance and the FR 2900 reporting requirements with a single filing.

DEPOSIT ACCOUNT REPORTS

RECOMMENDATION

Require reporting the "most common interest rate paid" on the FR 2042 monthly survey of selected deposits rather than requiring every interest rate paid.

BACKGROUND

A commenter recommended this modification to FR 2042, Monthly Survey of Selected Deposits, noting that under the current reporting format every rate and balance level of the selected deposits is required to be detailed. For a large bank with a widespread geographical territory that breaks this territory down into operating regions, this creates a reporting burden. Each operating region of a bank may establish its own rate structure based on economic influences in the area where these units operate. This autonomy creates minor rate differences for the same products throughout the system. The commenter suggested that more useful data for decision making could be provided by reporting the most common rate paid for each of the selected deposits. This information would give a more concise identification of the rate impact on deposit levels.

The Federal Reserve has collected information on the structure and pricing of deposit accounts since 1965. Over the years, the reports have undergone numerous revisions in content, reporting coverage, and reporting frequency. These revisions resulted from a variety of factors, including the deregulation of retail deposits, the introduction of new deposit instruments, and changes in economic and banking conditions. The current version of the report, the Monthly Survey of Selected Deposits (FR 2042), collects data on amounts outstanding, interest rates, frequency of compounding, and minimum balance requirements for NOW accounts, savings deposits (including MMDAs), and time deposits. For banks that offer more than one interest rate on NOW or savings accounts, the survey requests data for each interest rate offered. For time deposits, data are collected by maturity category. The monthly survey also collects the total level of IRA/Keogh deposits. The report is collected from a stratified sample of about 575 BIF-insured commercial and savings banks.[18]

The Federal Reserve uses these data, in conjunction with information from other reports such as the detailed deposits report (FR 2900), in the conduct of monetary policy. Specific uses include constructing and interpreting the monetary aggregates, forecasting growth of the monetary aggregates, measuring elasticities in money demand equations, assessing the changing behavior of commercial and savings banks in pricing deposit accounts, examining the pricing behavior of weak institutions and those operating in economically depressed regions, and assessing the interest rate risk exposure of depository institutions.

On the third Thursday of each month, aggregate FR 2042 data are published in a special supplementary table in the weekly money stock release (H.6).

Until 1989, the report collected the most common interest rate paid on the largest dollar volume of NOW and MMDA accounts. However, with the elimination of minimum balance requirements that occurred in stages under deposit deregulation, by the late 1980s

---

[18] An annual supplement (FR 2042a) collects information on the fee structure of NOW accounts and checkable savings deposits and on the rate and penalty structure of time deposits.

many depository institutions were paying different rates based on the level of balances maintained. With its scope limited to the most common rates paid, the FR 2042 no longer provided sufficient information for the construction of adequate measures of deposit pricing and structure. Consequently, under the 1989 review of the series, the "most common rate" approach was abandoned and replaced by the more comprehensive tiering approach. Under the regular triennial review schedule, the FR 2042 was last evaluated in 1991. At that time, the need for the tiering information was reaffirmed.[19]

DISCUSSION

While the completion of deposit deregulation ended the one-time deposit shifts that occurred, components of the monetary aggregates retain substantial sensitivity to differences in interest rates across categories of deposits, and between deposits and competing assets. Continued collection of timely data on the pricing of deposits remains vital to analysis of current trends in the monetary aggregates.

Since most institutions now offer several different rates on NOW accounts and checkable savings deposits such as MMDAS, the Federal Reserve continues to consider it necessary to collect tiering information in order to measure the range of rates offered to depositors and forecast monetary growth. The spread among rates can be significant within individual depository institutions, in particular at those institutions that have branch offices in a variety of geographic locations. The tiering information also provides insight into the pricing patterns of these various deposits, patterns that cannot be observed from the most common rate paid.

[19] At the same time, other revisions were made to the report, in part to make it compatible with recent changes to Regulation D and the significant reduction in item detail of the FR 2900, and in part to strengthen the Federal Reserve's ability to interpret the reported interest rates.

V. Examination Policies: Examiner Guidance and Training

EXAMINATION FAIRNESS

RECOMMENDATION

Consider whether third-party arbitration should be available within the examination process.

BACKGROUND

Some institutions have expressed concerns regarding the fairness of the examination process and have recommended review of disputed examination findings by a non-agency arbitrator. Each agency has established procedures for review of examination findings. When an institution disagrees with the examiner's findings it can appeal to its supervisory office. The appeals process does not delay any enforcement and supervisory decisions being pursued by the agency. The supervisory office makes the decision as to whether a dispute is material enough to warrant review by the senior management officials. Also, each agency reviews its own examiners' decisions.

DISCUSSION

From the perspective of a regulated institution, an independent review of examination findings by a non-agency arbitrator may give the appearance of a more objective process.

Reviews by senior management officials at the regulatory agencies, however, are made by impartial employees who do not directly participate in the examination of the institution. The agencies believe that requiring a review by a non-agency arbitrator could compromise the effectiveness of the regulators' supervisory process. Review by an Administrative Law Judge is available if an institution disagrees with agencies' enforcement decisions.

It appears that review by a non-agency arbitrator would actually add to regulatory burden of the examination process, rather than reduce it. Furthermore, institutions already have adequate examination review avenues and protections if they disagree with an examination or action flowing from it.

SIZE OF EXAMINATION STAFF

RECOMMENDATION

Match the number of examiners and number of examinations in a given year to bank staff and resources. The number of examiners performing an examination sometimes outnumbers bank employees (as might occur in a training situation).

DISCUSSION

Implementing this recommendation would help ease some of the burden of an examination, if it were feasible to make such changes. On-site examinations are scheduled with sufficient staff to expedite the examination process while providing quality reviews of the institutions. The realities of scheduling groups of examiners, coupled with the need to perform various types of examinations (commercial, compliance, trust, electronic data processing, visitations, etc.) make it difficult to perform all required examinations with a minimum number of employees. All of the agencies strive to minimize the disruptions caused by the examination process to the extent possible. Thus implementation of the recommendation is not feasible.

LOAN CLASSIFICATIONS

RECOMMENDATION

Do not classify any loan that has been current two continuous years, is properly collateralized, and where the borrower has not borrowed money for 12 months.

BACKGROUND

Recently there has been criticism of regulators for being overzealous in the classification of loans.

DISCUSSION

In order to address the broad concerns of overzealous regulation, particularly of real estate loan classifications, the agencies issued a series of interagency policies and clarifications in March and November 1991 to provide guidance to examiners and bankers alike. Examiners have been required to document in reports of examination that classifications follow these interagency policies. In addition, to promote consistency with the interagency guidelines on the evaluation of real estate loans and with related examination policies and procedures, the federal regulatory agencies established a random review or audit program, particularly encouraging appropriate use of appraisals in the loan evaluation process.

Notwithstanding these developments, the regulatory agencies do not believe that strict, inflexible guidance on the classification of loans is advisable. To the contrary, the agencies encourage examiners to evaluate a broad range of factors in coming to a conclusion regarding classifications. These factors include, but are not limited to the following: possible adverse economic conditions that may negatively impact collateral values; cross pledging of collateral; projected cash flow sources and uses; financial situation of the guarantors; other outstanding financial obligations of the borrower; and compliance with loan agreements and operating losses. Focusing only on those areas described in the comment may not provide an adequate assessment of the overall condition of a particular loan or the portfolio.

Other Recommendations

I. Bank Secrecy Act Requirements

INTRODUCTION AND BACKGROUND

Beginning in 1970, Congress, at the urging and with the support of the Treasury Department and other law enforcement agencies, enacted a succession of laws to enhance the detection and prosecution of criminal activities which generate large amounts of illegal proceeds, and the related laundering of those proceeds. Included among these laws was the Currency and Foreign Transactions Reporting Act, known informally as the Bank Secrecy Act (BSA), enacted in 1970 and codified at 31 U.S.C. 5311 et seq. As set forth in Section 5311 of the BSA, it was Congress' purpose "...to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings."

In exercising its regulatory authority, Treasury has been acutely concerned with striking an appropriate balance between the needs of law enforcement and the costs to the financial community of compliance with reporting and recordkeeping required by BSA regulations. Under the authority of the BSA, Treasury's regulations impose four major reporting requirements.

One of these reports, the Currency Transaction Report (CTR), directly affects banks and non-bank financial institutions, including securities brokers and dealers, currency dealers or exchangers, funds transmitters and the U.S. Postal Service with respect to the sale of money orders. The CTR requires designated financial institutions to report to Treasury cash transactions involving in excess of $10,000. Persons, including banks and financial institutions, importing or exporting currency and certain monetary instruments in excess of $10,000 are required to file the Currency or Monetary Instruments Report (CMIR). Finally, persons subject to the jurisdiction of the United States are required to file an annual report to the Internal Revenue Service regarding their foreign financial account relationships with an aggregate value in excess of $10,000 on the Report of Foreign Bank and Financial Accounts (FBAR).

In addition to these reporting requirements, the BSA imposes extensive recordkeeping requirements on banks, financial institutions, non-bank financial institutions, currency dealers or exchangers, brokers and dealers in securities, and casinos. Generally, and where financial institutions are concerned, these records may be those made in the ordinary course of business and must be retained for a period of five years. Obviously, if no record is made in the ordinary course of business of a transaction with respect to which records are required by the BSA to be retained, then such a record must be prepared and preserved for the specified period of time.

One of the central goals of the BSA is to ensure the creation and preservation by financial institutions, and the availability to law enforcement, of a paper trail to reconstruct the financial dealings of criminals, including money launderers. Because criminal activities, and drug trafficking in particular, generate large amounts of currency, the BSA meets its goal by requiring entities and/or individuals to create the described reports and records which enable law enforcement to relate cash, by its very nature fungible, to specific criminal activities and persons.

Recognizing and simultaneously wishing to sabotage the attainment of this goal, criminals and their associate money launderers constantly change their financial practices in order to evade the BSA's reporting and recordkeeping requirements and to subvert the creation of the paper trail critical to effective law enforcement. Accordingly, these reporting requirements have been modified where and when necessary to confront and combat the changing nature of financial crime and, in particular, money laundering.[20]

Because the laundering of criminally derived proceeds requires avoidance of (or fraudulent) BSA reporting and recordkeeping, money launderers "structure" their transactions in amounts below the $10,000 reporting threshold. Thus in 1986 Congress defined as a criminal offense the act of structuring transactions to evade the currency transaction reporting requirements of the BSA. (31 U.S.C. 5324). In a further effort to curb the structuring of transactions, Congress took two additional steps in the 1988 Anti-Drug Abuse Act.

First, in recognition of the fact that launderers purchase monetary instruments rather than deposit funds into the financial system in order to evade reporting requirements, Congress required that financial institutions record certain information regarding the purchases of certain monetary instruments in currency in amounts between $3,000 and $10,000, inclusive.

Next, recognizing that launderers will frequently move their structuring operations from one geographic region to another in order to obscure their trail from law enforcement, Congress authorized the Secretary of the Treasury to issue "Geographic Targeting Orders." Pursuant to these orders, the Secretary may require that financial institutions in a specified region and for a period not to exceed 60 days, unless renewed, report all transactions involving currency at an appropriate level as specified in the order. (31 U.S.C. 5325 and 5326).

[20] In 1986 Congress passed the Money Laundering Control Act, which defined as a crime the laundering of the proceeds of, and the knowing participation in monetary transactions involving property derived from, specified unlawful activities. (18 U.S.C. 1956 and 1957).

BSA GUIDANCE FOR BANKS

RECOMMENDATIONS

Provide clear and simple guidance as to the requirements of the Act and simplify the report forms.

Grant more autonomy to financial institutions with the use of a strong "know your customer" program.

BACKGROUND

Historically, the Department of the Treasury has always been concerned with providing clear and simple guidance to bankers regarding the requirements of the Bank Secrecy Act. In June 1972, one month before the BSA regulations came into effect, Treasury's Office of General Counsel published a general summary of the new regulations. This publication contained an overview and the text of the BSA statute, its implementing regulations, reports and report instructions. Additionally, and because a banker confronted with a customer bearing large amounts of cash and proposing a complex transaction may need immediate guidance, Treasury staff are available during business hours for telephone consultations. On a given business day, dozens of such consultations are provided to the financial community.

Separately, Treasury staff provide private letter rulings to financial institutions requesting guidance as to the operation and requirements of the BSA. In order to ensure consistency and uniformity in advice provided through private letter rulings and telephone consultations, Treasury has recently installed a computerized correspondence system. Through this system, Treasury staff are able to retrieve from this computerized system, private letter rulings on most BSA issues which have been addressed by Treasury. Because recurring questions indicate a need for industry-wide guidance, Treasury monitors these requests whether made by phone or letter and publishes responsive Administrative Rulings. These are widely disseminated through bank regulatory agencies, publication in the Federal Register, and through correspondence and provide clear and definitive guidance as to BSA requirements. Seven such Administrative Rulings are currently published as an Appendix to the BSA regulations, 31 CFR 103.

In its continuing effort to provide guidance to the financial community, in 1988 the Department of the Treasury published an Exemption Handbook which provides very detailed guidance to banks regarding the exercise of exemption authority. As set forth in greater detail below, the BSA regulations vest financial institutions with the authority to exempt from the $10,000 reporting requirement certain customers.

Finally, and perhaps most important, staff members of Treasury's Office of Financial Enforcement speak at numerous conferences and conduct BSA training seminars and workshops sponsored by various bankers' and other professional associations, law enforcement and even foreign governments and professional associations.

The steady decrease in the number of requests for guidance attests to the effectiveness of Treasury's program of telephone consultations, private letter rulings, Administrative Rulings, publications and public speaking and training. In 1990 approximately 1,008 requests for private letter rulings were received from financial institutions. Only 632 such requests were received in 1991. In 1992, only 561 requests were received as of October 15.

DISCUSSION

Treasury has been and is acutely concerned with striking an appropriate balance between the needs of law enforcement and the costs to financial institutions of compliance with the BSA. Treasury recognizes that banks, as the financial system's initial recipients of cash from whatever source derived, are in the front line in the war against drug traffickers and their money launderers. As such, they are best situated to "know their customers" or to identify potential money launderers. Accordingly, Treasury strongly encourages banks to formulate, adopt and implement strong know your customer policies.

More important, perhaps, the BSA regulations, as previously noted, vest banks with the authority to exempt from the $10,000 currency reporting requirement and to establish a higher reporting threshold for certain domestic retail merchants including, among others, grocery stores, sports arenas, bars, restaurants, hotels and licensed check cashing services or any public utility. 31 CFR 103.22 (2). Exercise of this authority requires the exercise of considerable discretion on the part of banks. In the exercise of this authority, banks are encouraged to closely review their customer's account records over a period of two or more months in order to determine an exemption level which is commensurate with the legitimate business activity of their client.

Before establishing an exemption, the bank is required to prepare a statement in which the affected customer is fully identified and which describes the nature of the business in question, records appropriate taxpayer identification number(s) and contains the customer's attestation as to the accuracy of the information contained therein.

Finally, as part of its continuing effort to ensure a balance between law enforcement's needs and the burden imposed on the financial community, Treasury has maintained an ongoing review of the regulations and reporting forms since the enactment of the BSA regulations. Through this ongoing and long-standing process Treasury has sought to ensure the effectiveness of the regulations and reporting forms and has made numerous reviews to both over the years. Treasury is currently engaged in a comprehensive review of the BSA regulations and reporting forms to ensure that they maximize benefits which outweigh costs to society; set performance, not prescriptive, standards; incorporate market mechanisms; are clear and certain so as to avoid litigation; and avoid unnecessary burdens on affected financial institutions.

RAISING THE CTR THRESHOLD

RECOMMENDATION

Raise the BSA reporting threshold from $10,000 to as high as $50,000.

DISCUSSION

Treasury recognizes that raising the threshold could result in the filing of fewer reports by financial institutions on transactions conducted by certain legitimate businesses, and notes commenters statements that a smaller Treasury financial database would be more manageable and, therefore, more productive for law enforcement intelligence analysts. In its review of the BSA regulations and forms, the current reporting threshold of $10,000 will be closely considered.

Treasury notes, however, that under the BSA regulations banks may, after a close screening, raise the reporting threshold of a wide range of retail and other businesses to a level that is commensurate with their legitimate activity. 31 CFR 103.22(2). This approach secures for both banks and Treasury the advantages of an elevated reporting threshold for retail and other businesses: it elevates the reporting threshold and thus ensures a trim financial database by avoiding the filing of superfluous reports regarding routine transactions by high volume cash businesses which may be of low utility to law enforcement. Simultaneously, by requiring a close review of customer accounts and the recording of identification and other data, this approach ensures that financial institutions adopt and implement good "know your customer" programs.

SIMPLIFYING THE CTR FORM

RECOMMENDATION

Revise the CTR form to eliminate some of the required information and to make the provision of other data optional.

BACKGROUND

Commenters note that some information required to complete the CTR is difficult to obtain, imposes a burden on legitimate customers, and creates a public relations problem. Others have commented that past revisions have created further burdens by requiring additional information which increased the costs of form processing and employee training.

DISCUSSION

Treasury recognizes, and the CTR form makes provision for, certain circumstances in which some information cannot be obtained. As set forth in the CTR instructions for item 3 - Excluding Certain Identifying Information - appropriate boxes in this item should be checked if a bank is reporting transactions by an armored car service, a mail deposit or shipment, a night deposit or ATM transaction, or multiple transactions where none of the individual transactions exceeds $10,000 or the exemption limit. In these cases, a bank need not complete Items 4 - 15 of Part I of the CTR, but is encouraged to provide whatever responsive information it has.

Treasury also recognizes that certain persons may not have forms of identification generally accepted by banks for cashing checks for non-depositors. In response to requests for guidance in such cases, Treasury has issued private letter rulings and an Administrative Ruling (92-1) instructing financial institutions to develop strong "know your customer policies" which make specific provision for, and specify the alternative documents to be used in, the identification of such customers. For example, Treasury has informed many financial institutions that, in cases involving the elderly, a social security, medicare or medicaid card, along with another document that contains the customer's name and address (for example, a real estate tax assessment or an auto registration) may be used as means of verifying identity. If upon reviewing those documents described in the bank's know your customer policy, and any other available information, the bank is certain that the person is who s/he says s/he is, the financial institution may accept the transaction and is instructed to note on the CTR "elderly" or "disabled" customer and the method used to verify identity.

Treasury will, in its review of the BSA and its reporting forms, consider whether all required information is essential to law enforcement and whether some of that data may be duplicated in other records kept by financial institutions. Generally, and because of the difficulties inherent in tracing transactions in cash to their ultimate beneficiaries, the detailed information that is considered burdensome by banks is necessary to law enforcement efforts. Without detailed information investigations may be stymied if not altogether frustrated.

CTR REPORTING EXEMPTIONS FOR SMALL BANKS

RECOMMENDATION

Banks with a low volume of CTR filings should be exempted altogether from reporting, or should be permitted to file quarterly.

DISCUSSION

The majority of financial institutions have what might be considered a "low volume" of CTR filings per year. A wholesale reporting exemption for such banks would provide launderers with unfettered access to the U.S. financial system. Effective, pro-active law enforcement requires timely and accurate information. Dated or stale information provided in quarterly reports would force law enforcement to react after the fact to prosecute, as opposed to blocking, criminal activity. Finally, even assuming that only relatively few financial institutions were qualified as exempt from CTR reporting requirements, reporting exemptions as proposed by commenters would render those banks "safe havens" for criminals and money launderers.

Conversely, Treasury does appreciate that smaller financial institutions may more keenly feel the effects of a regulation and has taken this into account in its recent proposed regulations for mandatory magnetic filing and mandatory aggregation. Under the proposed rule for mandatory magnetic filing, only financial institutions that file in excess of 1,000 CTRs per year will be affected. Only those banks with deposits of over $100 million and all non-bank financial institutions regardless of asset size, would be required to have manual or computerized systems for aggregating certain currency transactions.

PREPARATION OF CTRS

RECOMMENDATION

Shift the reporting burden from banks to the customers.

DISCUSSION

Effective law enforcement requires timely and accurate information. While reports prepared by customers at the time of conducting a transaction might not impair the timely transmission of reports to Treasury, it would certainly undermine the accuracy of those reports prepared by launderers and their agents, or recalcitrant customers. Any person wishing to circumvent the requirements of the BSA, for whatever purpose, would disregard filing requirements or fabricate information. Finally, Treasury would be powerless to ensure compliance because the BSA does not authorize the enforcement of filing requirements against customers.

FEEDBACK ON BSA UTILITY

RECOMMENDATION

Provide more feedback on BSA utility.

BACKGROUND

Several commenters have criticized Treasury for lack of feedback on the uses and utility of, as well as the law enforcement successes won as a result of, BSA data. Such feedback, according to these commenters, would serve as a graphic demonstration of the need for, even justify, the filing requirement. Some commenters are concerned that the information on the reports is rarely used for true law enforcement purposes and that the government is not properly managing the information provided.

DISCUSSION

The regulated industry has long been requesting feedback on the use and effectiveness of CTR reporting. Admittedly, increased information on the utility of CTR information could increase public understanding of the utility of, and enhance support for, CTR filing. Treasury has taken steps, and will continue to do so, to disseminate information regarding the use and utility of BSA data. For example, Treasury is testing an electronic bulletin board which may be accessed through a computer terminal and modem. Initially, the bulletin board will be used to disseminate BSA related information to and receive inquiries and comments from financial institutions. Separately, Treasury's Office of Financial Enforcement published an article entitled "Sharing Bank Secrecy Act Information With States" in the December/January 1992 edition of the Civil Remedies in Drug Enforcement Report, a newsletter of the National Association of Attorneys General with wide distribution. Treasury officials from the Office of Financial Enforcement, the Financial Crimes Enforcement Network (FinCEN) and the Criminal Investigation Division of the Internal Revenue Service will address a conference sponsored by the Washington Chapter of Internal Auditors. The focus of this conference, entitled Money Laundering -- How to Avoid Criminal Transactions, will be on the operation and utility of the BSA and other legal and regulatory measures in combatting financial crimes in general, money laundering in particular.

In a further effort to disseminate information regarding the use and utility of BSA data, Treasury's Financial Crimes Enforcement Network (FinCEN) publishes and disseminates on a quarterly basis FinCEN TRENDS, A Bulletin of Financial Crimes and Money Laundering. The April 1992 edition of this publication included a Q & A section regarding the filing of CTRs and other BSA issues, reported on then current trends in money laundering activity, and provided statistical information regarding the number of money laundering cases prosecuted by the U.S. Department of Justice, including cases involving money laundering offenses based on violations of the BSA. The quarterly edition of this publication appearing in the summer included articles on "Telltale Signs" to identify money laundering and the operation of the BSA's $3,000 rule (which requires the identification of persons purchasing certain monetary instruments for cash in amounts between $3,000 and $10,000, inclusive).

In order to ensure the widespread law enforcement use of and benefit from BSA data, Treasury has negotiated six memoranda of understanding with the states of Arizona, California, Florida, Illinois, Maryland and New York. Pursuant to these memoranda, tapes containing certain BSA reports originating in those states are provided to appropriate authorities on a regular basis. This initiative ensures that BSA data is used by state and local law enforcement in their official proceedings.

EXEMPTIONS

RECOMMENDATIONS

Revise the exemption process, for example, through simplification or elimination of the process; standardization (such as a formula for calculating exemption limits); expansion of the types of businesses that qualify for exemption; unilateral exemptions for multiple and multifaceted businesses; leaving to banker's discretion the monitoring of exemptions; automatic exemptions for government agencies; deletion of domestic banks from exemption list; and granting exemptions based on tax identification number instead of account number.

Periodically update the exemption handbook to include official and unofficial interpretive information.

Protect banks making reasonable efforts to comply from civil and criminal liability.

DISCUSSION

Exemption authority was included in the BSA regulations precisely because Treasury recognized that many commercial entities are cash-intensive and that reports on their currency transactions might be of little utility to law enforcement. Treasury has traditionally encouraged banks to fully and judiciously use this authority to establish higher currency transaction reporting thresholds for eligible accounts. For example, in September 1988, Treasury issued letters to fifty banks which had been identified, following extensive research, as the "top filers" of CTRs. Upon close review of filings by these financial institutions, their clients' accounts which appeared to fall within Treasury's guidelines for exemptions were identified. Treasury's Assistant Secretary for Enforcement wrote to the Chief Executive Officers of each of these financial institutions advising them of Treasury's finding and encouraging these banks to consider whether these customers' accounts could be exempted.

Similarly, Treasury has historically worked to both simplify and to clarify, wherever required, the process for exempting customers. For example, in 1988 Treasury published and widely distributed its "Exemption Handbook" in which the process for exempting customers was explained in detail. In January 1989, Treasury issued Administrative Ruling 89-1 in which it authorized banks to establish a single dollar exemption limit for certain groups of accounts belonging to the same customer.

Because the BSA regulations require that exemptions be tied to an existing account, a bank could not, prior to this ruling, grant one exemption for a group of existing accounts of the same customer. This ruling, however, simplified the exemption process by permitting banks to apply to the IRS for additional authority to grant a single exemption for groups of existing accounts of the same customer. Thus, for example, a single customer who owns four fast-food outlets, each with its own account, may be the subject of a single exemption, as opposed to four separate exemptions. This reduces considerably the amount of paperwork required by the bank and dramatically simplifies the exemption process.

An additional benefit of the Exemption Handbook and Administrative Ruling 89-1 is the standardization of exemption procedures. While Treasury is cognizant of and is considering recommendations for further standardization of the exemption process, it urges and will exercise caution.

While the recommendation that a simple mathematical formula be devised for calculating exemption limits is worthy of consideration, it must be carefully analyzed. So too those recommendations that Treasury authorize automatic exemptions for government agencies, not require banks to maintain lists of exempted domestic banks from exemption lists, and permit exemptions based on tax identification ("TIN") as opposed to account numbers.

Generally, Treasury's experience has been that neither hard and fast rules nor mathematical formulas are adequate in the application of the BSA regulations, including exemption procedures, to the myriad situations which course through financial institutions. Rather, the very nature of the financial services industry requires, and Treasury encourages, the judicious exercise of discretion by bankers.

Indeed, the current regulations regarding exemptions vest bankers with considerable discretionary authority to grant exemptions. To ensure the judicious exercise of that authority, bankers are required to review account histories, make a determination what exemption limit is commensurate with legitimate commercial activity of their customers, or the authorized activities of their government agency clients, and periodically monitor exempted accounts for changes in circumstances. Except as noted above in the discussion of Administrative Ruling 89-1 permitting a single dollar exemption for certain group accounts belonging to the same customers, bankers may only exempt "existing accounts" as opposed to "customers." The same law enforcement interest in the judicious exercise of bankers' discretion applies here: a wholesale exemption for all accounts belonging to a single customer, as recommended by some, is rife with potential for abuse and money laundering. This recommendation, if acted upon, would absolve bankers of any need to judiciously exercise their discretionary authority when granting exemptions.

In view of the scope of the law enforcement interests and concerns at stake, Treasury could not lightly reduce the exercise of this discretion to the application of a standardized mathematical formula, or by creating a wholesale exemption for government accounts, or by permitting exemptions for customers rather than for "existing accounts."

MANDATORY AGGREGATION

RECOMMENDATION

Reconsider proposed rule on mandatory aggregation of transactions.

BACKGROUND

Many commenters expressed concern that the proposed regulation on mandatory aggregation of transactions is burdensome and if adopted would require additional implementation time. Suggestions include aggregation by account number as opposed to individual; a $1,000 - $1,500 aggregation limit; and elimination of "on behalf of" information on transactions under $10,000.

DISCUSSION

This proposed regulation is still under consideration. These and other suggestions, comments and recommendations have been fully considered and, where appropriate, will be reflected in any final rule which may issue.

MANDATORY MAGNETIC FILING OF CTRs

RECOMMENDATIONS

Allow additional lead time to develop system capabilities before requiring certain financial institutions to magnetically report CTRs.

Provide appropriate software to the industry to facilitate compliance.

Allow magnetic filing to be optional.

Provide for direct electronic submission of CTRs.

DISCUSSION

The proposed regulation to which these recommendations relate is still under consideration. These and other suggestions, comments and recommendations have been fully considered and, where appropriate, will be reflected in any final rule. It is worth noting that Treasury has had in place since March 1987 a pilot program to test proposed magnetic media filing of CTRs. As of September 1992, 379 banks were participating in this program, up from 336 in June of the same year. In calendar year 1992 and up through the end of August, 2 million CTRs were filed by magnetic media by participating banks, up from 1,511,000 CTRs magnetically filed in 1991 and 168,000 in 1989. Treasury estimates that this magnetic media filing program has saved the financial services industry approximately $11 million in 1991 alone. The success of this pilot program opens many possibilities, including consideration of the option of electronic filing in the future.

FUNDS TRANSFERS

RECOMMENDATIONS

Revise the Treasury's proposed regulation on funds transfers because the cost outweighs the benefit to law enforcement.

Change the record retention requirements.

Provide a threshold dollar amount for transactions to be covered by the regulation.

DISCUSSION

The proposed regulation is still under consideration. These and other suggestions, comments and recommendations have been fully considered and, where appropriate, will be reflected in any final rule that Treasury may issue.

GEOGRAPHIC TARGETING ORDERS

RECOMMENDATION

Continuation of a geographic targeting order should be contingent on certification by the requesting federal or state law enforcement official that the information already received is proving to be useful and no less than two weeks or 10 business days notice should be given to an identified bank to permit implementation of adequate procedures.

DISCUSSION

Treasury is cognizant that any targeting order increases the reporting and recordkeeping burden of affected financial institutions. Treasury welcomes and will carefully consider any recommended measure that would eliminate any unnecessary burden and ensure that any burden imposed is fully matched by a corresponding benefit to law enforcement.

Treasury submits that Section 103.26 of the BSA regulations limits the issuance or continuation of geographic targeting orders to those cases where additional recordkeeping and/or reporting is necessary to prevent persons from, or detect those who are, evading the requirements of the BSA. Wherever possible Treasury will provide as much lead time as possible for implementing new reporting procedures. Indeed, in the two cases where such orders have been issued, Treasury provided exactly one week, from the issuance of the targeting order, for the initiation of the new reporting requirements.

Obviously, any lead time which is provided must be consistent with, and ensure the attainment of, the underlying objectives of law enforcement. One of the purposes of the geographic targeting order provisions of the BSA is to provide law enforcement with a tool to surprise and to capture the activities of launderers structuring their transactions. Because launderers seek to avoid the scrutiny of law enforcement by moving their operations from one area to another, any order issued must ensure the element of surprise without unduly burdening the affected financial institutions.

MONETARY INSTRUMENT LOGS

RECOMMENDATION

Abolish the requirement to log sales of monetary instruments, since the same data may be obtained from CTRs and/or other bank records, or simplify the log entry requirements.

DISCUSSION

Section 6185(b) of the Anti Drug Abuse Act of 1988 (31 U.S.C. 5325) prohibits financial institutions from issuing or selling certain monetary instruments in amounts of $3,000 or more in currency unless the financial institution verifies and records the identity of the purchaser as prescribed by regulation. The legislative history indicates that Congress felt that there was a need for heightened scrutiny over the sale of bank checks, cashier's checks, money orders and traveler's checks. This is because evidence established that money launderers commonly purchased these instruments for amounts under $10,000 in order to evade the reporting requirements of the BSA. In sum, this legislation and the implementing regulation issued by Treasury were specifically designed to combat a particular method of money laundering: structuring, or "smurfing", of transactions in order avoid the scrutiny of law enforcement.

In issuing its implementing regulation, the so-called $3,000 rule, Treasury took into account that certain information might already be contained in bank records. Thus, for example, the final rule provides that, for accountholders, a financial institution may either verify the fact that the customer has a deposit account or verify the identity of the accountholder. (31 CFR 103.29) This permits financial institutions to verify identity of accountholders either by reference to bank records or by viewing a piece of identification that contains the customer's name and address.

In general, however, the rule assumes that information as required by the final rule would not, in the ordinary course of business, be recorded regarding sales of monetary instruments to non-deposit accountholders or, for that matter, deposit accountholders. This information, for non-deposit accountholders includes social security number, date of birth, name and account numbers of any third party beneficiary, date of purchase, branch where the purchase occurred, the type, dollar amount(s) and serial number(s) of instrument(s) purchased, the amount in currency, and the payee(s) on each of the instrument(s) purchased.

Recognizing that certain information regarding deposit accountholders may, indeed, be held in other bank records, the rule requires less information for such purchasers. Required information includes: the purchaser's name and account number, the date of purchase, branch where the purchase occurred, the serial number(s) and dollar amount(s) of each instrument bought.

Failure to record this information would impede financial investigations and defeat Congress' intended purpose of detecting and deterring money laundering smurfs who structure their transactions to evade the BSA and other anti-money laundering laws. Finally, and in response to commenters' suggestion that information required by the $3,000 rule may be found in CTRs, the log recordkeeping requirement is intended to capture information regarding currency transactions which, because of the way in which they have been structured below the $10,000 threshold, would not require a CTR.

EXEMPTING LOW-VOLUME FINANCIAL INSTITUTIONS

RECOMMENDATION

Exempt financial institutions with sales volume of monetary instruments under a specified threshold.

DISCUSSION

Treasury is cognizant that the volume of monetary instruments sold for cash by a given institution will vary. It does not follow, however, that the likelihood of structured laundered transactions is necessarily lower in low-volume banks. Quite the contrary, creating an exemption geared toward the volume of monetary instruments sold by a given bank would effectively create a class of financial institutions to be targeted by launderers as ideal for their money laundering purposes. Law enforcement intelligence indicates that launderers would have no problem in locating the institutions for which logs would not be required. This would establish an approved vehicle for "smurfing" activities involved with laundering illicit funds through the purchase of monetary instruments. In sum, the elimination of log requirements for only a portion of the financial community is not a viable option.

COVERAGE OF TRAVELER'S CHECKS

RECOMMENDATION

Exempt traveler's checks from the rule.

BACKGROUND

One commenter recommended that Treasury not include traveler's checks among the monetary instruments that must be logged. The commenter states that, because traveler's checks are sold in such small denominations, they are not likely vehicles for money laundering.

DISCUSSION

Like the preceding recommendation, this suggestion, if implemented, would create a class of monetary instruments which would become the favored vehicle for money launderers. This is particularly true in light of the fact that travelers checks, along with money orders and other monetary instruments, are currently used in money laundering operations. Moreover, small denomination purchases, in the large volumes required to move the large amounts of cash generated by drug trafficking, are not a deterrent to smurfs. Rather, these frequent small transactions and the related costs are simply part of the overhead, "the cost of doing business" for narcotics trafficking and money laundering organizations. In sum, exempting travelers checks from log recordkeeping requirements would not serve, but rather disserve, the interests of law enforcement.

RECORD RETENTION

RECOMMENDATION

Reduce the record retention period for BSA records from five to three years.

DISCUSSION

Reduction of the current record retention requirement would create difficulties for law enforcement. There currently exists a gap in the time periods for record retention (5 years) and the statute of limitations (6 years) for pursuing enforcement action for violations of the act or regulations. Thus, reduction of the record retention period would further complicate Treasury's pursuit of enforcement actions against entities violating the BSA and its implementing regulations.

While this problem is not insurmountable, it does require that both issues be considered and resolved in tandem.

COST OF COMPLIANCE

RECOMMENDATION

Reduce the cost of compliance with BSA.

BACKGROUND

Several commenters expressed concern about the cost of compliance with the BSA, particularly with respect to filing reports, and training and testing of personnel. Various estimates were provided regarding the cost of filing a CTR. Some felt that small institutions are disproportionately burdened by the costs of reporting and recordkeeping as required by the BSA.

DISCUSSION

The cost of compliance depends on numerous factors such as the size and staff of an institution, its commitment to compliance, management capabilities and the institution's policies, procedures and training programs. These factors are routinely considered and taken fully into account when considering new regulations and reviewing comments thereon.

CIVIL PENALTIES

RECOMMENDATION

Reduce civil penalties in certain circumstances, especially for good-faith mistakes or situations that require policy interpretation.

DISCUSSION

In the Anti-Drug Abuse Act of 1986 (31 U.S.C. 5321), Congress substantially increased the penalties for noncompliance in support of national efforts to control money laundering and deter activities that generate illicit funds. Any change in the penalty structure would undermine this intended deterrent effect and require statutory and regulatory amendments.

When a civil penalty action is necessary, Treasury can and does mitigate penalties when appropriate. In exercising its authority to impose civil penalties, Treasury takes into account numerous mitigating factors, including the financial institution's history of compliance, whether its current compliance policies and programs are sufficient to ensure future satisfactory BSA compliance, management's attitude toward compliance, implementation of corrective action, whether or not the disclosure of BSA violations was voluntary or discovered in the course of an examination, positive efforts to assist law enforcement, including the reporting of suspicious transactions, and the financial stability of the institution.

SUSPICIOUS TRANSACTION REPORTING

RECOMMENDATION

Revise the rules for reporting of suspicious transactions.

BACKGROUND

Commenters expressed concern about the process of reporting suspicious transactions, such as damaging relationships with honest, long-term customers; liability for reporting a transaction later deemed to not violate the law; and the definition of a suspicious transaction.

DISCUSSION

There is currently no requirement to report suspicious transactions. Treasury does, however, encourage such reporting and the Right to Financial Privacy Act (RFPA) has been amended to permit such reporting within specific guidelines and without any risk of RFPA violations. Because such reporting could, and is encouraged to, occur without the customer's knowledge, the risk of damaging relationships is minimized. It is further minimized by the fact that honest, long-term customers would, presumably, rarely if ever be the subject of such a report. Finally, Treasury has taken several steps, both before and following the amendment to the RFPA, to assist financial institutions in recognizing and reporting suspicious transactions.

First, in May 1988, before the RFPA was amended, Treasury issued a letter to the Chief Executive Officers of leading financial institutions in which it identified six frequently observed characteristics of international money laundering schemes. Separately, in Administrative Ruling 88-1, issued in June of the same year, Treasury provided financial institutions with specific guidance on how and to whom to report suspicious transactions. Finally, throughout the years, Treasury has through speeches to banking associations, presentations at bank compliance seminars, and publications, sought to inform banks about the commonly observed characteristics of suspicious transactions.

REGULATING NON-BANK FINANCIAL INSTITUTIONS

RECOMMENDATION

Treasury should focus on the unregulated aspects of second and third tier financial services provided by non-bank financial institutions.

DISCUSSION

Treasury is cognizant that financial services are widely available not only from traditional banks but also from second and third tier non-bank financial institutions. Treasury is equally aware of and sensitive to the fact that banks are highly regulated by Treasury, and federal and state bank regulatory authorities, in contrast to non-bank financial entities which often operate without licensing requirements and, with the exception of the BSA as enforced by Treasury and the Internal Revenue Service (IRS), free of federal and often state regulatory oversight.

Precisely because of the foregoing, Treasury and its bureaus, in particular the IRS, have engaged in extensive outreach work to the non-bank financial services industry. Treasury has worked in many fora to encourage state regulators to more affirmatively and aggressively regulate those non-bank entities now subject only to Treasury and IRS BSA oversight. Separately, in speeches and seminars to check cashers associations and other such professional organizations, Treasury has taken affirmative steps to educate this sector of the requirements of the BSA and the utility of strongly enforced know your customer policies and practices.

More important, perhaps, the BSA regulations promulgated by Treasury have taken the non-bank financial services sector fully into account and imposed regulatory requirements wherever appropriate. This is equally true of currently proposed regulations regarding funds transfers and casinos which impose requirements specifically tailored to wire transmitters and casinos, respectively.

II. Recommendations That Concern Other Agencies

COMMODITIES FUTURES TRADING COMMISSION

1. CFTC should accept disclosure and reporting requirements OCC imposes on collective investment funds.

DEPARTMENT OF LABOR

1. Rulemaking should be initiated to establish fiduciaries' obligations in proxy voting.

FEDERAL COMMUNICATIONS COMMISSION

1. Standards for investment advisor advertising should be established by rulemaking.

2. 13f reporting should be eliminated or reduced in scope or frequency.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

1. Do not apply Real Estate Settlement Procedures Act requirements to investment properties that are not owner occupied.

2. Require disclosures concerning transfer of mortgage servicing rights at the time of transfer rather than at the time of mortgage application.

DEPARTMENT OF JUSTICE

1. Lower the threshold for investigation and prosecution of embezzlement.

2. Establish standard policies and procedures for response by United States Attorneys to uniform criminal referral form (12 C.F.R. § 21.11-Reports of crimes and suspected crimes).

IV. CONCLUSION

This report has provided an examination of the complex issue of regulatory burden. Chapter I presented an historical context, and Chapter II discussed general findings. These findings were based on extensive internal reviews of agency policies and procedures plus a study of public comments and testimony. The internal reviews involved several person years of effort, and the external analyses produced hundreds of pages of testimony and comments on all aspects of regulatory burden. The result has been a comprehensive look at policies, procedures, recordkeeping, and documentation for monitoring and enforcing compliance with banking laws under the jurisdiction of the agencies.

Chapter III reviewed a list of proposals for regulatory changes arising within the agencies and from the external comments and testimony. Many of the suggestions involved statutory requirements over which the agencies have no authority. Thus, although at first glance the opportunities for eliminating excessive burden through regulatory action seem endless, a closer look narrows the scope considerably.

Many of the suggestions received during this study arise indirectly from legislative requirements that the banking agencies are required to implement: for example, requirements for periodic examinations of all depository institutions regardless of financial condition; detailed operational standards; requirements for independent auditors to expand the traditional scope of financial audits; and consumer legislation that specifies complex and lengthy disclosures.

During 1992, the agencies acted on many suggestions for regulatory improvement, particularly on reporting, examination, and application processes. They plan to continue working on identified areas for regulatory streamlining in 1993 and beyond. Much of the remaining burden arises, however, from legislative mandates, and additional relief from regulatory burden may require statutory changes which are not the focus of this report.

The FFIEC has identified through the course of this report some issues for further consideration by the regulatory agencies in implementing regulations. These are discussed more fully as part of the general findings at the end of Chapter II. A few of the more noteworthy items are highlighted here once again.

Flexibility

Banking regulation should provide flexibility by tailoring requirements to specific facts and circumstances and by distinguishing among institutions according to meaningful criteria. Regulations that provide insufficient flexibility can cause unnecessary regulatory burden. Inflexible regulation also creates inefficiencies by preventing depository institutions from finding the most cost-effective means of complying. Distinguishing among institutions based on variables such as their condition and size seems to present opportunities to improve the efficiency of regulation.

Micromanagement

Regulation also should not undertake micromanagement of depository institutions. A risk of any regulation is dictating behavior of affected institutions in costly and counterproductive ways. Overly detailed regulation can create inefficiencies by preventing the institutions themselves from responding appropriately to regulatory requirements and changing conditions.

Consumer Protection

Consumer protection regulations produce the greatest frequency of complaints from regulated institutions, possibly because these regulations seem to change most often. A significant number of such requirements are mandated by statute, however, and the agencies can do little to reduce burden in such instances. Laws such as Truth in Lending, Expedited Funds Availability, Electronic Fund Transfer, and Truth in Savings are detailed in their provisions and, for the most part, the regulations track the statutory provisions. Therefore, the agencies have no power to alter many requirements that impose regulatory burden. At the same time, substantial changes, which can occur only through legislation, are likely to be controversial because of the strong interest in protecting consumer rights.

Independent Commission

An independent, nonpolitical group or commission charged with exploring possibilities for easing regulatory burden through broad political consensus could also be helpful. Such a commission could have limited life, be free of political partisanship, and be charged with making a comprehensive examination of all aspects of regulatory burden, especially that burden imposed through legislative mandates.

Finally, the Council's member agencies have agreed to continue meeting to identify and recommend possible statutory changes to further reduce regulatory burden. The Council hopes to prepare a separate report on those issues in the Spring of 1993.

Appendix A:
Summaries of Public Comments on Regulatory Burden

Appendix A:
Summaries of Public Comments on Regulatory Burden

Summary of Comments Received by the FDIC

Overview

A total of 421 comment letters were received. The comment letters were almost exclusively (398 total) from financial institutions, the vast majority of which are small institutions. Other commenters included an accounting firm, several individual attorneys, thirteen state or national bankers or mortgage bankers associations, and two state regulatory agencies.

Regulation O   46 comments

Comments regarding Regulation O generally indicated that this regulation was designed to prevent unsound banking practices and has turned into a regulation to exclude insiders from using their own bank. Commenters argued that directors and bank officers are scrutinized very carefully and their financial worth is determined in the same way as that of any other customer, so they should not have lending limits placed on the dollar amount they can borrow. A frequent comment was that it is difficult enough to hire and retain quality officers, and that Regulation O exacerbates this problem. Commenters felt that officers are treated like "second class" citizens, not even having borrowing power as a "regular" person. Commenters were concerned that it would reflect poorly on an institution if the CEO were forced to get a loan with a competing financial lender rather than through his own institution. This was stated as being particularly true in smaller banks located in rural communities. An additional complaint was that the regulation is very difficult to understand and that it is costly in time and effort to comply with while serving little valuable purpose.

Bank Secrecy Act/Currency Transaction Reports   70 comments

Commenters indicated that many costly hours per week are spent tracking down $1,000 transactions. Banks also spend time and money on filling out the currency reports, training employees the procedure, etc. One commenter stated "In today's economy, $1,000 is peanuts, and to have to log them all is excessive and unnecessary." According to the commenters small banks and ones in rural areas are particularly unlikely to be indirectly involved in money laundering as most know their customers very well, rendering the Act unnecessary. The last "add-on" of logging all "official" checks over $3,000 was considered to be just one more burden imposed on the industry at great expense and potential penalty, in order to catch a few. Several commenters felt that this "law enforcement" belongs to law enforcement agencies, not banks. Several commenters suggested that if the Act is to stay in place, compliance would be made much easier if there was some software program available to transmit the data electronically rather than having to document everything on paper.

Expedited Funds Availability Act/Regulation CC 38 comments

Each of the letters said essentially the same thing. Commenters argued that the costs (expensive machines, paperwork, etc.) don't justify the result - as most (small) banks feel that they were in compliance in the first place because they gave immediate credit at the transaction. It was recommended that only those banks that have had a problem in the past with holding funds should be required to go through the process. Several commenters stated that since the majority of banks have never delayed the availability of funds for any customer, there is no need for the regulation. It was argued that if a particular bank imposed an unnecessarily long hold on a customer's deposit, the customer would quickly become disgruntled and move his account to another local bank which does not place holds on deposits.

Flood Insurance 10 comments

Most commenters indicated that the flood insurance requirements are expensive and inconsistently administered. Some argued that there is no historic record indicating that a bank has ever sustained a loss of either principal or interest on a mortgage loan by flooding then they should not have to go through the documentation process.

Consumer Compliance - General 37 comments

Comments in this category were either with regard to compliance generally or indicated specific consumer protection regulations but made no specific complaint other than general burden. Almost all of the commenters expressed frustration over the time and expense involved in complying with consumer regulations. A pervasive opinion among the commenters was that little or no benefit is derived from the regulations, which they find burdensome. Many commenters indicated that although the banks expend considerable costs providing disclosures to customers, the customers most often throw them in the wastebasket before they even leave the bank. One commenter stated that he could make a better return on assets if not burdened by "totally ridiculous rules and regulations imposed by Congress." Another indicated that 10 percent of his employees' and 20 percent of his executives' time was spent keeping abreast and complying with regulations. Concern with the time and costs involved in educating employees was reiterated by several other commenters.

Some commenters expressed concern for the consumers who ultimately pay for the bank's need to comply with the regulations, both in increased third-party costs and in increased processing times. One commenter indicated that whereas it used to take an hour to complete a real estate loan, it now takes a day, due to increased regulation.

It was also suggested that there are ample regulations on the books to keep banks running the way they are supposed to, and that rather than adding more regulations for all banks to comply with, attention should be focused on the few banks that are causing the problem. One commenter opined that expanding laws and regulations leads to more jobs and expenses to banks and the government.

Several commenters expressed concern over the burden compliance regulations place on small banks, suggesting that, if the burden continues, there will be no small, community banks. One commenter summed up the general attitude of these letters saying that while bank customers want to be treated fairly, the small, independent bank needs to be treated fairly, too.

Fair Housing Act/12 C.F.R. Part 338 15 comments

Commenters consistently indicated that the regulation should not apply to small banks in rural communities because maintaining the necessary logs adds considerable operating expenses in trying to comply, and that the results received from small bank logs are immaterial.

Home Mortgage Disclosure Act/Regulation C 52 Comments

Most of the commenters mentioned the burden in time and cost incurred in complying with HMDA and Regulation C. The costs are passed on to the customers and impact on the banks' capital and productivity. Several commenters criticized the requirements as redundant. The usefulness of the data collected was questioned by many, with one commenter noting that the Federal Reserve will collect several times more data under new HMDA than it has collected on any other subject in its history. The disclosures were generally not seen as beneficial to consumers, who probably do not read or understand them.

Several letters suggested changes which would make certain exemptions for banks which have branches, but not the main offices, in Metropolitan Statistical Areas. One commenter complained about the application of certain requirements to his small non-MSA institution. It was also recommended that smaller banks be exempt from the requirements of HMDA and Regulation C. (Threshold sizes of $25 million and $50 million were suggested.) One commenter agreed with the intent of HMDA, but thought competition should be allowed to solve the problem; another indicated that community banks, by virtue of their charters, do not need HMDA regulations.

Homeownership Counseling 5 Comments

The consensus was that the time and expense required to monitor and send these notifications far exceeds any possible benefit. Several commenters indicated that some banks have people who receive these notices every month, and many receive dozens over the life of loan. It was suggested that an annual notice to borrowers with troubled loans would suffice.

Americans With Disabilities Act 7 comments

It was recommended (1) that for banks with less than $500 million in assets that the ADA be drastically reduced or eliminated due to the great non-financial regulatory burden, (2) that the facility requirements should apply to financial institutions which have not been constructed, and (3) that buildings that have already been completed should be grandfathered in. The costs of revamping existing bathrooms was cited as a specific example of the drain on the funds of a bank.

Electronic Fund Transfers/Regulation E   3 comments

Commenters were non-specific, indicating that compliance is expensive and unnecessary.

Equal Credit Opportunity/Regulation B   7 comments

One commenter stated: "It is difficult for us to understand the necessity of maintaining records of an applicant's sex and ethnic origin. Today the public is aware of their perception of discriminatory practices and would proceed to register their non-acceptance of the situation. Unless there is some historical evidence of the practice, eliminate the documentation." Other commenters basically reiterate this statement.

Truth in Lending/Regulation Z   66 comments

Regulation Z was described as one of the most confusing and unclear regulations. Bankers felt that, although developed with good intentions, it has been completely overdone to the point where it is impossible to determine whether or not they are in compliance. A frequent complaint was the cost of complying, including the cost of all the necessary disclosure forms. Commenters pointed out that the cost of complying is affecting the cost of credit to their borrowers. Over half of the commenters felt that the right of rescission was totally unnecessary and only amounted to increased cost. Several commenters indicated that they had never had a borrower rescind the transaction during the three-day waiting period. Finally, several commenters indicated that the disclosure requirements, and lack of tolerance, had resulted in them being unable to offer certain types of credit, including adjustable rate mortgages. One commenter indicated that disclosures for adjustable rate mortgages were so burdensome that his bank was precluded from making them. This same commenter indicated that he has a plan for making adjustable rate mortgages that would satisfy both the customers concern about increasing payments and the bank's concern about future costs of funds, but he cannot make the loans because he cannot figure out how to disclose to the satisfaction of the regulators.

Real Estate Settlement Procedures Act (RESPA)   38 comments

Nearly all commenters indicated that having to provide the Good Faith Estimate of settlement costs at the time of application was burdensome. According to the commenters, applicants are more confused with all the disclosures required than they would be without them. The process needs to be simplified for the benefit of all concerned. Many of the forms must meet special printing requirements that are costly and seldom ever reviewed by anyone but examiners. Customers appear to primarily be interested in settlement costs, and rarely inquire about other documentation. One commenter indicated that "This exercise seems totally absurd to me because it is time consuming, costly and benefits absolutely no one." Another indicated that he found that borrowers pay no attention to the disclosures required because they are so numerous and confusing.

One commenter stated that while the information may be beneficial and serve a worthwhile purpose, the requirement of providing this upon application goes too far as it requires the banks to complete the information and provide the disclosures including monthly payments, etc., even on those loan applications that will be declined. The commenter noted that there are occasions when upon receipt of the applications, it is immediately known by the bank that they cannot make the loan. It was suggested to provide these disclosures only upon approval of an application with some minimum time before closing the loan in order that the customer may review the details.

The required disclosure statement regarding transfer/sale of loan/servicing rights was specifically mentioned by five of the commenters. This information is also required upon filing of an application. The commenter suggested that providing this disclosure only upon approval would save unnecessary time and expense. The commenter also suggested that such forms not be required in circumstances where a bank has never transferred a mortgage loan nor has any intentions of doing so.

Community Reinvestment Act/Regulation BB 242 comments

In addition to FDIC-supervised institutions, comments were received from 1 state Department of Insurance and Finance, 1 attorney, 2 national banks, and 2 state banking associations.

The vast majority of the comments were received from small, rural banks who felt that CRA was not applicable to their institutions. There was a general statement that because they are "community banks," of course they serve their communities, otherwise they would be out of business. Comments generally fell into the following categories:

1) Small bank - 59 commenters felt that CRA was not necessary for their banks because it is in their best interest to "serve their community."
2) Geocoding - 44 commenters either spoke generally of having to geocode their loans or specifically mentioned the new policy on "Geographic Analysis of Lending Patterns."
3) Documentation burden - 43 commenters indicated, generally, that documentation required under CRA is burdensome. 23 commenters specifically stated that either examiners are requiring documentation or that documentation is being kept to show examiners. 14 commenters indicated that the public file and CRA statements are burdens and that no one has ever asked to see the file. 5 commenters indicated that the new rating system and public disclosure has led bankers to keep increased documentation.
4) Twenty-three commenters felt that FDIC examiners are subjective and inconsistent in review of compliance or that the FDIC tries to apply the same standards/expectations to small banks as to large banks. Two commenters stated that FDIC examiners do not know what CRA requires.
5) Thirty-seven commenters made specific statements supporting an exemption based either on asset or community size.
6) Eight commenters suggested that CRA should be done away with completely.
7) Two commenters responded that CRA was only useful to regulators to restrict regulatory approval of a proposed activity.
8) Eleven commenters responded that CRA is vague and ambiguous, difficult to interpret and understood by no one.
9) Eight commenters were insistent that their community is a homogeneous community.

Examination/Regulatory Process 87 Comments

About one-half of the comments said that the frequency of exams is far too high, and that there is too much duplication between the FDIC and the state exams or the Federal Reserve Board, etc. The banks must undergo them all and suggest that it would be much easier to have a much more uniform process of doing so. Other complaints were voiced about individual examiners. Many are "book learned" but have no practical banking experience. They "go by the book" and are not given any flexibility to make some common sense exceptions to the rules. There also were comments that exams have become increasingly hostile and that there is an attitude that the bank is "guilty until proven innocent." Over half of the comments were focused generally on over-regulation/cost, and the feeling was frequently expressed that small banks are being "squeezed."

Assessments - Premiums 20 comments

Consensus among the commenters was that a regulatory system must be developed which effectively allocates regulatory burden and premiums to real risk and quality of the institution. The CAMEL rating system, and a two or three-tiered system based on size of institution were mentioned by some as a more effective way of balancing the burdens. One commenter stated that "There's a limit on how much good banks can pay to cover the losses of the bad."

Call Reports 68 comments

It was generally felt that the time it takes to complete a call report is grossly underestimated, and that a large portion of the information that is gathered is merely for statistical purposes and has little to do with safety and soundness. Several commenters stated that the amount of work involved threatens to overwhelm small banks. It was noted that call reports were 8 pages annually in 1981, and 28 pages quarterly in 1991, and that they need to be simplified, not expanded and complicated. It was suggested numerous times that banks with a CAMEL rating of 1 or 2 should either have to do an abbreviated call report or only be required to do them semi-annually to ease the burden on those "good" banks. A frequent comment was that call reports change too often.

Appraisal Standards 74 comments

Each of the comments said essentially the same thing, that when the outside appraisals were mandated, the cost of them doubled and in many cases tripled, adding considerable cost to the consumer on the price of obtaining a loan. Commenters felt that the requirement to use outside appraisers not only drives up the cost but also the amount of time it takes to get an appraisal as well. At times this delay acts as a deterrent to increased borrowing. On a positive note, a large portion of those who commented about the appraisals said that they were very glad to see that the figure was raised from $50,000 to $100,000 in order to ease the burden.

FDIC Improvement Act of 1991 71 comments

The comments were universally negative. One commenter said he was thoroughly disgusted by the passage of FDICIA. Another thought that FDICIA was an example of regulatory burden being created by Congress rather than the regulators. The commenters noted that FDICIA requires some 60 new regulations, and at least four commenters characterized this as "regulatory overkill." Specific comments addressed Truth in Savings (TIS) which commenters believe will be overly cumbersome and drive up expenses without any significant benefit to consumers. One commenter believed that if banks had to be subject to TIS that competitors such as mutual funds which offer savings products should likewise be covered or banks will suffer an unfair competitive disadvantage. Other commenters believed that the new limits on loans to insiders will make it harder to attract competent people to serve on bank boards.

Miscellaneous 44 comments

Commenters addressed a wide variety of concerns including capital requirements, "mark-to-market" accounting requirements, lender liability under environmental protection and cleanup laws, increased civil money penalties and the effects of same upon bank executive recruiting and retention, the impact of the National Historic Preservation Act in branch applications, new requirements for external audits, conversion fees, and requirements for written policies. Also included in this category were general comments about over-regulation/burden where specific examples were not provided.

Summary of Comments Received by the FFIEC

Introduction

The Federal Financial Institutions Examination Council (FFIEC) received 448 comment letters concerning regulatory burden. Approximately 100 letters were from community groups; the remainder were from depository institutions. Approximately 95 letters contained general complaints about regulatory burden and did not refer to a specific regulation. In the remaining letters, the most frequently mentioned legislative Acts were the Community Reinvestment Act, the Federal Deposit Insurance Corporation Improvement Act, the Bank Secrecy Act, the Home Mortgage Disclosure Act, and the Financial Institutions Reform Recovery and Enforcement Act.

Several general complaints were made in many of the letters: (1) the lack of clear and consistent definitions in the regulations and between regulatory agencies: (2) insufficient coordination of regulatory agencies at both the federal and state levels; (3) regulations containing language written by and for lawyers that is incomprehensible to lay people; (4) the costs of constantly changing regulations; (5) regulations that are not sufficiently tailored to punish poorly managed institutions while minimizing the burden on well-managed banks; and (6) increasing micromanagement of depository institutions.

Regulation C - Home Mortgage Disclosure Act (HMDA)

Of the sixty-four letters that mentioned HMDA, forty-four contained objections. The majority of the suggestions were for minimizing problems with the validity of the HMDA data and making the process less complicated for consumers. The twenty letters that supported HMDA suggested either strengthening or maintaining the regulations.

Several comments about HMDA focused on the validity of the data. First, the data do not include all the criteria involved in the lending decision, and a denial based on legitimate credit-risk criteria counts against a bank in the HMDA data. Some commenters thought that the requirement that non-MSA loans be recorded as "not applicable" caused problems for banks that must comply with CRA but make the bulk of their loans in non-MSAs. Other commenters felt that the current system of reporting results in distortion of the denial ratios reported by lenders because brokered and correspondent loans are reported differently, penalizing lenders who rely on brokered loans, and that including brokered loans in the HMDA reporting results in the double counting of some loans.

More general complaints about HMDA were that the asset limit ($10 million) is too low and that the regulation leads to de facto credit allocation.

Several letters, all from community groups, argued that HMDA is beneficial because it helps poor people get assistance that would not be otherwise available.

The commenters offered two suggestions to minimize problems with the validity of data: (1) eliminate servicing purchases from HMDA, and (2) if a loan is generated in an office not in an MSA and if the property is not located in an MSA, exempt the loan from HMDA. One commenter suggested, as an alternative to the $10 million asset limit, setting a minimum number of mortgage applications that an institution must handle before having to comply with HMDA.

Other suggestions were that the FFIEC clarify and streamline information required under HMDA and Regulation B and that the FNMA/FHLMC application requirement of FHHLDS be incorporated into HMDA.

Regulation D - Reserve Requirements

Eleven letters contained comments on Regulation D. The most common complaint was that the Federal Reserve does not pay interest on reserves. Specific complaints concerned the Report of Transaction Accounts, Other Deposits and Vault Cash, which is viewed as burdensome and time consuming. Also, reserve requirements for banks below $45 million are well within operating cash needs. Finally, fluctuations in deposits in small banks are so small that they do not seriously alter calculations of M1 and M2. Reducing to quarterly the reporting frequency for banks subject only to the 3 percent reserve requirement was suggested.

Electronic Fund Transfer Act (EFTA) - Regulation E

Seven commenters mentioned Regulation E and proposed four suggestions. The most common complaint was that obtaining consumer cooperation is difficult. After a theft, banks have difficulty getting the cardholder to view pictures of persons using the ATM machine. Also, the statute does not allow enough time to complete investigations of improper usage.

Suggested remedies for these problems included amending the EFTA definition of unauthorized use to include implicit or apparent authority, thereby making the definition uniform with that in Regulation Z. Another suggestion was that the agency provide in Regulations E and Z, model agreements that strike a balance between the rights of consumers and the expectations of financial institutions so that consumers will know that they are expected to act responsibly in safeguarding the credit and access cards issued by the financial institutions. Cardholders also should be required to cooperate with financial institutions to help identify unauthorized users. The investigation periods for Regulations E and Z should be extended to fifteen and twenty-five days respectively to allow time to develop the film, conduct a proper investigation, and thereby minimize the loss to financial institutions.

Lender Liability under Environmental Protection

Seven commenters mentioned lender liability under environmental protection. One estimate was that this lender responsibility increases consumer costs by $2,000 to $10,000 per property. It also discourages lending for reasons that have little to do with safety and soundness. The suggested solution to this problem is to stop holding banks liable for environmental hazards.

Call Reports

The letters contained sixty-one comments and twenty-five suggestions on Call Reports. The most frequent suggestions included consolidating the reports, simplifying them, requiring them less frequently, and tailoring reporting to bank size.

The complaints about Call Reports focused on the complexity of the forms and the frequency with which they must be completed. Small banks complained that they suffer the greatest burden because their resources are limited. Another common complaint is that no comprehensive index of instructions exists for Call Reports. The reports are further complicated by new capital requirements that encourage investing rather than lending. Also, the OMB estimate of completion time is severely underestimated, and, therefore, so is the regulatory burden imposed by Call Reports. To further complicate matters, the feasibility of automating Call Reports is limited by the frequent changing of needed information.

Some commenters suggested that to facilitate the process and to minimize regulatory burden, Call Reports should be submitted along the same schedule as examinations and should be required less frequently of highly-rated banks; changes should be kept to a minimum; and the Call Report for banks with assets of less than $100 million in assets should be simplified. The small farm and small business reporting requirement should be eliminated because the data are not readily available to banks; if the requirement is not eliminated, agencies should provide a guideline or formula for estimating interest and fee income for these loans. Finally, commenters suggested that banks not be required to publish Call Reports in the local newspapers.

The comment letters also noted several parts of the Call Report that should be deleted because the information is reported in other documents: (1) Schedule RC-D, Assets Held in Trading Accounts, and Schedule RC-H, Selected Balance Sheet Items for Domestic Offices, are covered by the Weekly Report of Assets and Liabilities for Large Banks; (2) Schedule RC-O is a duplication of the FDIC assessment form; (3) Schedule RI-D is disclosed in the annual report; and (4) Schedule RC-M, Memoranda, Item 7 is outdated.

Insider Lending

The letters contained thirty-one comments and eleven suggestions on regulations regarding insider lending. Most of the suggestions concerned modifying the rules relating to insider loans and exempting publicly traded bank holding companies.

The letters complained that the regulations impair the ability of banks to acquire good bank officers, limits the participation of quality board members, and requires banks to send its best customers to competitors. Because of these factors, the argument goes, limits on insider loans threaten safety and soundness.

The letters offered several suggestions to alleviate some of these problems: (1) the agencies should make permanent the aggregate limit of 200 percent of unimpaired capital for small banks; (2) publicly traded bank holding companies should be exempted from the definition of insider as they pose no risk to insured depository institutions; and (3) loans that are fully collateralized by the borrower's own funds should be exempted.

Examinations and Evaluations

The letters complained that examinations are too frequent and often duplicative. The redundancy is a particular problem because exams are expensive for the banks. Several letters complained that examiners lack sufficient knowledge of the banking industry and, therefore, require more time of the bank officers. With regard to CRA, some commenters felt that examiners are too concerned with documentation and not with results.

Several letters complained about a lack of coordination among regulatory agencies in the area of examinations. The letters express approval for the OTS and FDIC agreement on examination procedures.

Some commenters suggested that the agencies continue to consolidate examination rules to improve consistency, and that safety and soundness exams and compliance exams be combined into one audit.

Accounting Inconsistencies

Several letters complained that regulatory accounting practices have differed from generally accepted accounting principles (GAAP) in several respects, necessitating two sets of calculations, one for disclosures and one for compliance. Specifically, the market value disclosure of assets under FASB 107 is contrary to the going concern principle of accounting. Also, according to the glossary for the Call Report, SBA loans sold on the secondary market must be recorded under regulatory accounting principles (RAP) not GAAP. The letters suggested that numerous differences between RAP and GAAP be eliminated.

Regulation Y

The comments on Regulation Y focused on reporting requirements, interstate banking restrictions, and risk weight adjustments. Bank holding companies complained that the revised frequency for reporting under Regulation Y-6 imposes a significant burden. Several banks complained about the restrictions on interstate banking, which require them to set up separate legal entities to operate in different states, adding significantly to legal fees.

Several letters offered suggestions about the risk-based capital requirements: (1) all loans secured by real estate should be in the 50 percent risk category without regard to number of units, provided certain economic criteria are met; and (2) home equity loans and second deeds of trust should be treated the same as home loans when the combined debt is less than 80 percent of the market value.

Federal Deposit Insurance Corporation Improvement Act (FDICIA)

The comments on FDICIA focused on several specific aspects of the legislation. The most common complaints concerned Sections 132 (Executive Compensation) and 288 (Notice of Branch Closures). Banks wrote that executive compensation should not be controlled by statute because such control places severe restrictions on hiring qualified employees and constitutes micromanagement of banks by regulators.

Some commenters thought the Section 288 requirement that banks notify regulators ninety days in advance of a branch closing is unjustified because notification is required under CRA. Also, notification of customers individually is expensive, and in most cases distinguishing among customers by branch is impossible. Finally, the closure of a single ATM in an urban area is not likely to inconvenience many people. Suggestions for exemption include urban ATM machines, branches acquired from failed institutions, and instances when a bank is moving one branch or ATM machine within the same market area.

The letters also mentioned Sections 112 (on audits) and 302 (on risk-based deposit insurance premiums) of FDICIA. A letter from a bank holding company suggested that if a binding commitment of strength exists between the holding company and its banks, then financial reporting and capital assessment should occur at the holding company. This procedure would streamline the reporting process, maximize compliance, and minimize regulatory burden.

Flood Insurance

Several letters complain about the problem of flood insurance and bank liability. If a mortgagor decides to cancel flood insurance, the bank must pick up the cost and there is no way to recoup these damages. Often the maps given to banks are not accurate. The letters suggest that the agencies should oppose lender liability for decisions made on the basis of outdated flood maps and plats and should mandate that flood insurance decisions be part of the appraisal.

Regulation Z -- Truth in Lending

Commenters complained about the Truth in Lending Act as one of the most burdensome and least beneficial laws, serving no benefit to the consumer and so complex that it is virtually impossible for a bank to be in full compliance. Some commenters complained that many banks are inadvertently in violation because the disclosure requirements are not clear, that the disclosures are too complex for consumers, and that the disclosure of estimated closing costs is redundant of a RESPA good faith estimate.

One complaint was that there are too many situations when a new disclosure is required. For example, an error in the Fed Box when the right of rescission is involved requires a new disclosure and a new right of rescission--even when the mistake is something as simple as failure to notify the customer that he will not get a refund of a $25 processing fee if the loan is repaid.

Another common complaint concerned the three-day right of rescission required for loans: because there is no "hard sell" for real estate loans, the right of rescission is nothing but a nuisance. Also, during the waiting period, customers do not receive the loan proceeds but are still charged interest.

Suggestions for improving Truth in Lending were: (1) simplify the disclosure forms to make them more understandable and to increase public benefit; (2) clarify and reduce the number of situations that require a new disclosure; (3) include provisions to allow disclosures to be provided within three days of receipt of application; and (4) rescind the right of rescission clause.

Regulation BB - Community Reinvestment Act

The Community Reinvestment Act (CRA) regulations received the most comments. The documentation problem is by far the most burdensome. Several letters complained that the regulation focuses too much on the procedure of documentation and not enough on results. One commenter wrote, "It is possible to provide documentation without making a substantial effort to improve the community." Several commenters noted that although the CRA file is maintained for the public, no one but examiners ever asks to see the file.

Several letters complained about problems caused by examiners. Because the CRA is vague about what constitutes compliance, financial institutions are at the mercy of the examiners to be in compliance. Examiners often require more documentation than is required by statute. For example, the regulation states that banks may delineate communities by political boundaries or demographic areas, but examiners insist that the delineation be defined as the effective area from which a substantial portion of deposits are taken and loans made.

Several letters stated that the CRA is unnecessary because the market provides discipline by rendering unprofitable any business that does not serve the needs of its community. This argument is particularly popular among small banks. Some commenters thought that (1) geocoding, required under CRA, is of limited use to banks and does nothing to verify the creditworthiness of the borrower; (2) spending money marketing loans to those least likely to have the resources to repay is absurd; (3) the law does not consider loans closed or on the books in determining CRA performance; and (4) the amount of time spent on compliance efforts is greater than has been estimated.

The letters proposed a variety of criteria for determining if a bank should be exempt from CRA, including size of the bank (exempt under $100 million asset size), population of the area where the bank is located (exempt banks in small towns or banks operating in a restricted geographical market), history of bank performance (exempt banks with satisfactory performance from constant examination), and the status of state law (exempt banks if they must comply with a similar state law). Other suggestions were to allow satisfactory banks to open branches without regard to CRA considerations and to exempt credit card banks.

The letters also asked for clarification of several aspects of the law and regulation. Specifically, they said that (1) before the results of an examination are made public, inconsistencies between regulators and examiners should be clarified; (2) to avoid conflict with examiners, the definitions of "signed written contract" and "delineated community," as used in the regulation, should be clarified; and (3) the regulation should distinguish between retail and wholesale banks.

Some commenters felt there is a conflict between the requirements of CRA and the risk-based capital requirements, which should be relaxed for CRA loans, and that examiners should reduce the emphasis on documentation.

Approval for CRA

Approximately 100 comment letters came from community groups that support CRA and believe the law has been successful in securing otherwise unavailable funds for low-income neighborhoods. Contrary to the bankers' claim that the market provides the necessary discipline, the community groups maintain that small banks do not do a good job of serving the needs of low-income and minority communities. For example, 83 percent of "less than satisfactory" ratings have been given to banks with assets of less than $100 million, and many community banks have small loan-to-deposit ratios. Some commenters argued that any "safe harbor" would hurt efforts to rebuild communities and would make banks less sensitive to community needs, and that CRA "provides a conscience for the banking system." Self-certification by banks would be unacceptable.

These commenters also maintained that banks exaggerate the costs of compliance, that many banks waste money on unnecessary CRA consultants, that banks are at the beginning of the learning curve for CRA and problems with compliance should lessen in the future, and that regulators need to develop appropriate and effective compliance tools for banks.

Regulation CC -- Expedited Funds Availability

The most common complaint about Regulation CC was that it threatens the ability of banks to manage losses, which in turn threatens safety and soundness. Many banks stated that they were already allowing next-day availability for funds and that the regulation requires needless recordkeeping.

More-specific complaints concerned "local items"; the definition of the term in the regulation is too broad to allow receipt of local items within the allotted two-day time period.

The letters contained two suggestions for reducing bank liability: exempt large denominations from next-day items to reduce forgery and fraud, and allow next-day availability of Treasury checks only when deposited at a branch.

Title XI FIRREA--Appraisal Standards

The letters contained many complaints about the requirement that banks use outside appraisers; commenters felt that outside appraisers are unreliable, slow, and in most cases impractical and that they have less knowledge about land values than do local bankers. Several commenters argued that the requirement limits community development by making real estate loans too expensive, imposes excess cost for no reason, and, by making credit cost prohibitive, conflicts with ECOA, HMDA, and CRA. Some commenters thought the threshold level for Title XI appraisals is too low and that residential real estate appraisals over the years have not been a problem.

Along different lines, some commenters thought the agency relationship between banks and mortgage companies prohibits banks from capitalizing the premiums for servicing rights under GAAP and that this was not the intention of the statute.

The letters offered several suggestions for solving the problems identified: (1) the agencies should raise the threshold level for Title XI appraisals; (2) the appraisal requirements should be limited to commercial property only; (3) properties with low loan-to-value ratios should be exempted; (4) banks should not be required to review appraisals; (5) it should not be required that the lender engage the appraiser as long as the appraiser is qualified; and (6) the language that requires a mortgage company to be an agent of the bank should be replaced with language that permits a mortgage originator to order the appraisal regardless of whether it is a supervised institution.

Bank Secrecy Act--Currency Transaction Reports

A number of letters complained about the uselessness of the information--that it is Treasury information gained at the banks' expense, is not used very often, and serves no preemptive purpose for law enforcement. Some commenters thought that the paperwork is particularly burdensome for small rural banks and that the fines for inadvertent mistakes are excessive. Another common complaint was that the minimum reporting requirement has not been adjusted since it was set in 1970.

The subject of exemptions was mentioned frequently in the letters. There was no consensus on the list of exemptions.

Suggestions for streamlining and simplifying the process included the following: (1) raise the minimum amount to account for inflation; (2) reimburse banks for the cost of gathering the data; (3) incorporate the CTR into the Fedline System; and (4) to minimize the amount of time required by bank personnel, require reporting for non-customers only.

Some commenters suggested having the customers fill out the forms to save time, and reducing the amount of information on CTRs.

Americans with Disabilities Act

No letters spoke against the spirit of the Americans with Disabilities Act; several, however, complained about the cost and practicality of applying the act to ATM machines. Some commenters thought that the term "visually impaired" is not clearly defined and pointed out that the solutions to some visual impairments are not applicable to all. Some letters complained that the use of an audio-equipped ATM for the visually challenged raises concerns about privacy and security and also that the requirements of the law necessitate designing a new ATM machine, which is very costly.

Bankruptcy Laws

One letter offered several specific suggestions about bankruptcy laws: (1) amend Section 707(b) of the Federal Bankruptcy Code to permit third-party challenges to a Chapter 7 filing, based on the debtor's earning sufficient regular income to permit repayment of debts under a Chapter 13 plan; (2) do not limit Chapter 13 repayment plans to sixty months; (3) allow creditors to seek payment from co-debtors automatically in Chapter 13 cases for balances not covered in the recovery plan; and (4) if a creditor obtains an Exemption of Discharge, require the debtor to pay the creditor's legal expenses.

Other suggestions were to require attorneys to advise debtors about debt management counselors instead of proceeding immediately with bankruptcy procedures and to require that all open-end creditors of the debtor be notified of a bankruptcy filing, including creditors with which the debtor has a zero balance.

Homeownership Counseling

Banks must send a notice within forty-five days of each delinquency which advises the homeowner that he can call HUD for counseling. However, HUD will counsel only those homeowners whose mortgage payments are three months past due and to whom a foreclosure notice has been sent. Commenters suggested that banks should not have to send the notice if counseling is not available. Currently, a notice is sent each time a mortgage payment is missed. If a payment then arrives on time, the cycle begins again, and another notice is sent the next time a payment is missed. It is argued that this second notice is costly and unnecessary.

Consumer Credit Regulations

Commenters suggested that Fair Housing, ECOA, HMDA, and CRA be condensed into one equal-credit regulation, with reporting requirements tailored to the size of the community and a complaint process clearly available to monitor noncompliance.

Regulation B -- Equal Credit Opportunity Act

Several letters pointed out apparent contradictions between ECOA and HMDA. ECOA generally forbids the collection of data on race and gender, but HMDA requires the collection of this information. The effects test creates the burden of arbitrary regulatory examination and opens avenues for needless litigation.

The letters suggested that the record-retention time be shortened to twelve months.

Adverse Contracts Proposal

Commenters thought that the current FDIC proposal regarding adverse contracts, if accepted, would disrupt service agreements and require that they be renegotiated. The commenters indicated that the proposal contradicts Section 4(c)(1)(c) of the BHCA, which permits holding companies to establish service corporation affiliates to create economies of scale.

Real Estate Settlement and Procedures Act (RESPA)

The complaints concerning RESPA focused on problems with providing the disclosures: The Mortgage Servicing Disclosure Statement is costly and of little benefit prior to change of servicing, and when a new real estate project is being offered, the volume of applications is so large that it is impossible to meet the three-day period for disclosures.

Suggested solutions for these problems are to allow five days for provision of the "settlement costs" booklet and the "good faith" estimate and to eliminate disclosure requirements for refinancing.

Regulation DD -- Truth in Savings

Several of the letters mentioned Truth in Savings, but there were no suggestions or complaints that did not appear in the comments received by the Board. Therefore, no detailed notes on the comments are included here. Sixty-six people mentioned Regulation DD and twenty-five offered suggestions.

Miscellaneous

General suggestions for improving the regulatory environment included having sunset provisions for all regulations; establishing a tiered regulatory system that matches resources with compliance requirements; and imposing a semiannual limit to changes in a given regulation.

One letter offered several suggestions about the frequency of various reports: money supply figures should be reported weekly; balance sheets should be filed monthly; BC and BL series reports should be filed quarterly; and FC-1 and FC-2 series should be filed monthly.

Summary of Testimony at FFIEC Hearings

Overview

The Federal Financial Institutions Examination Council held three hearings on the burden of bank regulation in 1992--on June 18 in Kansas City, Mo, on June 19 in San Francisco, Calif., and on June 25 in Washington, D.C. A total of seventy-nine witnesses--representatives of three regional bankers associations, twenty-six regional and state bankers associations, several municipal and state examiner offices, and several community groups and also three private individuals--presented testimony.

Insider Lending

Eleven witnesses commented on regulations regarding lending to insiders. Most bankers associations felt that the restrictions on insider lending would severely limit recruitment of competent directors. Banks would lose either good directors or good loans or both, forcing dedicated directors to go to competitors for loans. Bankers contended that directors are being treated as "second class borrowers" instead of being shown deference as reliable borrowers and leading business people, which in most communities they are.

Suggested reforms included repeal of the limitations on insider lending and a higher lending limit. One banker asked that the regulatory agencies develop a standard approval form.

Bank Secrecy Act (BSA) and Currency Transaction Reports (CTRs)

Five witnesses commented on the Bank Secrecy Act or the Currency Transaction Reports required by that Act. Comments focused on the awkward role of "policeman" that banks play through the use of currency transaction reports. Bankers from small communities complained about the staff time and cost required to fill out CTRs on individuals who have historically been good bank customers. Several bankers expressed frustration about the lack of Treasury Department followup on transactions that were reported according to BSA requirements.

Bankers suggested that BSA requirements be limited and that CTR forms be simplified. The role of policeman should be returned to the Treasury and Justice Departments, because laundered money or drug money is rarely discovered through the use of CTRs.

Regulation CC -- Expedited Funds Availablilty Act

Regulation CC was mentioned seven times in the testimony. Bankers from small communities commented that Regulation CC merely codified practices already in existence but increased operating expenses related to printing new forms and training staff on compliance. For some community bankers, implementation of Regulation CC put holds on some deposits that had never had them before.

Several witnesses also expressed concern about loss from fraud. Regulation CC provides inadequate protection for banks and should reflect the banks' exposure to financial risk. A cost-benefit analysis to determine the need for this regulation was suggested.

Consumer Compliance--General

Many bankers groups commented that consumer compliance regulations have evolved from well-intended congressional mandates into unwieldy and onerous regulatory procedures. Taken individually, consumer regulations are manageable burdens, but taken together they become difficult to implement, often because they are highly technical or contain contradictory dictates. The time spent on consumer compliance is diverted from the paramount concerns of safety and soundness and community lending. One banker estimated that 16 percent of bank board of directors meeting time is devoted to compliance issues. Many associations provided time and dollar estimates of the costs of compliance.

The comments indicated that the time involved in reviewing amended regulations, training staff on compliance, reprogramming computer software, and redesigning forms is significant; one estimate showed that 20 percent of officer time is devoted to compliance. Costs of consumer compliance include expenditures on new software to handle new regulations, expenses for developing and printing new disclosure forms, mailing costs, costs of subscriptions to publications about compliance, compliance seminar fees, and fees for outside attorneys, auditors, and consultants.

Bankers argued that the consumers ultimately pay the cost for increased consumer compliance through lower savings rates, higher interest rates on loans, and increased fees. Thus, the benefit of consumer protection is more than offset by the costs to the bank, which may be passed on to consumers.

Finally, several witnesses complained that banks are at a competitive disadvantage relative to nonbank institutions because such institutions--insurance companies, AT&T, and GM, for example--do not face as many consumer compliance regulations. According to the bankers, banking products are uncompetitive compared with mutual funds, which offer higher rates that do not reflect compliance costs.

Community groups expressed dissenting views that the benefits to society outweigh the costs to banks. Several community organizations stated that without specific consumer compliance regulations, such as the Community Reinvestment Act requirements, low- and moderate-income neighborhoods would not receive needed loans. Contrary to bankers' suggestions, community groups insisted on the maintenance or strengthening of consumer compliance regulations.

Specific recommendations to minimize the burden of compliance included holding seminars sponsored by federal regulatory agencies to teach bankers how to comply effectively with consumer regulations, allowing adequate time for compliance, and reducing supervision for banks that have a two-or-three-year record of good ratings. One community group called for establishment of a consumer compliance division and toll-free consumer complaint number at each regulatory agency.

In all, eleven consumer compliance comments and suggestions were offered. The most common suggestion was modification or elimination of duplicative regulations.

HUD Requirements and Fair Housing Act

Seven witnesses commented on HUD requirements or the Fair Housing Act. One banker cited HUD's retroactive escrow reporting requirements for mortgage loans as an example of the constantly changing regulatory demands on banks. The cost to his $120 million bank to make the necessary changes was $30,000. One representative of a large bank complained that the data required in the Fair Housing Home Loan Data System (FHHLDS) are identical to those required under the Home Mortgage Disclosure Act (HMDA). Another banker complained that the new HUD disclosure requirements bring to forty-two the total number of disclosures provided to FHA applicants.

Reforms suggested ranged from simplification of HMDA and FHHLDS to elimination of FHHLDS because of the burden of duplication and the difficulty in assessing race and gender via telephone or mail-in applications. A general suggestion was to review and revise FHA and other federal housing programs.

Home Mortgage Disclosure Act (HMDA)--Regulation C

Both community groups and bankers associations commented on the burdens and benefits of HMDA. Eighteen mentions of HMDA, including comments and suggestions, were made in testimony. Of the five suggestions, four supported no change to the regulation, or at least no further weakening.

Bankers focused primarily on the extensive reporting requirements mandated by HMDA and the new geocoding requirement issued by the FFIEC. A concern of small institutions was the lack of scale economies in data collection, which places an inordinate burden on community banks. One banker also complained that regulator-suggested computer software was incompatible with the reporting requirements of the regulation.

Community groups across the board agreed that HMDA facilitated their efforts in getting banks to lend in low- and moderate-income neighborhoods. According to the community groups, HMDA helps banks find their "problem areas" and provides data that community groups use to analyze lending patterns of large banks. Community organizations encouraged the extension of HMDA analysis to include state and regional breakdowns, and one group asked that the "Reasons for Denial" category be made mandatory.

Bankers' suggestions included requesting the regulators to curb reporting requirements and to establish a de minimis exemption rule.

Homeownership Counseling

One bankers' association testified on homeownership counseling and cited a lack of consumer interest. The costly notifications sent to delinquent borrowers rarely resulted in counseling. The association therefore recommended that the requirement to mail counseling notifications be scaled back to once or twice a year for delinquent accounts, instead of forty-five days after each delinquency.

Equal Credit Opportunity Act (ECOA)--Regulation B

Regulation B or the Equal Credit Opportunity Act was mentioned five times in testimony. Several bankers stated that ECOA is duplicative, as its requirements are mirrored in HMDA and CRA requirements. One community group complained that enforcement of ECOA has been "pitiful."

Bankers associations suggested that the ECOA requirement for demographic information be combined with HMDA requirements into one regulation. An alternative proposed by another banker was uniform disclosure forms for ECOA, Truth in Lending, and the Real Estate Settlement Procedures Act (RESPA).

Truth In Lending

Truth In Lending was mentioned sixteen times in the testimony. Five of the six suggestions were for simplified disclosure requirements. Bankers cited the complexity of disclosures, which led some banks to limit the range of loan products offered, and the right of rescission, which few people exercise but which irritates consumers because of the three-day delay in loan disbursement. Also, many consumers are subjected to information overload because of the number of required disclosures. The need for early disclosure of adjustable-rate mortgages was also questioned, because of the possible changes in the quoted rate, complicating an already difficult shopping process. Bankers stressed that consumers simply want to know "What is the rate?" and "How much do I pay per month?"

Some commenters thought that the regulatory requirements have gone far beyond the intent of the original law. Several reforms were suggested: use of simpler, streamlined disclosure forms written in layman's terms; elimination of the right of rescission; elimination of the fifteen-year historical example; improvement in the past-trend index; and use one disclosure instead of an initial and an amended disclosure.

Real Estate Appraisals

Real estate appraisals were mentioned eight times. Bankers associations complained that the new real estate appraisal standards make mortgage lending more expensive and time consuming. Inflation of appraisal fees has led some bankers to start in-house appraisals, taking valuable officer time away from lending. Not only have appraisal fees increased to almost double in many towns, but some rural counties don't even have certified appraisers. Small communities also may not be able to comply with the "comparables" rule, because real estate turnover is low or because no other buildings of comparable size or worth exist in a given region. One bankers group stated that new standards work against the spirit of another federal regulation, namely the CRA.

Bank trade associations asked that the $100,000 de minimis rule be kept intact, and even raised for the most highly rated banks, and that the rule not be extended to mortgage refinancings.

Real Estate Settlement Procedures Act (RESPA)

RESPA was mentioned fifteen times, with three suggestions for simplification of disclosures. Complaints about RESPA generally focused on the unnecessary disclosures required by the statute and the confusion that these disclosures cause consumers.

Bankers stated that they should be allowed to mail the RESPA servicing disclosure within three days of receipt of application, and that they should also have the right to decline further disclosures if the loan is declined within three days.

Community Reinvestment Act (CRA)

The Community Reinvestment Act was mentioned forty-nine times in the testimony. Of the nineteen mentions supportive of the current regulation, twelve were suggestions that the regulation not be weakened. Of the thirty mentions critical of CRA, eight were requests that small banks be exempt and six were requests that standards be clarified to make compliance easier.

Many bankers associations and community organizations commented positively on the intent of CRA, but the groups disagreed on the usefulness of the method of implementation. Bankers felt that the CRA documentation requirements showed them to be "guilty until proven innocent," while community groups felt that statistical evidence "proving" discrimination demanded such an approach.

Bankers associations felt pressured by examiners to demonstrate their compliance by developing a sizable CRA file, not through their outreach and loan activity. According to the associations, "CRA examiners reward banks for generating paperwork rather than meeting the community's credit needs."

Representatives of small community banks argued that they do not need the CRA requirements, because they are investing in their communities with or without the statute. According to these banks, if they don't lend in their community, the community dies, and so does the bank. Another complaint from bankers associations was that CRA compliance takes away from safety and soundness activities, especially careful lending, and is threatening credit allocation. They also felt that CRA ratings are highly subjective, sometimes leaving an important bank rating to an inexperienced examiner who has never been in banking. Finally, bankers questioned the need to geocode, as there is no statutory basis for it. Small banks in rural communities also face an inordinate burden because of problems getting non-MSA neighborhood breakdowns.

Community organizations stressed the need to continue CRA examinations. According to them, the public is served well by having CRA in place, and CRA also enables banks to discover their weak lending areas. A 1990 study by one community group showed that the highest concentration of lenders with the poorest rating was in Los Angeles. CRA led to development of low-interest revolving loans and other profitable loan products geared toward low-income individuals. The cost of CRA compliance works out to $3-$4 per loan, according to one community group. Community groups argued that a de minimis rule for community banks with assets of less than $100 million and rural banks with assets of less than $250 million would exclude 90 percent of all banks. The argument that community banks serve their community is also a fallacy, as 83 percent of the poorest CRA ratings in 1991 were given to small and rural banks.

Bankers proposed allowing "safe harbor" for banks rated "satisfactory" or better; providing de minimis exemptions (at the $500 million or $1 billion level); allowing for short-form CRA examinations for banks with historically good ratings; eliminating the public CRA file; simplifying and clarifying CRA standards so banks know how to comply; giving relief from geocoding of loan applications; and giving more CRA credit for loans extended in target areas. Finally, one bankers association representative asked that banks in non-MSA areas with fewer than five branches be exempted.

Changes to the CRA suggested by community groups included not allowing a "safe harbor" for mergers, branching, and acquisitions; extending CRA to include business and consumer loans; and disallowing a de minimis exemption for banks of all sizes.

Examinations and Examiners

Examinations and examiners were mentioned nineteen times in the testimony. Many bankers feel that an antagonistic relationship has developed between bankers and their examiners, in part because of the "zero tolerance" rule that most examiners seem to be using to determine compliance. Bankers feel that examiners are looking to catch banks in noncompliance with the letter of the law, even if they are following the spirit. Several banks were distressed to receive conflicting recommendations from examiners from different agencies, or even from different examiners from the same agency. Lack of coordination between state and federal agencies resulted in duplicative examinations. Four of the eight suggestions were that regulatory agencies coordinate examinations better.

Other suggestions regarding examinations and examiners were matching the number of examiners and examinations in a given year to bank staff and resources; establishing agency liaisons to facilitate communication between regulators and the regulated; and convening a task force similar to the FDIC Call Report Task Force to review the examination process and regulations. Also, several bankers suggested that capital ratios be used to determine the level of supervision and that a broader, expedited application process be developed by the OTS.

Regulatory Process

Banking associations complained about a lack of coordination among the regulatory agencies and the inconsistency in report forms; they noted that with only small modifications, the report form could be made uniform. A common complaint was that because regulatory agencies do not face the economic constraints of efficiency and effectiveness, regulation is undisciplined. Banks feel that the regulatory burden they face places them at a competitive disadvantage relative to nonbank financial providers and is slowly driving community banking out of existence. Finally, bankers associations stressed that the ultimate victim of regulatory proliferation is the banking public itself, and that the Congress is either insensitive to or unaware of the burden that increased regulatory statutes places on "Main Street America."

Bankers suggested changes both to the regulations themselves and to examinations and examiners. One representative of a community group emphasized that regulators "must set clear, consistent, common-sense requirements for compliance." A community banker offered five principles to guide regulatory reform:

1. Is the regulation economically feasible and practical?
2. Are there existing regulations that suffice?
3. Does the regulation allow bankers to be bankers?
4. Is there a sunset provision in the regulation?
5. Will American society be better off?

The most common suggestions were that regulators streamline and unify duplicative regulations and that flexibility be built into regulation. Specifically, bankers asked that the dual banking system be enhanced; that regulation be exception-based rather than universal; that model disclosure forms be designed by agencies (much as the Federal Reserve does); and that identical definitions (for example, definitions for categories of discrimination) be used in all regulations. Also, several bankers suggested that banks be allowed a specified amount of time to correct problems arising from their misapplication or misunderstanding of regulations before they are penalized. Finally, general suggestions regarding the regulatory process included sweeping reform of regulatory agencies into "one good regulator" and state-by-state cost-benefit analyses.

A total of sixty comments were made on the regulatory process. Of the twenty-nine suggestions offered, nine were requests that a modified or tiered regulatory structure be established and five were requests that regulatory agencies make their applications and procedures uniform.

Deposit Insurance Premiums

Six witnesses commented on risk-based deposit insurance premiums. One banker felt that the new FDIC assessment system sets a good precedent by having premiums reflect bank management and capitalization. Several bankers associations questioned the usefulness of subjective examiner input in determining premiums when most examiners have never been professional bankers. One representative of a regional bankers association stated that risk-based capital rules limit lending and perpetuate the credit crunch, because government securities carry a lower risk rating than commercial or personal loans.

Witnesses suggested that deposit insurance premiums be based on capital levels, including a "high water mark" (as flood insurance is), thereby lessening the subjectivity and complexity of the FDIC's new assessment system. An alternative suggestion was that premiums assessments be based on CAMEL ratings. One representative of a large bank asked that bank holding companies be exempt from capital requirements if all subsidiaries hold appropriate capital.

Call Reports

Call Reports were mentioned fifteen times in testimony. Four of the seven suggestions were for fewer requirements or less-frequent reporting. Two other suggestions were that banks not be required to publish Call Reports in the newspapers, as copies can be obtained from banks.

Bankers complained of the excessive and repetitive nature of Call Reports. One bankers association representative complained about the lack of automation of Call Reports and the underestimation by agencies of the length of time required to compete the reports (fifteen to seventeen days per quarter for most banks, according to the commenters).

Suggested reforms included unifying all Call Reports into one report for all agencies; simplifying the Call Report data required; eliminating requirements to report small business and rural lending; and allowing smaller banks to submit a short-form Call Report. Finally, banks suggested that Call Reports be submitted biannually rather than quarterly.

Truth In Savings (TIS)

Although Truth in Savings has not yet been implemented, many bankers associations expressed frustration at the projected cost and burden of this new regulation. Regulation DD was mentioned nineteen times in the testimony. Witnesses stressed that the disclosure of savings rates is already common practice, precluding any need for TIS. As with Truth in Lending, bankers feel that the additional costs that TIS will entail will limit the savings products offered by banks, particularly small community banks. TIS will result in consumer information overload, much as TIL does now.

An industry estimate of the cost of compliance with TIS totaled $278 million. One banker stated that the postage costs for disclosure alone will reduce the rates banks will be able to pay on savings accounts. A specific concern was the APY that will have to be quoted on certificates of deposit that mature within one year: Customers may be confused by the rate on the CD that will be less than the APY quoted. One banker feared that TIS will drive consumers to nonbank competitors which will be able to offer higher rates because they will not incur the costs of regulations such as TIS.

Federal Deposit Insurance Corporation Improvement Act (FDICIA)

FDICIA was mentioned twenty-one times in testimony, with no common suggestions. In general, witnesses suggested limiting the micromanagement of banking and keeping the regulation simple. Through this statute, the Congress is now taking on the unwelcome role of micromanagement. The fifty to sixty requirements mandated by FDICIA will hamstring an already overburdened industry. Specifically, the bank-closing policy and executive-compensation guidelines were criticized as being too intrusive.

Written policies

The testimony included six comments on written policies. Bankers from small communities felt that preparing written policies took a considerable amount of officer time away from their more important responsibilities of loan review, loan-application processing, and other safety and soundness activities. In small communities, written policies are often criticized by examiners for being too brief, inappropriately worded, or lacking in other trivial ways. In a small bank, written policies are not important anyway, because individuals can question the bank president or senior staff directly. Bankers saw little usefulness to written policies, which must be corrected or updated frequently. Community bankers asked that they be exempt from written policies, or that the requirements be scaled back to reflect the time restrictions on community banks, which have smaller staff than large banks.

Miscellaneous

Other comments included concerns about the usefulness and costliness of external audits, marking assets to market, and the exorbitant penalties assessed because of human error in compliance procedures. Banks asked that the interest from their sterile reserves be returned to them or deposited with the Bank Insurance Fund. Regulators were asked to avoid one-size-fits-all loan-to-value ratio standards and not to establish nationwide real estate lending standards. Various bankers asked that GAAP and RAP accounting standards be unified. One executive of a troubled bank applauded the FDIC's "hospital" approach to troubled institutions with a good chance of recovery and asked that the approach be extended. Finally, the witness representing the American Bankers Association asked that all regulatory agencies "honor the spirit and the letter of the Paperwork Reduction Act and the Regulatory Flexibility Act."

Summary of Comments Received by the OCC

Overview

The OCC received 200 comment letters. Of these 175 were from financial institutions, 16 from bankers associations (American Bankers Association, Association of Bank Holding Companies, Community Bankers of Louisiana, America's Best Banks, Independent Bankers Association of America, Mortgage Bankers Association of America, and the Colorado, Illinois, Kentucky, Missouri, Nebraska, New Jersey, Ohio, South Dakota, Texas and Washington State Bankers Associations), and nine from other institutions and individuals (Investment Company Institute, Center for Women's Business Enterprises, Newtrend, Appraisal Institute, E.L. Burch and Associates Bank Consultants, National Association of Realtors, attorneys, and a private citizen.

Community Reinvestment Act (CRA), 12 U.S.C. 2901-2905, 12 C.F.R. 25

One hundred nine comments addressed CRA. Most commenters feel that CRA is intended to address banking services in the more populous, metropolitan areas, and that small/community banks should be exempt. The comments gave two reasons for an exemption - first, the burden of compliance imposes a substantial cost with no commensurate benefit; second, community banks can be relied on to adequately serve the community since the community would not exist without the credit extended by the banks. Many also noted that securities firms, insurance companies and credit unions are not subject to CRA. Some noted that no one had asked to see their files and that no complaints had even been filed. The recently issued FFIEC Community Reinvestment Act Policy Statement on Analysis of Geographic Distribution of Lending was criticized for expanding documentation requirements considerably, increasing costs to financial institutions without a clear return in social benefit. Other suggestions for improvement included establishing a system for the appeal of a rating, elimination of repeat examinations, and reinstituting the pre-FIRREA abbreviated CRA process for banks located outside the MSA.

Fair Housing Home Loan Data System (FHHLDS), 12 C.F.R. 27
Home Mortgage Disclosure Act Regulations (HMDA), 12 C.F.R. 280

Forty-seven comments were received. Eleven comments contended that HMDA is burdensome, time consuming and costly, and provides no benefit to the public.

Twenty-three commenters stated that in light of recent changes to HMDA, the FHHLDS is duplicative and should be eliminated. Five commenters, noting that the FDIC has eliminated the FHHLDS and its log sheets, suggested that other financial institution regulators should also eliminate the FHHLDS requirements.

Specific comments addressed the following:

- Increase the asset limit from $10 million to $25 or $30 million.

- These regulations unfairly burden banks in comparison to other types of mortgage lenders.
- Eliminate requirements for banks in rural areas which have proven responsive to the needs of their community.
- Exempt home mortgage loans and home improvement loans of less than $50,000.
- HMDA and FHHLDS should be bank size, geographic and/or rural/suburban sensitive.

Appraisals, 12 C.F.R. 34

Eighty-three comments addressed Part 34. Many commenters stated that the threshold requiring a licensed or certified appraiser should be raised to at least $100,000; some commenters suggested an even higher threshold. Specific comments addressed the following:

- Incorporate in Part 34 the Departure Provision in the Uniform Standards of Professional Appraisal Practice (USPAP). The Departure Provision permits an appraiser to enter into an agreement to perform an assignment that calls for something less than, or different from, the work that would otherwise be required by the specific guidelines.
- So that "market value" and "fair value" are not confused as equivalent terms, add a statement to 12 C.F.R. 34.42(f) reading "This definition of market value does not automatically require discounting to fair value, if a property can not be sold within 12 months."
- Issue a final rule overriding state laws that go into effect prior to January 1, 1993.
- Exempt transactions in which a lien is placed on real property solely through an abundance of caution.
- The Appraisal Subcommittee of FFIEC should be responsible for the quality of the appraisals produced by the appraisers.
- A new appraisal should not be required when the transaction represents nothing more than a transfer from one financial institution to another.
- Clarify Advisory Letter AL 92-1 "New Implementation Date for Licensed or Certified Appraisers" to reflect the implementation date of 12/31/92 for licensed or certified appraisers.
- Permit the borrower to employ the appraiser.
- Permit a current appraisal prepared for a borrower to be recertified by an appraiser for the bank.
- Raise the appraisal requirement on OREO property from $25,000 to $100,000 and require an appraisal every 18 months in lieu of annually or allow de minimis annual appraisals based on a tiering system.
- Lessen the requirements contained in BC 225 "Real Estate Appraisals."
- For borrowers who have not performed satisfactorily, a bank should have a strong collection practice in lieu of the appraisal requirements contained in 12 C.F.R. 34.43 (a) (4) (i) .
- Amend 12 C.F.R. 34.43(a) to include extensions of credit fully secured by other collateral.
- Permit informal, in-house appraisals on second mortgage loans secured by owner-occupied residential property.

- o Devise a form for a short appraisal on residential real property. One class would be all residential real property under $100,000, and another class would be owner-occupied real property under $200,000.
- o BC 208 "Guidelines for Troubled Real Estate Loans", which mandates annual appraisals on troubled real estate loans, should have a de minimis of at least $50,000.
- o Exempt single family dwelling appraisals (below an appropriate dollar amount).
- o Exempt appraisals of 1-to-4 family residential properties prepared in accordance with FHLMC or FNMA criteria.
- o Clarify the regulation in certain areas, including appraisals on construction loans and when a previous appraisal may be used (such as in connection with a refinancing or an appraisal conducted for another lender or another transaction).
- o Define "real property" and "real estate" to exclude mineral rights, timber rights, growing crops and water rights.
- o Accept appraisals prepared for loans insured or guaran ›ed by government agencies.
- o Permit bank personnel to provide the annual update.
- o Clarify that the appraisal rules apply only to loans that are originated or purchased for an institution's portfolio and that the rules do not apply to loans taken as security for the extension of credit to a third party.

The commenters noted that there are not enough qualified appraisers. In addition, the cost of an appraisal has risen considerably. The effort to stimulate the economy through reduced market rates is offset by higher costs and delayed projects.

Only one commenter was opposed to increasing the threshold to $100,000 and suggested delaying any further action until OMB conducts a study, as required by Section 472(c) of FDICIA, to determine whether there is a need to establish a de minimis level for commercial real estate.

Real Estate Settlement Procedures Act (RESPA), 24 C.F.R. 3500

Seventeen comments addressed RESPA. The commenters addressed the following:

- o Provide RESPA disclosures only at the pre-approval stage. This would eliminate expending funds on those denied credit.
- o Eliminate the new regulation on real estate escrow accounts which requires the lender to pay insurance premiums and property taxes, on behalf of the borrower, even if the borrower has failed to make payments into the escrow. Such a requirement is contrary to prudent business sense, and a probable reason either not to offer escrow service or decline a loan.
- o It is burdensome for both the consumer and the bank to have to obtain a signature (24 C.F.R. 3500.21(d)) on a transfer disclosure form when a customer has either mailed in or withdrawn an application.
- o Exempt business transactions from RESPA coverage.
  Business customers are sophisticated enough to protect their interests in financial transactions with a bank.

- o Amend 24 C.F.R. 3500.21(b) to require that mortgage servicing transfer disclosures be made only if the lender routinely sells servicing of loans to other institutions.

Commenters argued that the public does not care about most of RESPA disclosure. The customer only wants to know if there is insurance, taxes, etc., and the amount and length of time of the monthly payment.

Truth in Lending/Regulation Z, 12 C.F.R. 226

Forty-three comments addressed Regulation Z. The majority of commenters believe that Regulation Z is too complex, burdensome, complicated to understand, and provides information that consumers do not want. The costs associated with providing the required information diminishes bank earnings and/or adds costs to the consumers/borrowers. The commenters' suggestions for improvement included the following:

- o Revise the regulation so that material is given only to customers who specifically request information.
- o Eliminate the right of rescission required by 12 C.F.R. 226.23. Another commenter offered the same suggestion but narrowed the elimination to refinancing or consolidation of debt secured by a consumer's principal dwelling.
- o Exempt business transactions from coverage.
- o Provide an exemption based on volume in terms of dollars or in terms of number of applications.
- o Amend 12 C.F.R. 226.3(a) to provide that the borrower's statement of business purpose made at the time the loan is applied for or consummated is conclusive and binding upon the borrower.
- o Provide a time period for claims of "unauthorized use" similar to those for billing error resolution.
- o Amend 12 C.F.R. 226.3 to provide that a loan on non-owner occupied rental property is deemed for a business purpose.
- o Allow a bank to make small home equity loans and adjustable rate mortgages without the excessive documentation.

Truth in Savings, required by FDICIA

Twenty-three comments addressed the new legislation on Truth in Savings. Commenters argued that the "Notice of Change" requirement will force banks to change to variable rate deposit accounts, which are more difficult to understand, and which could decrease income for both the consumer and the financial institution. One comment stated that most of the requirements for Truth in Savings are already addressed in 12 C.F.R. 217, Interest on Deposits. The comments from the bankers associations noted that the recent legislation does not impose requirements on mutual funds and other deposit-like products offered by non-bank competitors. Two comments suggested that the legislation should be repealed as unnecessary since their customers were not complaining. The comments generally complained about the additional burden and cost.

Specific suggestions were:

- o Give information only to those customers who request it.
- o Place all the requirements for advertising in a single regulation. Try to make the rules as uniform as possible and provide "safe harbor" text.

Reports of Condition - Call Reports

Twenty comments addressed the following:

- o Reduce the quarterly reporting burden. The volume of data reported does not permit making it available for public use in a timely fashion. Consider a summary report for quarterly intervals.
- o Reporting the number of loans to executive officers is burdensome and of questionable value. Since full data about these loans is available on other reports, delete the call report requirement.
- o Review all schedules in the quarterly reports to determine usage of data and value of same. Financial institutions are probably providing some data segments that cannot be justified based on usage.
- o Eliminate the newspaper publication requirement.
- o Place a three year freeze on changes in the call report.
- o Since it is illegal for financial institutions to collect minority ownership information, it is unclear how they will be able to comply with the FDICIA requirement to report this information for small business and small farm loans.
- o Data collection requests should be accumulated from the numerous agencies and reviewed for reasonableness. An evaluation of the long-term costs versus benefits should be performed. Additions and revisions should only be implemented once a year, with ample advance notice.
- o Provide an index to the instructions.
- o The Paperwork Reduction Act estimates of time and cost submitted by the regulators to OMB are generally too low.
- o Regulatory agencies should supply the software and be responsible for updates.
- o Fines for late filing are excessive for small banks.
- o Eliminate memo items. Eliminate redundancy - loans are addressed in approximately eight sections. Group all bond reporting and loan reporting together.

Examinations

Six comments on examinations included:

- o The three federal regulatory bodies should develop a coordinated examination approach. Some banks are being hit with similar, but not identical, exams from more than one regulatory body in a single year.
- o Examiners are doing less examination and more micromanagement. Examiners are too often inexperienced. Examinations have grown longer and the demands upon management more intense.

- FDICIA requires the OCC to conduct annual on-site examinations of each national bank. Any related assessment increase will have a direct negative impact on bank earnings. One must seriously question whether the benefits to be derived from these additional examinations will justify the costs associated with this requirement.
- Exempt one- and two-rated banks with assets under $150 million from the annual on-site examination provision of FDICIA.
- Banks under close supervision should be required to file quarterly status reports in lieu of monthly status reports.

Financial Accounting Standards

Five comments addressed financial accounting standards:

- If mark-to-market accounting is implemented, another costly round of changes will be necessary. Also, this method could alter the sound investment buying practices of banks by limiting the number of municipals that could be considered.
- Change FASB 91 to include a breakpoint for deferred amortization, i.e., fee equal to or greater than 1 percent of loan proceeds.
- FASB 91 creates an asset on the books of the bank that cannot be audited.
- Rigid interpretation of FASB 66 rules by the regulators for OREO eliminates the more flexible case-by-case approach for sales pursuant to FASB 66 as used by the accounting community. This makes it difficult to dispose of foreclosed properties.

Internal Revenue Service Information Reporting

Nine comments addressed IRS reporting. Comments included:

- Allow financial institutions to be reimbursed by IRS for time and material required to complete all IRS reporting forms. Reimbursement should also be provided for the time and effort required to collect, remit and report backup withholding to the IRS.
- The Section 3406 B-Notice wording should be simplified to reduce the confusion about what is being required and eliminate "due diligence" requirements on older accounts.
- There are conflicting regulations for backup withholding. IRS requires that the primary account holder's name appear in the first name line, while the US Bankruptcy Court insists that the Trustee's name appear there.
- Financial institutions should only be required to provide 1099's on interest income received.

Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. 9601

Five comments addressed CERCLA. The commenters believed that there is no sound public policy reason for holding the lending industry liable for customer mishandling of hazardous waste. The cost of the environmental study is passed on to the consumer, and many loans are being denied because of the potential lender liability and the excessive monitoring requited.

Americans with Disabilities Act, 42 U.S.C. 12101

Nine financial institutions addressed this issue. While it is too early to estimate the burden and expense, most commenters stated that not only would documentation be costly, but also the required structural changes to the buildings would be quite expensive, particularly for those institutions with no disabled customers or employees.

Availability of Funds and Collection of Checks, Regulation CC, 12 C.F.R. 229

Thirty-six comments addressed Regulation CC. The majority of comments argued that only those financial institutions failing to give proper availability should be required to meet certain guidelines or be penalized. The disclosure procedures are extensive and costly. Comments included:

- There is a problem in the interface between Regulation CC and revised Articles 3 and 4 of the Uniform Commercial Code.
- Apply business transaction exemptions.
- Funds availability schedule is too short. At least one additional day, preferably two, is needed for the collection of local checks.
- Delete the $5,000 Long Deposit Provision of Section 229.13.
- The next day availability for government and official checks exposes financial institutions to monetary loss.
- All checks should be treated the same without regard to the issuer.
- Provide relief from the requirement for $100 next day availability on checks where excessive overdrafts or reasonable doubt of collection is in evidence.
- Returned check technology has not been streamlined to the degree of the forward collection process. Therefore, the number of permissible "hold" days - 2 days for local and 5 for non-local - may result in the bank's making uncollected funds available to depositors on items under $2,500. Financial institutions bear the loss in these cases.

Bank Secrecy Act (BSA)/Currency Transaction Report (CTR)

Thirty-five comments addressed this regulation. Most comments complained about burden and cost and many believed that their efforts do not result in arrests. Several stated that financial institutions are reporting for the benefit of law enforcement agencies but not being reimbursed for their efforts.

Specific comments suggested the following:

- o Reduce the record retention period to three years.
- o Requirement to log the purchase of cashiers checks with cash in amounts over $3,000 should exclude transactions by known bank customers, i.e., only log non-customers.
- o Requirements should apply to all organizations performing financial transactions.
- o Increase the flexibility on unilateral exemptions that may be granted by the bank.
- o Businesses should file directly with the Treasury Department for an exemption. This will allow banks to reduce their filings and make surveillance much more efficient.
- o Compliance with BSA should be mandatory only if the bank exceeds a certain number of CTRs per year.
- o The law should be modified to apply only to certain regions of the country and sizes of banks.
- o Eliminate travelers checks from the requirement for listing on monetary instrument logs. The small denominations of these checks makes them impractical for money-laundering alternatives.
- o New requirements (such as the proposed wire transfer and mandatory aggregation rules) impose new cost and time burdens on banks.
- o Lowering the minimum from $10,000 to $3,000 on cash purchases of cashiers or travelers checks has caused an additional burden. The minimum should have remained at $10,000.
- o Change the CTR reporting requirement to include only the total number of transactions, i.e., exclude the individual forms.
- o Form 4789 is made up of 55 boxes unless it is a multiple transaction or more than one person is involved, which requires an additional 45 items of information. Fines of $1,000 can be imposed on a single box having an error. Such errors can be as slight as not rounding a transaction to the nearest dollar. Some of this information does not seem to be pertinent to the transaction.
- o Raise the required reporting floor from $1,000 to $5,000 or allow market mechanisms such as industry loss averages to drive the minimum reporting requirements.

Summary of Comments Received by the OTS

The Office of Thrift Supervision (OTS) received 58 comment letters on the 90-day Regulation Review and heard testimony from 19 representatives of savings associations, law firms and trade associations. The letters and testimony contained comments on almost every aspect of thrift operations and regulation. The comments were fairly evenly split between general issues, such as the uncertainty inherent in a changing regulatory environment, and very specific recommendations.

I. GENERAL COMMENTS

Most commenters asked OTS to consider a general change in the structure of thrift regulation by decreasing the examination burden, adopting differential regulations based on size or health of associations, providing relief from perceived excessive reporting, or insuring parity between thrifts and banks in their operations or reporting.

A. <u>Examinations</u>

The most common concern of the commenters is the overlap in examination/regulation by the OTS and the FDIC. Associations cited frustration with conflicting signals from the OTS and the FDIC and increased examination costs and inefficiency due to separate examinations. Institutions want the government to speak with one voice.

B. <u>Differential Regulation by Institutions Size and Health</u>

Many institutions asked OTS to consider size and health of institutions in implementing regulations. Several letters from small associations detailed the strains of consumer protection law and interest rate risk reporting. One commenter requested that OTS prepare an impact analysis under the Regulatory Flexibility Act on each new regulation to focus on the effect of the regulation on small associations. Well capitalized associations emphasized their relatively low risk of failure, and thus, low risk to the taxpayer.

C. <u>Parity between Savings Associations and Banks/Merging of OTS and OCC</u>

Five commenters specifically asked for an increased awareness of the disparity between bank and thrift reporting and regulation, and several other commenters mentioned specific requirements that apply to thrifts but not to banks. Most of these comments cited capital treatments that vary between banks and thrifts, or regulations that take a "cookbook" approach to specifying business practices, rather than specify the end product. One commenter asked for OTS help to level the playing field among all financial service providers.

Three commenters endorsed combining the OTS and OCC and one urged that a combined regulator create one set of rules for all financial institutions.

D. Uncertainty

Many commenters noted that their most difficult problem was creating a sound business plan in the face of ongoing regulatory uncertainty. One commenter asked OTS to influence Congress to stop reregulating savings associations. Many of those testifying stressed the costs of retraining staff and recreating systems to accommodate changing regulations. They asked OTS to set the rules and be done with it.

E. Other

Commenters focused on several other general issues. Five commenters asked that OTS clarify the difference between regulations and bulletins. Several institutions consider bulletins to be suggestions, but by no means requirements, whereas examiners at those institutions considered the bulletins required practice. One hearing participant encouraged OTS to issue all of its directives in the form of regulations to initiate public comment. Three commenters expressed concern over the differences between OTS-Washington staff explanation of policies and field-staff implementation of those policies. One commenter criticized OTS for requiring thrifts to generate a large number of internal policy statements, and to reapprove these statements annually.

Several comments centered on the high cost of being a thrift and requested OTS lower its assessment and fee structure.

II. SPECIFIC COMMENTS

A. Regulations and Policies in Process

Almost a third of the comment letters and testimony gave additional comments on proposed regulations or notices that have already been published for notice and comment. Comments on Real Estate Appraisals, Applications Restructuring, Interstate Branching, Fidelity Bonds, Interest Rate Risk, Leverage Ratio and Miscellaneous Capital Amendments, Monthly Reporting Requirements, Mutual Holding Companies, Uniform Accounting Standards, Supervisory Conversions and Transactions with Affiliates and Insiders will be submitted as part of the comment records on those issues or considered in this process.

We also received a number of comments on issues on which we plan to propose regulations or issue bulletins including comments urging OTS to retain core deposit intangibles, allow optional membership in the Federal Home Loan Bank System, exempt covered assets from percentage of assets or capital limits, streamline applications for minor merger transactions and clarify recourse rules. We will consider these comments as we write the proposed rules, bulletins or opinions.

We also received extensive comments on four other issues:

1. General Valuation Allowances

The ten comments on GVA policy asked OTS to coordinate loan loss methods with FDIC, to clarify the interplay between GVAs and capital calculations, or to simply change our current methods of calculating GVAs. Several commenters argued that examiners take the most conservative view possible of assets, an attitude inconsistent with the "credit crunch" initiatives.

2. Qualified Thrift Lender (QTL) Test

Five commenters asked for relief from the Qualified Thrift Lender (QTL) test. Most see the test, even with the recent liberalization, as over-burdensome, costly and antiquated. (One called it the "dinosaur of the thrift industry.")

Several point to the fact that Congress has changed the test three times in the last four years and such changes are extremely costly.

3. Mutual to Stock Conversion Applications

Six commenters, including 4 law firms and 2 appraisal firms, all recommended that authority to review and approve applications for a mutual to stock conversion be retained in OTS-Washington rather than being delegated to the Regional Offices, as proposed in the Applications Restructuring Regulation. Most of these commenters stated that the current process works extremely well and should not be changed.

One commenter noted that it "is the most efficient, cost effective and socially beneficial regulatory process the OTS has". Also, most of these commenters stated that shifting the delegation from a highly expert centralized staff to the Regions will make the process more complex, result in delays, increase the potential for unfair conversions, frustrate capital raising and growth,and be inconsistent with the mandate of the President's 90-day Regulatory Review Program to streamline government regulation.

One commenter recommended in his testimony that the conversion regulations should be modified to increase the amount of conversion stock that can be purchased by insiders from 35% to 40% or 45% for small associations, with proportional increases for larger associations.

B. Changes Initiated by the Regulation Review Process

A number of comments and testimony focused on areas that OTS staff had identified in the regulation review process as needing revision or are areas that have been covered in recent regulations.

1. Liability Growth

One commenter suggested that the Liability Growth regulation (563.131) was antiquated.

2. Liquidity

Two commenters suggested that the Liquidity regulation (Part 566) is outdated and should be modified to include mortgage backed securities secured by government sponsored enterprises (FHLMC, FNMA, and GNMA) as liquid assets.

3. Forward Commitments, Options and Futures

Two commenters pointed to inconsistencies in OTS regulations on forward commitments, options and futures (563.96, 563.173, 563.174, 563.175).

4. Branch Openings and Forms of Account

Commenters asked for streamlined notice procedures for branch openings and submission of forms of deposit accounts.

C. Compliance

The most common specific comments centered on compliance with some consumer protection laws and regulations. Many commenters asked for relief from various provisions of the Bank Secrecy Act (BSA), Truth in Savings Act, Truth in Lending Act, the Flood Disaster Protection Act and the Expedited Funds Availability Act. Many of these comments urged OTS and the Congress to consider the relative costs and benefits of these rules and whether the costs were appropriately placed on financial institutions.

All of the above compliance requirements are either implemented by regulations of another agency or are mandated by statute. Some of these requirements are being reviewed by the FFIEC study of regulatory burden under Section 221 of FDICIA, which will determine on an interagency basis, whether the regulatory burden imposed by those regulations can be streamlined or simplified.

Several comments did focus on OTS compliance regulations that do not specifically interpret statutory requirements. Another commenter objected to Community Reinvestment Act (CRA) requirements and to CRA compliance as a condition for expedited application approval. One commenter suggested that examiners should focus more on actual CRA performance and less on documentation of CRA activities. Two asked that OTS allow thrifts to use ARM indexes within their control to be consistent with bank regulators, and one commenter asked OTS to drop the prepayment penalty restriction on adjustable rate loans.

One commenter objected to the uneven application of the RESPA section 8, generally known as the anti-kickback section. This has resulted from a recent court ruling and a HUD exception for a few institutions exempting some institutions from the requirements. HUD currently has a final regulation with OMB to resolve this problem.

D. Suggestions for Further Changes

OTS also received a number of requests for regulatory changes designed to foster a more pro-growth environment.

1. Directors' Responsibilities

Eight comments described problems electing directors in light of the high standards to which OTS is holding directors. Institutions cite difficulty in obtaining blanket bond and director/officer insurance coverage due to mandatory formal enforcement actions against institutions with MACRO ratings of 3, 4 or 5. They ask that Regional staff address some concerns through informal means and that OTS reconsider its definition of the role of directors.

2. Executive Compensation

Five commenters asked that OTS rescind or substantially change its bulletin on Executive Compensation. One commenter contends that examiners are extending the restrictions in the bulletin beyond "problem institutions."

Another urges OTS to consider that thrifts have to compete with nonregulated financial service providers for personnel. All note that the bulletin is open ended and can affect any institution.

3. Loans-to-one-borrower (LTOB)

Two comments focused on the OTS loans to one borrower (LTOB) rule. One asked for OTS to allow associations to apply the LTOB rule to the "end users" of loans. For example, loans to builders for pre-sold homes would be considered loans to the individual home purchasers for LTOB purposes, provided the thrift independently checked the creditworthiness of each home purchaser.

Another commenter asked that we allow OTS Regional Directors to exempt institutions from LTOB restrictions on a case-by-case basis. While waivers or exceptions from the general LTOB limits are not permissible under the statute, the current statutory and regulatory provisions do contain sufficient flexibility, such as the higher limits allowed for loans to develop domestic residential real estate, to address, in part, this commenter's concern. Finally, a commenter urged OTS to authorize an "untroubled association" to use its salvage powers to exceed LTOB limits in "selected circumstances, and as approved by its Board of directors."

4. Capital Distributions

One commenter objected to a limit on capital distributions by the highest rated institutions, so long as they still met fully-phased-in capital levels after the disbursement.

5. Capital

While a large number of the comments and testimony commented on capital changes initiated in the Leverage Ratio rule or in the Miscellaneous Capital Amendments rule, and still others commented on other capital changes in provisions mandated by FDICIA, a few commenters raised new capital issues. One recommended lowering the risk weight on home equity loans to 50% if the combined loan-to-value ratio of the first and second mortgage is below 80%. One commenter asked that OTS exclude FHLMC stock from the equity securities deducted from capital because Congress recently approved it as a qualified thrift investment.

6. Change of Control

One commenter, a law firm, indicated that provisions relating to presumptions of control and the procedures for a rebuttal of control should be simplified, since they are more complex than the similar rebuttal standards under the Federal Reserve Board's acquisition of control regulations. Further, the commenter recommends that the procedure for a rebuttal should be streamlined to allow an acquisition to be made and given safe harbor treatment upon the filing of an executed rebuttal agreement.

7. Management Questionnaire

One comment explained that an examination Management Questionnaire requires the names and number of shares of the institution's common stock held by all directors, officers and employees of the institution.

8. Servicing Rights

One testimony focused on the interpretation of GAAP literature on mortgage servicing rights. The institution representative argued that excess servicing rights bought in a whole institution transfer should continue to be considered excess servicing rights.

E. Other

A number of comments asked for relief from specific requirements that OTS believes are necessary for safety and soundness purposes, are FIRREA requirements, are dictated by generally accepted accounting principles, or should be addressed by other federal government agencies.

1. Lending Limits

One commenter requested that we ease the 400% of capital limitation on non-residential real estate lending, especially for institutions involved in Small Business Administration (SBA) lending. The 400% limitation is a statutory requirement that the OTS does not believe is appropriate to revise. We believe that the rule appropriately focuses thrifts on residential lending. We also note that SBA-guaranteed loans, like other government guaranteed loans, are exempt from the 400% limitation.

2. Capital

One commenter asked that OTS consider lowering the capital risk weight on all manufactured housing and mobile home communities. OTS currently gives a 50% risk weight to manufactured housing with a loan-to-value ratio below 80%, and mobile home communities may qualify for the 50% risk weight for multifamily dwellings if they contain fewer than 36 units.

Another asked for a 50% risk-weight on loans to fund education. Another asked OTS to consider counting both cumulative and noncumulative perpetual preferred stock as core capital. The last asked that Federal Home Loan Bank stock receive a 0% risk weight. These three suggestions would require further differences between thrift and banking capital rules.

3. Corporate Governance

One commenter recommends that the federal regulations be revised to follow state law provisions on limiting liability for directors. In the past, the FHLBB and the OTS have expressed concerns about provisions that would unduly limit liability for management of any savings associations.

4. OTS Programs to Manage Resolution Process

OTS asked for those testifying to consider all of OTS policies and procedures along with its regulations. One found the paperwork requirements of the Accelerated Resolution Program (ARP) excessive. Another considered the Thrift Administration Review Program (TARP) to be unnecessary because all of the low-rated institutions covered by its requirements were bound for the RTC. Two commenters adamantly opposed the Early Resolution Accelerated Mergers (ERAM) and one urged OTS to work with capital-deficient thrifts to insure the least possible resolution cost for the thrift crisis.

5. Service Corporations

One commenter explained that an institution must file an application with OTS and FDIC to establish or acquire a new subsidiary or to engage in additional activities in an existing subsidiary. FIRREA requires the filing procedure.

OTS does not act on these applications, it merely receives a copy from the FDIC. The FDIC must act on the application.

6. Market Value Accounting

Two commenters adamantly opposed mark-to-market accounting. One asserted that the accounting method uses too many valuations to be used for all assets. The other alleged that mark-to-market accounting places the valuation of the balance sheet in the federal government's hands because it controls the interest rates. Both predicted that mark-to-market would have dire consequences for the financial services industry.

7. Troubled Debt Restructuring (TDR)

Another commenter asked OTS to standardize the definition of TDR. FASB 15 specifically defines by technical definition assets determined to be TDR. The OTS Handbook only expands on this definition by providing examples. All TDR must be considered in light of FASB 15 and FASB 5.

8. Environmental Liability

One commenter asked OTS to help in seeking clarification of secured lender exceptions to environmental liability statutes. The comment cites court interpretations of environmental laws and regulations that have resulted in lenders' reluctance to lend to any business that might pollute. EPA recently issued a proposed rule that addresses this problem.

9. Federal Reserve and IRS Requirements

One commenter asked for relief from the Federal Reserve requirement on transaction accounts and another criticized the IRS for the amount of information they require and for "unfair" penalties. This commenter and another asked for relief from the IRS B-Notice Backup withholding program.

10. Specific Applications

OTS also received several letters on specific applications. These comments will be addressed directly with the institutions involved.

Appendix B: Summary of Comments Received by NCUA

Overview

On July 28, 1992, the National Credit Union Administration (NCUA) Board issued a request for comment on regulations affecting federally insured credit unions which impose unnecessary or excessive costs or burdens and what changes could be made to reduce those costs or burdens. (See 57 Fed. Reg. 34090, 8/3/92.) Comment was requested on NCUA regulations as well as any additional federal laws and regulations to which credit unions are subject. The Board noted in the request that the Federal Financial Institutions Examination Council (FFIEC) was mandated by statute to conduct a study and provide a report to Congress on regulatory burden. Neither the NCUA nor credit unions were included in the study and report. NCUA's request, however, will facilitate both our review of our own regulations and our participation in the FFIEC project. The request was issued with a sixty-day comment period that ended on October 2, 1992.

Seventy-three comments were received. Fifty-two were from federal credit unions (FCUs), thirteen were from federally insured, state chartered credit unions (FISCUs), five were from state credit union leagues and two were from the national trade associations (Credit Union National Association (CUNA) and National Association of FCUs (NAFCU)). One comment was received from a computer software company. For the most part, comments addressed regulations that NCUA did not issue. A relatively small percentage of the comments addressed NCUA regulations. The majority of those addressed the proposed quarterly filing of the 5300 call report and the business lending regulatory and reporting requirements. IRS (i.e. requirement for separate 1099 filing) and Bank Secrecy Act (i.e. requirement for log for transactions between $3,000 and $10,000) regulations received the most comment. Regulation C (HMDA), Regulation Z (Truth in Lending), Regulation CC (Expedited Funds Availablilty) and Regulation E (Electronic Funds Transfer) also received much criticism. Below is a more detailed analysis of the comments.

Comments on Non-NCUA Laws

Several commenters (including CUNA and NAFCU) believe that Congress should be mandated to do a legislative analysis looking at what burdens will be imposed before issuing new laws. CUNA also believes that Congress should do a mandatory periodic review of all consumer laws. One commenter believes that all regulations should have a two year sunset provision that would force agencies to review burdensome requirements. Other commenters state that the cumulative affect of all the regulations rather than one particular regulation is overly burdensome. One commenter noted that regulations are particularly burdensome on small credit unions. These comments stem from the commenters general belief that many of the "consumer" regulations do not necessarily benefit consumers and are quite burdensome to credit unions. Several commenters noted that Regulation Z, for example, requires such complex, lengthy disclosures that most consumers do not understand or even read them, hence the burden on the credit unions required to give the disclosures is much greater than any benefit derived by the consumers.

Internal Revenue Service (IRS) requirements received the largest number (over forty) of comments. The vast majority of these concerned the requirement to mail members a separate 1099 form at the end of each year. Apparently the information contained in the year-end 1099 is also found in the last quarterly statement that is sent to credit union members. Commenters also complained of backup withholding requirements. They believe that the IRS should deal with this issue directly with the taxpayer; the credit union should not be involved. Several commenters also mentioned the requirement for mailing form 5498 to IRA account holders. This form is delivered after tax returns are due and is duplicative of the year-end mailing. CUNA states that it serves no purpose except to confuse members.

Requirements originating from the Bank Secrecy Act received thirty-five comments. The Bank Secrecy Act's implementing regulations are issued by the Treasury Department. By far the commenters' greatest complaint is the requirement to maintain a log for purchases of certain monetary instruments with currency in amounts between $3,000 and $10,000. Several commenters also believe that the $10,000 threshold for filing a currency transaction report (CTR) should be raised. Two commenters requested that the Treasury Department show that these requirements are producing tangible results (e.g. reduction in money laundering), otherwise the requirements should be eliminated.

Another regulation that engendered much criticism is Regulation E (Electronic Funds Transfer). The one aspect of Regulation E that caused the most concern is the liability placed on issuing institutions (credit unions) for users' negligence. Commenters noted that consumers are protected from their own negligence in, e.g. PIN security, and giving their cards to unauthorized users. Close to thirty commenters addressed this issue. A few commenters had additional suggestions concerning Regulation E: the ATM receipt should suffice for the required periodic statement; and increase in notice requirements for change in terms (21 to 30 days).

Over twenty comments were received on Regulation Z (Truth in Lending). As noted earlier, credit unions believe that required disclosures are too lengthy and complex, and do not achieve their purpose of informing the consumer. Seven commenters specifically complained of the complex home equity disclosures. This includes the fifteen year historical example. Four commenters believe that the three day right of rescission is no longer needed.

Regulation C (Home Mortgage Disclosure) requires certain credit unions making mortgage loans to maintain informational registers. Over twenty commenters addressed Regulation C. Many of these stated that the purposes of Regulation C (to serve housing needs and identify discriminatory practices) are not being met. Several noted that Regulation C should not apply to credit unions since credit unions can only serve members.

Twenty commenters addressed Regulation CC (Expedited Funds Availability). Several stated that the local check hold maximum of two days should be extended to three days. Others noted that new accounts should be defined as those in existence for up to 90, rather than 30 days. Two commenters (including CUNA) recommend that credit unions be permitted to use a general rather than a specific hold period and that the recent same day payment amendments give too much leeway to the presenting bank to refuse to accept the paying bank's location.

Seven commenters addressed the Soldiers' and Sailors' Civil Relief Act. Most of these commenters believe the reduction in interest rate for military to 6% is too drastic. Suggestions were made to allow for a reduction of several percentage points or to somehow tie a reduction to the market rate. Several commenters also noted that it should be the borrowers' responsibility to provide evidence of eligibility for relief under the Act. CUNA also suggested that either the Justice Department or the Department of Defense should have official responsibility to interpret the Act. Currently no agency has authority to either issue regulations or interpret the Act.

Eight commenters (including NAFCU and CUNA) addressed Regulation D (Reserves). Most of these commenters suggest that the Federal Reserve System should pay interest on reserves. CUNA suggests that a commentary to Regulation D be developed.

Eight commenters (including NAFCU and CUNA) addressed flood insurance requirements. Most of these were concerned with the difficulty in determining when flood insurance is required. This problem should be addressed by Federal Emergency Management Administration, who issues flood maps.

Seven commenters (including CUNA) addressed the issue of record retention. They noted that various regulations (e.g. Regulations B, Z, Bank Secrecy Act, Regulation C, etc.) have different record retention requirements. They suggested that record retention requirements be made uniform for all federal regulations.

Four commenters (including CUNA) addressed RESPA requirements. Suggestions were made to eliminate refinancings from RESPA disclosures and to streamline escrow statement and loan servicing disclosures. Five commenters (including NAFCU and CUNA) addressed FASB requirements. CUNA suggests that FASB decisions have a tremendous affect on credit unions, but credit unions have no forum to influence FASB decisions. NAFCU is concerned with the AICPA's mark to market initiatives. Six commenters addressed the Bankruptcy Code. CUNA suggests that a loan should not be charged off when some payment is continuing. NAFCU notes that a creditor should be permitted to enter a motion to dismiss based on a debtor's sufficient regular income.

Comments on NCUA Regulations

As already noted, most of the commenters did not criticize NCUA regulations. In fact, several commenters (including NAFCU) stated that they had little problem with NCUA Regulations; that our regulations generally worked very well. There were a couple of areas that did generate comment. The NCUA regulation that received the most comment was the requirement for the filing of the 5300 call report (12 C.F.R. 741.13). Eleven commenters addressed this requirement. Several stated their opposition to the proposed requirement for quarterly 5300 filing. CUNA believes that only problem credit unions should be required to file quarterly. They also note that bankruptcy data should be reported using charge offs rather than bankruptcy filings. NAFCU noted that credit unions should not be required to submit both a disk and hard copy of the call report. one commenter noted the unnecessary complexity of the 5300 form while another stated the difficulty in separating insured from uninsured funds in the report. One commenter recommended that the 5300 be required annually only. A proposed rule was issued by the Board in July requiring a quarterly call report filing for credit unions with assets in excess of $20 million. Quarterly filing is now required for credit unions with assets in excess of $100 million. All other credit unions file semiannually. The comment period ended October 2. A separate memo discussing those comments was distributed on October 9.

The NCUA regulation receiving the second largest number of comments (10) was the business lending rule (12 C.F.R. 701.21(h)). Most of these commenters (6) criticized the new requirement to report all business purpose loans on the 5300 report. Commenters noted the difficulty in tracking such loans, especially if the loans are not subject to the business lending rule. One commenter noted that the personnel requirements of the new business lending rule are too stringent, another believes that the new rule discourages business loans. One commenter believes that senior management personnel should not be prohibited from receiving business loans. NAFCU noted that the new exemption procedure for loan-to-value requirements is too restrictive. They would like the exemption procedure open to new as well as existing loan programs.

Four commenters addressed field of membership requirements and procedures (IRPS 89-1). Three of these noted that there is some discrepancy among the Regions in applying FOM requirements. One commenter requested that certain select employee groups be added without NCUA approval (e.g. vendors and contractors of sponsor groups). Four commenters (including CUNA and NAFCU) addressed our appraisal regulation (12 C.F.R. 722). They believe that NCUA's threshold of $50,000 requiring a certified or licensed appraiser should be raised to $100,000 or be made flexible so that it can adjust to the market. The other financial regulators set their threshold at $100,000. One commenter believes that the appraisal requirements should be pared down, that commercial rather than residential real estate should be subject to the requirements. Three commenters (including CUNA) addressed the proposed rule on allowance for loan losses (ALL) (12 C.F.R. 702.3). A separate memo summarizing the comments on this proposed rule was distributed on September 10. Two commenters believe that the ALL proposal will require double counting, CUNA believes NCUA should convene a task force to address the issue.

Three commenters (including CUNA) believe the usury ceiling should be eliminated. This would require a statutory change. Three commenters mentioned NCUA's requirements for an outside audit (12 C.F.R. 701.13) and thought some of the requirements should be eliminated. This again would require a statutory change. Three commenters addressed our fixed asset regulation (12 C.F.R. 701.36). One believes that neither leases nor equipment should be included as fixed assets, another believes that abandoned property should be exempt from fixed assets. Two commenters addressed our risk asset definition (Section 700.1) and stated that assets that are fully insured or guaranteed should not be included as risk assets, regardless of maturity.

CUNA also commented on the CDCU loan program (12 C.F.R. 705 & 701.32). They want the definition of low income member broadened, an increase in the 20% limit on nonmember deposits and improvement in technical assistance. There is currently a committee reviewing this program. A proposed revision to 701.32 and 705 is scheduled to be presented to the Board in November. CUNA suggested a modification to the loan participation rule (12 C.F.R. 701.22) to allow for participation after the loan proceeds have been disbursed.

Although it is not yet a proposed rule, twelve commenters (including CUNA and NAFCU) addressed the soon to be proposed truth in savings regulation. Most noted that the regulation will be burdensome, especially on small credit unions without computer capacity. Three commenters wanted the effective date delayed (Congress has approved but the President has not yet signed a three month delay) and three wanted certain disclosure requirements dropped. These would again necessitate statutory change. CUNA recommends that each credit union be able to determine the length of its grace period in offering roll back accounts.

CUNA also had several other suggestions for us. These would involve statutory and policy changes. They would like CUSO services incorporated into the FCU Act as permissible FCU services; they suggest a major review of the statutory authority for FCU investments. They would like a national clearinghouse of federal and state consumer laws established. They would like NCUA to be required to file comment letters with other agencies whenever other agencies propose rules that will affect credit unions. They would like NCUA to hold hearings around the country to see how credit unions can better serve the needs of small businesses. They would like us to improve the appeal process for examinations and to improve the coordination between federal and state regulators.

One commenter noted that NCUA has used Letters to Credit Unions to regulate (e.g. ALL requirements, quarterly 5300 reporting for credit unions over $100 million in assets and real estate lending requirements). The commenter suggested these requirements should go through the normal notice and comment process before they can be enforced.

Appendix C:
The Cost of Regulation: A Review of the Evidence

Of the thousands of studies of government regulation of financial institutions, only a few address the costs of such regulation. Accounting systems used by financial institutions do not normally segregate regulatory costs from other costs. Thus, data on regulatory costs are generally only available from case studies or surveys that are designed specifically to collect such information. In a few instances, however, researchers have attempted to infer the costs of regulations from secondary data using econometric or analytic methods. This appendix reviews the available evidence on the costs of regulation of financial institutions from both primary and secondary sources. The review focuses on regulatory costs at commercial banks, although it considers a few studies investigating financial regulations at other financial institutions.

Case Studies

Case studies may be chosen as a method for studying regulatory costs because the lack of readily available data makes constructing estimates a difficult task. By concentrating efforts on one or a few financial institutions, a researcher has considerable control over the quality of the data that are collected. As a result, carefully designed and well-executed case studies can provide accurate and comprehensive information about regulatory costs at the financial institutions studied.

Although focusing on a few institutions may produce good quality data, it has several important disadvantages. First, the representativeness of any case study is obviously limited. Second, because studies of compliance costs have no common methodology, different case studies are typically not comparable with each other; so generalizing from the results of several case studies is difficult. These limitations also prevent case studies from providing information on the variability of costs across the population of institutions, a consideration that is important for assessing the effect of regulatory costs on firms of different sizes.

A review of several case studies illustrates the advantages and limitations of using them to examine regulatory costs. These case studies cover a fairly large number of regulations and appear to be reasonably well executed. This review is not exhaustive, but probably not many more publicly available case studies exist.

In 1979, Darnell (1980) studied of compliance costs for about 170 federal, state, and local government regulations at a $1.6 billion commercial bank. The regulations included ones covering general business and ones specific to financial institutions. Data were collected from each department in the bank on the total regulatory costs that the department incurred.[1] These costs included the following components: (1) the direct labor cost of interpreting regulations, formulating policies and procedures, and implementing the regulatory requirements; (2) costs of project development for data processing; (3) other direct costs such as examination fees, assessments, printing, and materials; (4) overhead costs; and (5) the opportunity cost of holding idle reserves at the Federal Reserve.

Darnell estimated total direct and indirect costs of government regulations (components 1-4) to be $6.2 million. This amount was 13.8 percent of the bank's noninterest expenses and 33.2 percent of before-tax income in that year.

Direct labor was the largest component, although other direct costs and overhead were almost as large. The $2.1 million direct labor cost was one-third of total direct and indirect regulatory costs. This amount was about 10 percent of the bank's total expenses for wages, salaries, and benefits--an equivalent of having one of every ten employees working full time to comply with government regulations.

Darnell singled out consumer regulations as particularly burdensome. Compliance with consumer regulations amounted to $2.6 million, or 5.9 percent of noninterest expenses. Department managers most frequently identified Truth in Lending as the regulation requiring the greatest amount of resources to satisfy. The opportunity cost of holding idle reserves with the Federal Reserve (component 5) was a large component of regulatory costs not counted in the statistics presented above. Darnell estimated that at interest rates prevailing at the time of

[1] Darnell estimated total regulatory cost (the cost of performing all of the activities required by regulations) at the bank rather than incremental or marginal costs (the cost of performing those activities required by regulations that would not have been performed in the absence of regulation). However, he also asked department managers to indicate the usefulness of the regulations covered by the study. Of the 170 regulations studied, 13 percent were voluntary, 18 percent were mandatory and considered to be necessary for effective bank management, 18 percent were mandatory and considered to be desirable, and 52 percent were mandatory and viewed as unnecessary for management purposes. These opinions suggest that most of the regulatory reports were prepared solely because they were required. Thus, the marginal component of regulatory costs at this bank seems to have been substantial.

the study, foregone interest on idle reserves was $6.1 million.[2] Adding this amount to the direct and indirect regulatory costs yielded a total regulatory cost of $12.3 million, which was 27.3 percent of the bank's noninterest expenses and 65.6 percent of before-tax income.

More recently, McKinsey & Company (1992) studied compliance costs at four commercial banks. Their study estimated the ongoing incremental costs associated with 60 regulations covering deposit insurance, safety and soundness, the holding company, consumer compliance, other compliance, and reserves. McKinsey & Company considered only regulations that applied solely to FDIC-insured institutions and only the ongoing component of the costs of these regulations. Data were collected regulation by regulation.

They estimated that total regulatory costs (including the cost of idle reserves) were 8.4 percent of the noninterest expenses of the four banks.[3] By type of regulation, estimated costs were 4.1 percent of noninterest expenses for deposit insurance regulations, 0.9 percent for safety and soundness regulations, 0.1 percent for holding company regulations, 0.8 percent for consumer regulations, 0.3 percent for other regulations, and 2.3 percent for holding reserves (an opportunity cost).

In the same study, McKinsey & Company also estimated provisionally that regulatory costs for FDICIA would be 1.5 percent of noninterest expenses.[4] The rise in regulatory costs from the act would occur mainly in the deposit insurance area, but new safety and soundness regulations and Truth in Savings were also mentioned as major items contributing to costs.

In a study for the Independent Bankers Association of America, the accounting firm Grant Thornton (1992) estimated compliance costs for thirteen regulatory requirements at nine commercial banks.[5] The regulations or regulatory requirements were Call Reports, the

---

[2] Darnell subtracted vault cash, which would have been necessary to hold regardless of whether balances were held with the Federal Reserve, from required reserves to obtain the amount of idle reserves on which interest was foregone. At this bank, vault cash was about 11 percent of the $6.2 million average daily reserve requirement.

[3] Opportunity costs of idle reserves were estimated as reserve balances times the 30-year Treasury bond rate.

[4] The estimates for the regulatory costs of this act are necessarily provisional because the study was undertaken before the regulations implementing the act had been promulgated.

[5] Case studies were conducted to develop a methodology for a survey to estimate aggregate compliance costs for the thirteen regulations. The case study results were based on extensive field interviews of bank employees and are of interest in themselves. The survey estimates are presented in a later section of this appendix.

regulatory examination process, the Bank Secrecy Act, the Community Reinvestment Act, the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, appraisal requirements, the Expedited Funds Availability Act, geographic loan coding, loans to insiders, the Truth in Lending Act, the Real Estate Settlement Procedures Act, and formal written policies.[6] The banks ranged in asset size from about $17 million to $221 million. Costs included direct labor, other direct expenses, and overhead for each of the thirteen regulations.

The total cost of these regulations was on average $302,317, which was 41.8 percent of these banks' before-tax income.[7] Direct labor was 49.2 percent of total regulatory cost and 14.0 percent of total expenses for wages, salaries, and benefits. The most costly regulations or regulatory requirements were the Community Reinvestment Act (on average, $63,448), the Expedited Funds Availability Act ($50,181), bank examinations ($47,769), Truth in Lending ($36,747), and written policies ($35,228).

Survey Evidence

Surveys are another source for estimates of the costs of regulation. Although surveys have commonly gathered information on particular components of regulatory costs in some areas, surveys collecting comprehensive data on costs of regulations covering financial services have been rare. Such surveys require a level of detail nearly equal to that of case studies but on a much larger scale.

There have been a few surveys of the costs of regulations for consumer financial services. These surveys have permitted investigation of scale economies in compliance costs and have identified the relative size of various categories of regulatory costs (such as administration, training, and labor). In a few cases, survey data have also permitted a comparison of ongoing and start-up costs for a regulation. Because of sampling limitations (small, nonrandom samples or low response rates), surveys generally have not been adequate for constructing estimates of aggregate regulatory costs.

---

[6] The choice of these regulations for the study was based on a survey that asked banks' opinions of the most costly and most aggravating requirements from a list of 52 regulatory requirements. It is worth noting that deposit insurance premiums and reserve requirements, requirements that McKinsey & Company found to be among the most costly, were not included in the list.

[7] Average bank size was $63 million in assets.

Economies of Scale

Economies of scale exist when larger output is associated with lower average cost. Economists generally use a statistical cost function to investigate scale economies. The cost function, which is derived from the firm's cost minimization decision, relates cost to the level of output and input prices (for example, wage rates and rent).[8] By estimating the cost function, differences in cost due to different output levels can be distinguished from those due to different input prices or combinations of inputs.

Murphy (1980) estimated cost functions for compliance costs for the Equal Credit Opportunity Act. Data were from a survey of 37 relatively large commercial banks, which the Consumer Bankers Association conducted in August 1976.[9] Costs covered both initial and ongoing costs during the first year that the law was in effect.

Murphy assumed that compliance costs consisted of two separable components, legal costs and all others. He estimated Cobb-Douglas cost functions for each component.[10] Only the regression results were presented. No descriptive statistics (such as average compliance cost per bank or per account) are reported.

The results of estimation suggest large economies of scale in legal and other compliance costs at relatively large banks for the first year of compliance with the Equal Credit Opportunity Act. In the legal cost function, both output and the wage rate for legal services are significantly different from zero. Of particular importance is the result that the output coefficient is significantly less than one. This result indicates the existence of economies of scale in compliance costs, that is, larger banks have a relative cost advantage in complying

---

[8] See Baumol (1977) for a general discussion of the cost minimization decision. For a derivation of the cost function, see Henderson and Quandt (1980).

[9] Results of the survey were reported in testimony submitted by the Consumer Bankers Association before a subcommittee of the House Committee on Government Operations and have been cited frequently in other studies. For example, see Commission on Federal Paperwork (1977), Smith (1977), and Carroll et al. (1989).

[10] The Cobb-Douglas is one of many functional forms that satisfy theoretical requirements for a well-behaved cost function. The Cobb-Douglas function has been widely used in empirical cost studies. In this form, the logarithm of cost is a linear function of the logarithms of output and factor prices. The coefficients of this function can be interpreted directly as elasticities (that is, percentage changes in costs associated with a per-unit change in output or factor prices). For further discussion of the Cobb-Douglas function, see Henderson and Quandt (1980).

with the regulation. The size of the estimated coefficient suggests that a 10 percent increase in output (measured by the volume of consumer credit outstanding) increases legal costs 5.7 percent. In the other cost equation, the wage rate coefficient but not the output coefficient is significantly different from zero. The output coefficient is, however, significantly different from one, indicating that a 10 percent increase in output increases other costs 4.1 percent.

In 1981, the Federal Reserve Board conducted a survey of compliance costs for regulations implementing the Electronic Fund Transfer, Truth in Lending, and Equal Credit Opportunity Acts. Respondents were requested to estimate incremental costs of these regulations in eight cost categories. They were provided with a list of requirements and possible compliance activities to assist them in completing the questionnaire. The sample consisted of 85 commercial banks that either had attempted on their own initiative to estimate compliance costs or had been identified by Federal Reserve Banks as being capable of completing the questionnaire. Sixty-seven of these banks provided usable data on compliance costs for the Electronic Fund Transfer Act, and 51 banks provided usable data for the Truth in Lending and Equal Credit Opportunity Acts. Schroeder (1985) and Elliehausen and Kurtz (1985, 1988) presented the results of this survey.

Schroeder estimated cost functions for start-up and ongoing compliance costs for the regulation implementing the Electronic Fund Transfer Act, which had been issued two years before the survey. He estimated cost functions for start-up and ongoing compliance costs as functions of the level of output, the type of electronic fund transfer (EFT) services offered by the bank, and selected other characteristics of the bank. In both equations, coefficients of the output variables were significantly less than one, indicating economies of scale. The size of these coefficients indicates that a 10 percent rise in output increases start-up costs 7.7 percent and ongoing costs 4.3 percent.[11]

Elliehausen and Kurtz (1988) investigated the issue of scale economies in ongoing compliance costs for the Truth in Lending and Equal Credit Opportunity Acts. They estimated a Cobb-Douglas function and a modified Cobb-Douglas function, in which a quadratic term for the logarithm of output was added to allow economies of scale to vary with

[11] The descriptive statistics from the survey reflect these economies of scale. Average start-up compliance costs per EFT transaction ranged from $0.116 for banks with deposits of less than $100 million to $0.061 for banks with deposits of $3 billion or more. Average ongoing compliance costs per EFT transaction ranged from $0.217 for banks with deposits of less than $100 million to $0.035 for banks with deposits of $3 billion or more.

the level of output. In both equations, coefficients of output (measured by the number of consumer credit accounts), factor prices, and output homogeneity variables (which controlled for differences in the types of consumer credit held by the banks) are significantly different from zero. The Cobb-Douglas model indicates significant economies of scale, with a 10 percent increase in output being associated with a 6.8 percent increase in compliance costs. Results for the modified Cobb-Douglas function suggest, however, that scale economies vary with the level of output. The coefficient allowing scale economies to vary with output is significant, and estimates of scale economies suggest substantial scale economies at relatively low levels of output, then a gradual reduction in scale economies as output expands in the intermediate range of outputs to higher levels of output, and finally the possibility of diseconomies of scale at the highest levels of output.

Elliehausen and Kurtz illustrated the effects of scale economies, using the estimated cost function to calculate average compliance costs per account at different levels of output. For banks with branches, average compliance cost per account falls from $9.44 at an output level of about 1,800 accounts to $0.93 at 454,000 accounts; thereafter, average compliance costs per account rise, reaching $1.11 at an output level of about 2 million accounts. For banks with no branches, average compliance costs per account are $5.39 at an output level of 1,800 accounts, $0.54 at 454,000 accounts, and $0.63 at 2 million accounts.[12]

In a study conducted for the Federal Trade Commission, Boyle (1982) surveyed 201 mortgage banking companies on the total costs of complying with Truth in Lending in 1980 and 1981. The questionnaire followed the approach of the Federal Reserve survey: Respondents were requested to estimate incremental costs of the regulation in eight cost categories and were provided with a list of requirements and possible compliance activities. The sample was drawn from the membership of the Mortgage Bankers Association, which includes the vast majority of mortgage originations in this industry, and a reasonable response rate was obtained. Therefore, the sample can be viewed as representative of the mortgage banking industry.

[12] These estimates hold constant all factors affecting compliance costs except the level of output. They thus provide a better indication of the effect of scale than the raw data. An earlier version of the study (Elliehausen and Kurtz 1985) reports the raw descriptive statistics from the survey. Average compliance costs per consumer credit account fall from $20.51 for banks with fewer than 5,000 accounts to $0.88 for banks with between 50,000 and 499,999 accounts and then rise to $1.52 for banks with more than 500,000 accounts.

Although Boyle did not estimate cost functions, the survey responses nevertheless suggested the existence of scale economies in the mortgage banking industry. For 1980, compliance costs for Truth in Lending were $30.91 per mortgage application at firms with less than $50 million of loan originations, $22.30 at firms with $50 to $199 million of loan originations, and $11.72 at firms with $200 million or more loan originations. For 1981, compliance costs were $35.74, $26.77, and $15.77 per mortgage application at the respective size groups of firms.

The regulation implementing a major revision to the Truth in Lending Act became effective in 1981 and mandatory in 1982. By comparing cost estimates of firms that had begun conversion to the revised regulation in 1981 to those that had not begun conversion, Boyle was able to estimate at least part of the start-up costs associated with the revision. For firms that had begun conversion, average compliance costs rose $6.11 per application, from $13.61 in 1980 to $19.72 in 1981. In contrast, average compliance costs for firms that had not begun conversion hardly changed at all ($13.91 per application in 1980 and $13.10 per application in 1981).

Components of Compliance Costs

Schroeder (1985) reported that nearly half of the start-up costs for the Electronic Fund Transfer Act were for changing data-processing systems. The second largest component was administration costs, which were 18.4 percent of total start-up costs. The distribution of start-up costs across categories varied by size of bank. The costs of changing data processing were relatively lower and administration costs were relatively greater at smaller banks than at larger banks.

For ongoing costs of the Electronic Fund Transfer Act, Schroeder reported that administration and labor costs were 53.6 percent of the total. The next largest components of regulatory costs were postage (17.0 percent) and printing or purchase of statements (10.2 percent). Administration and labor costs appeared to be relatively greater for smaller banks than for larger banks, but the decline in this component's share of costs from the smallest to the largest groups was not consistent.

Elliehausen and Kurtz (1985) reported descriptive statistics for ongoing compliance costs for the Truth and Lending and Equal Credit Opportunity Acts by cost category. Administrative and labor expenses were the largest component of ongoing compliance costs for these federal consumer credit regulations. Depending on the number of consumer credit accounts, administrative and labor expenses were about half to three-fourths of compliance costs.

Boyle found that administrative and labor expenses were the largest single component of compliance costs for Truth in Lending in the mortgage banking industry. In both years, administration and labor costs were more than half of total compliance costs at mortgage banks with less than $200 million of applications and 35 to 40 percent at mortgage banks with $200 million or more of mortgage applications.

Estimates of Aggregate Regulatory Costs

The staff of the Federal Reserve Board (1978) surveyed eight large creditors about certain provisions of the Equal Credit Opportunity and Fair Credit Billing Acts.[13] The provisions covered were separate credit histories for married persons and adverse action notification in the Equal Credit Opportunity Act and resolution of billing errors in the Fair Credit Billing Act.

The sample was intended to provide information on a large cross-section of consumer accounts, but, to minimize the reporting burden on the consumer credit industry, it was limited to eight creditors that were believed to have readily available records. Although such a sampling approach may include a large number of accounts, it is unlikely to provide a representative sample. The sample provides essentially eight case histories.

For initial mailings of the notice of the right to a separate credit history, seven companies mailed 48.5 million notices at a cost of $5,000 to $88,000 per company.[14] The average cost per notice sent was between 0.3 cents and 2.8 cents. In response to the mailings, 5.3 million customers requested separate credit histories. The cost of processing the requests and reporting the new information was between $20,000 and $150,000 per company. The average initial cost per request was between 5 cents and 36 cents. Annual maintenance

[13] Three of the creditors were retailers, three were banks, one was a travel and entertainment card company, and one was an oil company.

[14] Several companies mentioned that inclusion of the notice with billing statements displaced advertising inserts, which resulted in a loss of sales. These cost estimates do not include this cost.

costs for reporting separate credit histories for these accounts were estimated to be between $3,000 and $89,000 per company and between less than 1 cent to 14 cents per account.

The cost of providing reasons for adverse action varied widely. Three of the surveyed companies automatically provided reasons to rejected applicants. The average cost per rejection of automatically providing reasons for adverse action ranged from $0.59 to $1.07. For the other four companies, which provided reasons upon request, the average cost per rejection was $0.22 to $5.25.

For the requirement that creditors inform customers of their billing rights, five creditors reported informing customers in periodic statements, and three reported informing customers in separate mailings. Only one company reported a cost estimate for informing customers in periodic statements: That cost was $7,308 per year or less than 0.1 cent per active account. The three companies informing customers in separate mailings reported costs of between $25,760 and $67,300 or between 0.7 and 1.9 cents per active account.

As part of their study for the Independent Bankers Association of America, Grant Thornton (1992) surveyed independent banks to estimate aggregate compliance costs for the thirteen regulations or regulatory requirements that were covered in their case studies. They sent questionnaires to a sample of 2,600 banks, which was stratified into three asset-size groups; each bank was asked to report the number of employee hours spent on compliance activities for one of the thirteen regulations (thus, the sample for each regulation was 200 banks). Questionnaires were returned by 765 banks (between 43 and 83 responses per regulation).

Standard salary, benefit, overhead, and other direct cost rates derived from the case study results were used to estimate compliance costs from compliance hours, and survey results were projected to the population of independent banks. They estimated aggregate compliance costs of $4.2 billion for the thirteen regulations. The Community Reinvestment Act ($1.5 billion) was the most costly regulation, followed by formal written policies ($499 million), regulatory exams ($396 million), and Truth in Lending ($367 million).[15]

The American Bankers Association (1992) surveyed its members on regulatory costs during the spring of 1992. The questionnaire asked respondents to estimate (1) the percentage of noninterest expenses incurred for outside legal and consulting services, compliance

[15] In contrast to the case studies, the survey responses did not place the Expedited Funds Availability Act among the most costly regulations.

training for bank employees, and training materials; (2) the dollar amount of salary and benefit expenses for compliance staff; and (3) the percentage of noninterest expenses incurred for salary and benefits for the time that noncompliance staff devoted to regulatory matters. About 900 of the association's 9,000 member banks responded.

Several limitations of the survey should be noted. The questionnaire did not specify which regulations were to be counted nor provide guidance on compliance activities associated with regulations. As a consequence, the set of regulations and compliance activities on which responses were based likely differed from respondent to respondent. Also, compliance staff time on nonregulatory matters was apparently included in the estimates for regulatory costs, and overhead costs and most nonlabor compliance costs were not included. These limitations suggest that response errors are probably larger for this survey than the previously discussed case studies and surveys.[16]

Based on the size distribution of the population of banks, responses to the survey were weighted to produce an estimate of aggregate regulatory costs. The survey indicates that expenses for outside legal and consulting services, compliance training, compliance staff, and regulatory activities of noncompliance staff were around $10.7 billion per year, or about 10.0 percent of the industry's noninterest expenses in 1991. Adding an estimate for the opportunity costs for idle reserves ($1.6 billion) and deposit insurance premiums ($5.2 billion) yields regulatory costs of $17.5 billion or 16.4 percent of noninterest expenses.

Unlike other surveys of regulatory costs, Boyle's (1982) survey of the costs of Truth in Lending in the mortgage banking industry was based on a relatively large random sample of firms and achieved an adequate response rate. Hence, aggregates estimated from this survey are probably reliable. Based on the survey results, Boyle projected that the aggregate marginal cost of Truth in Lending to the mortgage banking industry was $11.9 million in 1980 and $13.3 million in 1981.

[16] It is not obvious whether the lack of guidance provided to respondents of the American Bankers Association survey would bias responses or simply increase variability in responses. Based on distributions of costs from case studies, the negative bias from omission of nonlabor costs would likely be greater than the positive bias from including noncompliance activities of compliance staff.

Other Surveys

The FDIC (1992) conducted a study of the burden of preparing call reports. The study collected information from a series of focus groups and a survey of banks employees that prepare call reports for their banks. Of the 12,664 banks that received questionnaires, 6,740 banks returned them.

Most of the survey questions concerned bankers' perceptions of call report instructions and the availability of assistance from FDIC staff, but a few questions addressed the time spent by bank employees in preparing the call report. On average, banks reported spending 27 hours preparing each quarterly call report. Of this time, an average of 3 hours (range 7-60 hours) were for understanding the instructions, 8 hours (range 26-25,000 hours) for gathering the information for preparing the report, 8 hours (range 25-900 hours) for preparing the report after the information has been gathered, and 8 hours (range 26-397 hours) for final approval by bank management.[17]

Econometric Evidence

Estimates of costs derived from econometric studies using secondary data are also occasionally undertaken. Typically, such studies estimate costs using correlations between activity costs and regulatory differences across observations in cross-section data or examining changes in costs when regulations change in time-series data. The problem is that the regulation in question is seldom the only factor affecting costs. Controlling adequately for each separate factor that influences costs is often difficult. Even in multivariate statistical models, it is sometimes not possible to conclude with confidence that the estimated difference in the cost of an activity is due to the regulation (for discussion, see Phillips and Calder 1979, 1980).

In a study for the National Commission for Consumer Finance, Benston (1972) investigated the effects of regulation of creditor remedies on operating costs at consumer finance companies. Using data on 124 consumer finance companies for 1968-70, Benston estimated a Cobb-Douglas cost function. Included among the independent variables were four dummy variables indicating the restrictiveness of state regulations governing wage

[17] The wide range of reported preparation times occurs at least in part because of differences in the size and complexity of banks in the population.

assignments, holder in due course, wage garnishment, and confessions of judgement. Except for wage assignments, the signs of estimated coefficients suggest that operating costs of finance companies are generally higher in states with more restrictive creditor remedies than in states with less restrictive creditor remedies. However, the magnitudes for the estimated coefficients appear to be unreasonably high, and only one coefficient (restrictive regulation of garnishments in the 1968 cost function) is statistically significant at conventional levels of significance.[18]

Other Studies of Regulatory Costs

Smith (1977) used data from the Consumer Bankers Association survey, the Federal Reserve survey, an econometric study, case studies, and various other sources to construct estimates of aggregate start-up and ongoing compliance costs of creditors for the Equal Credit Opportunity Act. Smith identified requirements of the act affecting creditors' costs, constructed per-unit cost estimates for these requirements using available secondary data, and then converted the per-unit data to aggregates. Because these estimates are constructed from a variety of sources, however, they have the same limitations as the other studies; specifically, they are not based on a single, consistent framework for measuring costs, and they lack an assurance of the representativeness of the data.

Smith estimated that creditors' start-up compliance costs for the Equal Credit Opportunity Act were $131.8 million, of which $34.8 million was at commercial banks and $97.0 million at other creditors. These costs included expenses for legal services ($2.4 million at banks, not estimated for other creditors); employee training ($1.4 million, banks; $6.2 million, other creditors); destruction of obsolete forms ($2.4 million, banks; $9.5 million, other creditors); printing and mailing a notice on married persons' right to separate credit histories ($15.4 million, banks; $33.1 million, other creditors); and changing computer

---

[18] As Benston realized, the use of dummy variables may inadequately control for differences in creditor remedies across states. Restrictions on wage assignment and garnishment may be a prohibition or a limitation on the amounts that can be assigned or garnished. Also, intercorrelations among creditor remedies (that is, states that restricted one remedy were likely to restrict others) and between creditor remedies and other regulations may contribute to insignificant or unrealistic results. For further discussion, see Barth, Gotur, Manage, and Yezer (1983).

and reporting systems to maintain separate credit histories ($13.2 million, banks; $48.2 million, other creditors).[19]

The ongoing costs associated with the act were $127.5 million, of which commercial banks had $24.4 million and other creditors had $103.1 million. Ongoing costs included expenses for increased computer usage and report preparation time due to separate credit histories ($2.3 million, banks; $10.2 million, other creditors); additional credit reports ($8.5 million, banks; $36.5 million, other creditors); additional losses due to prohibitions in the use of information in credit evaluation ($9.0 million, banks; $36.2 million, other creditors); increased collection expense ($2.9 million, banks; $12.9 million, other creditors); and additional record retention ($1.7 million, banks; $7.3 million, other creditors).

Two studies have attempted to estimate opportunity costs for reserve and capital requirements. Baer (1988) defined the cost of reserve requirements to be the interest rate multiplied by the average reserve requirement. Assuming a constant interest rate of 10 percent, according to this definition, the cost of reserve requirements fell from 45 basis points to 18 basis points per dollar of assets between 1976 and 1985. This result reflects the general decline in reserve requirements during this period. Baer defined the cost of capital requirements to be essentially the tax difference between capital and debt financing of assets. In the 1980s, capital requirements were increased. The cost of capital requirements rose from 20 basis points to 45 basis points per dollar of assets between 1976 and 1985. Thus, rising capital requirements largely offset the fall in reserve requirements during this period. In 1986, the opportunity cost of both reserve and capital requirements was 63 basis points, about the same as that of a decade earlier. These estimates probably overstate the opportunity cost of reserve and capital requirements because they assume that all reserves and capital are maintained to satisfy regulatory requirements and would not be otherwise maintained.

Hannan (1988) computed incremental costs for reserve and capital requirements based on results derived from a theoretical model of a bank's lending decision. Using the interest rate for time deposits (which varied during the period under consideration) as the cost of marginal funds at banks, Hannan estimated that the cost of reserve requirements increased from 20 basis points to 35 basis points for each additional dollar of assets between 1976 and 1985. Hannan considered capital requirements to be costly only if they were binding. His

[19] Smith also estimated that credit reporting agencies would incur start-up costs of $34.0 million for maintaining separate credit histories.

calculations for the cost of capital requirements depended on his assumption about the proportion of bank assets accounted for by banks with binding capital requirements. In contrast to Baer's estimates, Hannan's estimates for the cost of capital requirements fell during the 1980s. Using a relatively low threshold to determine when capital requirements were binding, Hannan estimated that, depending on bank size, the cost of capital requirements fell 70-80 basis points to 42-51 basis points from the early 1980s to 1985. Using a higher threshold, Hannan found greater cost differences by size of bank (because the capital requirement was not binding for most small and medium-sized banks). The cost of capital requirements fell from 11-17 basis points to 4-6 basis points at small and medium-sized banks and from 58 basis points to 16 basis points at large banks during this period. Hannan's calculations provide perhaps a better estimate than Baer's of the cost per dollar of assets for reserve and capital requirements. However, the amount of reserves and capital held because of regulatory requirements, and hence the aggregate dollar amount of opportunity costs, remains an unanswered question.

Conclusion

Information is insufficient to produce a highly reliable estimate of the aggregate cost of regulations on commercial banks. Only a few case studies and one survey have attempted to provide a comprehensive estimate of regulatory costs. Case studies cannot, however, be used as a basis for estimating aggregate costs, and the representativeness of the American Bankers Association survey is unknown. Moreover, the survey data probably have a large amount of measurement error.

Nonetheless, ignoring for the moment the issue of the representativeness, case studies indicate that regulatory costs may be 6-14 percent of noninterest expenses, not including the opportunity cost of reserve requirements, and 8-27 percent of noninterest expenses including the opportunity cost of reserve requirements.[20] Noninterest expenses of commercial banks in 1991 were $124.6 billion. This number suggests that regulatory costs in 1991 could be between $7.5 billion and $17 billion, without any adjustment for the cost of reserve requirements. This estimate is also consistent with the very limited available survey evidence.

[20] The opportunity cost of reserve requirements depends crucially on the assumed interest rate. The wide range of regulatory costs when reserve requirements are included reflects the large differences in prevailing interest rates between the earlier and later studies.

Whatever the true costs attributable to regulation alone, a crude estimating procedure of this sort indicates that the amount is considerable with or without the inclusion of the opportunity cost of reserve requirements.

The issue of including the cost of reserve requirements as a regulatory cost depends crucially on the amount of clearing balances that banks would hold regardless of legal reserve requirements. Clearly banks would hold some reserves of cash for transaction and precautionary purposes regardless of whether required or not. Those reserves would not contribute to regulatory costs. Only one of the studies estimating opportunity costs for reserve requirements accounted for that factor. In that study, which was conducted over a decade ago, reserve requirements were a large component of regulatory costs. The opportunity cost of reserve requirements likely remains a significant cost today, despite lower levels of interest rates and reserve requirements.

Several studies using survey data investigate the effects of size on compliance costs for various regulations affecting consumer financial services. These studies suggest the existence of scale economies in compliance costs. Compliance costs appear to rise 6-8 percent for every 10 percent increase in output, depending on the type of cost and regulation. One study finds that scale economies vary with the level of output. Economies of scale are large at relatively low levels of output and decline as output increases. The basic conclusion is similar for all of these studies. Average compliance costs for regulations are substantially greater for banks at low levels of output than at moderate or high levels of output.

The case studies and surveys suggest that compliance activities for regulations are labor intensive. Labor costs are the major component of compliance costs. Some of these studies also suggest that a large part of the labor cost of complying with regulations is the time that bank officers and managers devote to compliance activities.

The available evidence from case studies and surveys suggests that in general each regulation may contribute only a little to the total, although some regulations clearly do contribute a great deal. Truth in Lending, for example, appears in more than one study as a major source of regulatory cost. Deposit insurance premiums and reserve requirements also appear to be large components of regulatory costs. Taken as a whole, the set of regulations imposed on commercial banks appears to be a significant component of operating expenses and may weigh disproportionately on smaller banks.

References

American Bankers Association. Survey of Regulatory Burden: Summary of Results. American Bankers Association, mimeo, June 1992.

Baer, Herbert L. Regulatory Burden Handicaps Low-Risk Banking. Chicago Fed Letter, Federal Reserve Bank of Chicago, January 1988.

Barth, James R., Padma Gotur, Neela Manage, and Anthony M.J. Yezer. The Effect of Government Regulation of the Personal Loan Market: A Tobit Estimation of a Microeconomic Model. Journal of Finance 21 (September 1983): 1233-51.

Baumol, William J. Economic Theory and Operations Analysis, 4th edition. London: Prentice-Hall, 1977.

Benston, George J. The Costs of Extending Consumer Credit at Consumer Finance Companies. In Technical Studies, Vol. II, National Commission on Consumer Finance. Washington, DC: Government Printing Office, 1972.

Boyle, John M. A Survey of the Mortgage Banking Industry Concerning Costs and Benefits of Regulation. Report prepared for the Federal Trade Commission. Washington, DC: Louis Harris and Associates, 1982.

Carroll, Evelyn F., John P. Danforth, Carter F. Golembe, and P. Michael Laub. The Burden of Bank Regulation. Washington, DC: American Bankers Association, 1989.

Commission on Federal Paperwork. Consumer Credit Protection. Washington, DC: Government Printing Office, 1977.

Darnell, Jerome C. A Study of the Costs of Complying with Government Regulations. Report prepared for the United Bank of Denver, 1980.

Elliehausen, Gregory E. and Robert D. Kurtz. Scale Economies in Compliance Costs for Federal Consumer Credit Regulations. Journal of Financial Service Research 1 (January 1988): 147-59.

__________ and __________. Scale Economies in Compliance Costs for Consumer Credit Regulations: The Truth and Lending and Equal Credit Opportunity Laws. Staff Study 144. Washington, DC: Board of Governors of the Federal Reserve System, 1985.

Federal Deposit Insurance Corporation. Call Report Study. Washington, DC: Federal Deposit Insurance Corporation, 1992.

Federal Reserve Staff. Exercise of Consumer Rights Under the Equal Credit Opportunity and Fair Credit Billing Acts. Federal Reserve Bulletin 69 (May 1978): 363-366.

Grant Thornton. Regulatory Burden Study. Report prepared for the Independent Bankers Association of America, 1992.

Hannan, Timothy H. The Regulatory Burden and its Impact on Large Corporate Lending. Board of Governors of the Federal Reserve System, staff memorandum, September 14, 1988.

Henderson, James M. and Richard E. Quandt. Microeconomic Theory: A Mathematical Approach, 3rd edition. New York: McGraw-Hill, 1980.

McKinsey & Company. Estimating Bank Regulatory Cost Burdens. Presentation to Federal Reserve Officials, May 1, 1992.

Murphy, Neil B. Economies of Scale in the Cost of Compliance With Consumer Credit Protection Laws: The Case of the Implementation of the Equal Credit Opportunity Act of 1974. Journal of Bank Research 10 (Winter 1980): 248-50.

Phillips, L.W. and B.J. Calder. Evaluating Consumer Protection Programs: Part I, Weak But Commonly Used Research Designs. Journal of Consumer Affairs 13 (Winter 1979): 157-85.

_________ and _________. Evaluating Consumer Protection Programs: Part I, Promising Methods. Journal of Consumer Affairs 14 (Summer 1980): 9-36.

Schroeder, Frederick J. Compliance Costs and Consumer Benefits of the Electronic Fund Transfer Act: Recent Survey Evidence. Staff Study 143. Washington, DC: Board of Governors of the Federal Reserve System, 1985.

Smith, James F. The Equal Credit Opportunity Act of 1974: A Cost/Benefit Analysis. Journal of Finance 32 (May 1977): 609-22.

Appendix D: Federal Agency Actions to Reduce Regulatory Burden

Appendix D: Federal Agency Actions to Reduce Regulatory Burden

Since the passage of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), the agencies participating in this study have renewed their efforts to identify and remove unnecessary regulatory burden. To that end, each of the agencies has set forth in this appendix its initiatives to relieve regulatory burden within the past year.

Federal Deposit Insurance Corporation

By memorandum dated January 28, 1992, President Bush requested the major federal regulatory agencies to set aside a 90-day period to "weed out unnecessary and burdensome government regulations, which impose needless costs on consumers and substantially impede economic growth." Each federal regulatory agency was requested to evaluate existing regulations and programs and to identify and eliminate any unnecessary regulatory burden.

The Federal Deposit Insurance Corporation (FDIC) solicited public and industry comment through publication of a request for comment in the Federal Register and through a Financial Institutions Letter sent to all FDIC-supervised institutions. In addition, the FDIC requested and received comment from its regional and field office staff. To comply with the President's request, the FDIC created a Regulatory Review Committee comprised of high ranking officials from separate functional areas within the FDIC. After evaluating each regulation, policy statement, and program, the Committee identified modifications that could be made without compromising safety and soundness or consumer protection and made various recommendations for initiatives aimed at reduction of unnecessary regulatory burden.

Since passage of FDICIA the FDIC has taken a number of steps to reduce regulatory burden and promote growth in a broad variety of areas. With respect to real estate appraisals, the FDIC approved an increase from $50,000 to $100,000 in the threshold amount below which a real estate appraisal is not required and exempted loans that finance the purchase of real estate, but are not secured by real estate. As authorized by the Depository Institutions Disaster Relief Act of 1992, the FDIC and the other agencies that comprise the FFIEC published a statement and order authorizing certain temporary exceptions to the real estate appraisal rules in major disaster areas when the exceptions would facilitate recovery from the disaster and would not be inconsistent with safety and soundness.

The FDIC adopted a final rule amending its procedural regulations to delegate to the Director of the Division of Supervision or his designee the authority to approve "Oakar" transactions under section 5(d)(3) of the Federal Deposit Insurance Act (FDI Act). Thus, the same individual would approve both the Oakar application and the Bank Merger Act application. In addition, rather than requiring the filing of a separate application, the FDIC prescribed that requests for approval should be submitted by attaching a transmittal letter to the merger application stating that the transaction falls within section 5(d)(3) of the FDI Act and that the transaction will not result in the transfer of insurance for any deposits from one deposit insurance fund to another.

The FDIC also adopted a policy statement announcing that the FDIC consents to foreclosure on Corporation property by holders of voluntary liens where the FDIC's interest in a property is not of record. This statement relieves affected parties of the burden of obtaining the FDIC's consent prior to foreclosure.

In addition, the FDIC adopted a policy statement that permits institutions to append a copy of an application to a chartering authority to the FDIC application for deposit insurance thus relieving institutions of the burden of unnecessary paperwork.

In accordance with the Regulatory Review Committee's recommendations, the FDIC recommended that the FFIEC modify or rescind outdated or superseded policy statements on disclosure of statutory enforcement actions, interagency coordination of formal corrective action, interagency policy regarding assessment of civil money penalties, and Community Reinvestment Act (CRA) information statements.

In the legislative area, the FDIC wrote legislative language that would promote the reduction of regulatory burden. The FDIC wrote legislative language amending section 7 of the FDI Act to authorize the FDIC to calculate insurance assessments based on reports of condition and income data from an earlier assessment period. This would facilitate preparation by the FDIC of preliminary certified statements for insured institutions.

At the request of Congressman Bereuter, the FDIC wrote legislative language to reduce regulatory burden associated with a number of statutes including the Truth in Lending Act, the CRA, and the Home Mortgage Disclosure Act (HMDA). The FDIC wrote legislative language that would eliminate the three-day rescission period under the Truth in Lending Act for credit transactions by "sophisticated customers." The FDIC also wrote legislative language to exempt wholesale and special purpose banks from the CRA. Further, the FDIC wrote legislative language to extend the exemption from HMDA to institutions with assets of less than $25 million from institutions with assets of less than $10 million.

The FDIC and the other federal banking agencies considered the reluctance of lenders, in some cases, to extend credit to sound borrowers and determined that the supervisory definition of "highly leveraged transactions" (HLT) had largely accomplished its purposes. Accordingly, the FDIC and the other federal banking agencies published a Federal Register notice discontinuing the HLT definition and the requirement to report HLT exposure after June 30, 1992.

To improve coordination and communication between external auditors and federal examiners and thereby to alleviate burden, the FDIC and the other federal banking agencies issued a policy statement regarding scheduling, copies of reports, and meetings.

Under the auspices of the FFIEC, each federal banking agency committed to announce all reporting changes that will take effect the following year prior to the end of each year, except for certain reporting changes necessitated for safety and soundness, insurance assessment, or other regulatory reasons.

With respect to the CRA, the FDIC and the other federal banking agencies adopted examination procedures and clarified their expectations regarding recordkeeping and documentation. The new guidance emphasizes that CRA performance is based on meeting community credit needs and not on maintenance of documentation.

Federal Reserve Board

Over the past year, the Board has taken a variety of actions to reduce the regulatory burden on the banking community. The Board developed some of these initiatives independently, and others are part of joint efforts undertaken by the four federal financial institution regulatory agencies. The Board has long been committed to ensuring the efficiency of the implementation of its regulatory responsibilities. The Board will continue its policy of examining all existing and pending regulations to minimize the burdens of its regulatory programs, while carrying out specific statutory requirements and maintaining the safety and soundness of the banking system.

The Board conducted an in-depth review of all its regulations. It also carefully reviewed its application process to ensure that it is functioning as efficiently as possible, consistent with statutory requirements. As a result of the review, the Board identified proposals to improve processing efficiency and reduce burden on applicants, and requested public comment on the proposals in August 1992. The proposals relate to the efficiency of pre- and post-application procedures, notice requirements for investments in bank premises and stock redemptions, delegation of authority to Reserve Banks, and case monitoring.

The Board also took several steps to eliminate unnecessary application and approval requirements. Specifically, the Board waived certain bank holding company applications that have already been reviewed by the bank's primary supervisor under the Bank Merger Act, increased the size of nonbank companies that can be acquired under expedited notice procedures, increased the relative size of nonbank assets that can be acquired without prior approval, exempted mergers of affiliated thrifts from section 23A requirements in certain cases, and eliminated the requirement for member banks to obtain prior approval before issuing subordinated debt that is considered to be capital. The Board also approved initiatives to streamline branch application procedures and reduce newspaper publication requirements. Furthermore, the Board approved the addition of four new nonbanking activities to the list of permissible activities for bank holding companies, pertaining to leasing, financial advice, full service brokerage, and investment advice.

The Board has taken various steps to reduce burden on member banks and bank holding companies by amending capital requirements. For example, in January 1992, the Board approved a proposal to permit bank holding companies to raise additional Tier 1 risk-based capital through the sale of perpetual preferred stock. The Board has also proposed amendments to its capital adequacy guidelines regarding the treatment of purchased mortgage servicing rights, purchased credit card relationships, and various types of housing loans.

The Board has taken several steps to address "credit crunch" problems. Board staff has issued supervisory letters and policy statements and held meetings with examiners over the past year to explain and clarify Federal Reserve policy and to ensure that Federal Reserve policies or actions of examiners do not result in curtailment of credit to creditworthy borrowers.

Other regulatory or policy actions taken by the Board to help reduce burden on the financial community include: discontinuing reporting requirements for "highly-leveraged transactions;" amending anti-tying rules to expand banks' abilities to offer credit cards to their customers; rescinding a policy statement requiring Board approval prior to any relocation across state lines of a bank owned by a bank holding company; simplifying rules regarding bank security devices; reducing from 21 to 14 the number of data items collected on the detailed deposits report; reducing the required reserves for net transaction account balances from 12 to 10 percent; and increasing flexibility in reserve computation and maintenance.

In cooperation with the other financial institution regulatory agencies, the Board has adopted measures to limit the frequency of changes in financial and supervisory reports and to provide adequate lead time for such changes, to clarify the documentation required to demonstrate whether banks are meeting their responsibilities under the Community Reinvestment Act, to clarify the permissibility of "prescreening" customers under the Fair Credit Reporting Act, to coordinate examination of state member banks with state regulators, to coordinate with external auditors to minimize scheduling conflicts and burdens on banks, and to facilitate sharing of information between auditors and examiners.

The Board is working with the other regulatory agencies on various additional initiatives, such as eliminating duplicative examinations and applications; simplifying and standardizing application forms; expediting applications processing for healthy institutions; standardizing examination report forms and procedures, examiner training, and charter and insurance requirements; coordinating implementation of common statutes; minimizing appraisal requirements; and developing common definitions, policies, and standards for classification and valuation of assets, accounting issues, and minimum levels of general valuation allowance.

Department of the Treasury

The Department of the Treasury and four of its bureaus have made significant strides in reducing burden. This summary of Department actions is divided by bureau.

Main Treasury

To follow through on its commitment to relieve regulatory burden, the Administration introduced the Credit Availability and Regulatory Relief Act of 1992 (CARRA). CARRA contains 27 recommendations to reduce regulatory burden.

The Department's pursuit of legislative action proved fruitful. Some of the provisions of CARRA were passed in the Housing and Community Development Act of 1992, which had seven burden-reducing provisions. The following three provisions were taken from CARRA: (1) the bill clarifies that lenders need not provide information booklets about settlement costs in connection with consumer real estate loans if the lender denies the loan within three days;

(2) non-consumer loans are exempted from the consumer-oriented provision requiring caps on adjustable rate mortgages; and (3) the bill grants discretion to the regulators to set the *de minimis* level for real estate appraisals. The bill also contained four non-CARRA related burden reducing provisions. First, regulators may grant savings associations case-by-case extensions of up to two years in the schedule for phasing-out their direct real estate investments from their capital. Second, the Federal Reserve Board may make exceptions to restrictions on loans to bank insiders. Third, the executive compensation standards required under FDICIA will not set specific levels or ranges of compensation. Fourth, banks are given an additional three months to comply with the Truth in Savings regulations.

Office of the Comptroller of the Currency

The Office of the Comptroller of the Currency (OCC) has undertaken several initiatives intended to reduce the regulatory burden on national banks. Immediately following the announcement of the President's Regulatory Initiative on January 28, 1992, the OCC undertook an intensive review of all regulations and programs that may impose unnecessary burdens or costs on national banks or the public. The agency also sought to identify and accelerate action on initiatives that will eliminate unnecessary regulatory burden or otherwise promote growth.

To ensure maximum public comment, on February 21, 1992, the OCC published a notice in the Federal Register soliciting ideas and simultaneously issued a press release requesting specific suggestions. The agency also mailed a Banking Bulletin describing the regulatory initiative and soliciting input from every national bank chief executive officer and every OCC bank examiner. Moreover, OCC industry liaison staff contacted state bankers' associations and national trade groups to obtain their input. These solicitations resulted in over 200 comments. OCC staff members were also assigned to review each regulation and program in light of the President's criteria.

As a result of these initiatives, the OCC has issued several final and proposed rulemakings intended to lessen regulatory burden.

Two significant initiatives have been taken with respect to real estate: (1) a lowering of the threshold for real estate appraisal requirements; and (2) the joint publication with the other FFIEC member agencies of a statement and order authorizing the creation of exceptions from the real estate appraisal requirements in localities the President declares to be major disaster areas. The first initiative is a final rule that was issued exempting certain real estate-related financial transactions from the requirement that an appraisal be obtained by a certified or licensed appraiser. It increases from $50,000 to $100,000 the threshold above which such appraisals must be obtained and exempts certain government guaranteed or insured loans. The effect of the rule is to lower the cost of financing for customers and reduce paperwork burdens on national banks.

Under the second initiative, the OCC and the other FFIEC member agencies published a statement and order authorizing the creation of certain temporary exceptions to the real estate appraisal rules in major disaster areas when the exceptions would facilitate recovery from the disaster and would not be inconsistent with safety and soundness. This action was implemented under the Depository Institutions Disaster Relief Act of 1992, and will have the effect of streamlining and expediting procedures in disaster situations.

Several initiatives were advanced to ease bank capital requirements. A final rule was issued that reduces the amount of capital banks must hold against qualifying loans to builders of one-to-four family pre-sold homes. This new rule may stimulate residential construction. In addition, a Notice of Proposed Rulemaking (NPRM) was issued that would allow national banks to include a higher value of certain intangible assets in regulatory capital. The effect of the rule could be to increase the availability of both new mortgages for home buyers and bank funds for borrowers.

In order to streamline bank capital requirements, a final rule was adopted that clarifies and makes technical changes to the risk-based capital guidelines, including the capital treatment of the unused portion of commitments and of assets sold with recourse. The rule maintains consistency with the guidelines of the other federal banking agencies, other federal statutes, and the Basle Accord.

The OCC also took steps to streamline and reduce the burden of bank securities regulation. Regulations were adopted that reduce reporting and filing requirements for national banks required to comply with the Securities Exchange Act of 1934 by specifically cross-referencing Securities and Exchange Commission (SEC) rules and eliminating separate OCC rules. The regulations will save time and expense for the approximately 56 national banks required each year to comply with this regulation.

In addition, a NPRM was issued that would repeal current OCC regulations regarding requirements for offers and sales of national bank securities, and incorporate by reference certain rules of the SEC that implement the Securities Act of 1933. Incorporation by cross-reference of certain SEC rules will ease reporting and filing requirements and simplify compliance since investors and securities counsel for banks and investors are more familiar with SEC rules.

Finally, a NPRM was issued that would eliminate the requirement that banks holding certain securities maintain specified credit information on the issuers of those securities. Instead, banks would be required to maintain information establishing the prudence of those investments under general supervisory standards.

Office of Thrift Supervision

In February 1992, the Office of Thrift Supervision (OTS) began a comprehensive review of all existing OTS regulations and policy statements to identify those that could be modified or deleted to reduce regulatory burden/costs and promote economic growth, while maintaining the standards of safety and soundness. That review was undertaken by a working group of senior level staff from several divisions within OTS.

In addition to the internal review, on March 12 and 16, OTS held public hearings in San Francisco and Washington, D.C., to solicit public comment on our regulations and regulatory programs. The OTS heard testimony from 19 representatives of savings associations, law firms, trade associations and other regulatory agencies. In addition, the OTS solicited written comments from the public and received 58 response letters.

This effort resulted in several revisions to, or deletions of, existing regulations and policies. Listed below are some of the major initiatives undertaken by the OTS in 1992.

FDIC/OTS Joint Examination Agreement: This agreement between the two agencies, issued on May 18, 1992, establishes the conduct of examinations, supervisory and enforcement actions, and capital plan reviews in which the FDIC has an interest. The agreement is expected to significantly reduce examination time for thrifts while increasing exam effectiveness.

Interstate Branching: This rule permits nationwide branching by federal savings associations.

Applications Restructuring: This regulation restructures the role and processing of applications for thrifts and streamlines many applications and notice procedures. Several applications have been reduced to notices for savings associations with adequate capital, and satisfactory CRA and compliance ratings.

Supervisory Conversions: This rule eases the requirements for troubled mutual thrifts to qualify for a supervisory conversion.

Monthly Thrift Financial Reports: Beginning January 1, 1993, the OTS will no longer collect a monthly report. After 1992, only quarterly information will be collected.

Operating Subsidiaries and Service Corporations: This rule allows thrifts to establish and acquire "operating subsidiaries" similar to those permitted for national banks. This rule would provide a new vehicle for attracting capital and increasing profits.

Conflicts of Interest and Insider Transactions: This rule simplifies a set of overlapping and confusing rules by adopting bank rules on extensions of credit and other transactions with insiders.

Real Estate Appraisals: This rule increased the *de minimis* standard for an appraisal from $50,000 to $100,000. This rule allows for evaluations rather than more costly appraisals for loans under the *de minimis* level.

Uniform Accounting Standards: This regulation clarifies that GAAP is the reporting standard used by the OTS (unless the Director promulgates another standard for safety and soundness). The regulation also consolidates all accounting rules under one section of the Code of Federal Regulations.

Mutual Holding Companies: This regulation outlines procedures for mutual institutions to obtain approval to form mutual holding companies and permits the savings association subsidiaries of the resulting holding companies to issue minority stock. This results in added flexibility in corporate structure for thrifts while permitting thrifts to pursue a new avenue for raising capital.

Holding Company Reporting Requirements: This rule streamlines holding company reporting requirements and alleviates confusion surrounding various forms used for similar reporting purposes.

Mergers and Combinations Involving Federal Associations: This rule revises existing restrictions on conversion transactions, thereby easing artificial barriers to consolidation of the industry and providing thrifts with greater access to capital.

Regulatory Review--General: In addition, the OTS has proposed to rescind several regulations that are outdated or are overly burdensome. These regulations include restrictions on operations such as liability growth, appraisals, debt securities, service corporation secured debt, and flood disaster notices for purchased loans. In addition, the proposal includes regulations involving corporate structure, corporate title advertising, compliance recordkeeping, and numerous additional regulations.

Financial Management Service

During 1992, the Financial Management Service (FMS) completed one regulatory action designed to reduce bank regulatory burden and clarify existing rules. FMS eliminated the regulation regarding the Letter of Credit - Treasury Financial Communications System (LOC-TFCS). This action finalized the phase-out of the LOC-TFCS.

Bureau of Public Debt

The Bureau of Public Debt (BPD) completed one regulatory action designed to reduce insurance costs and regulatory burden on banks. This action permits the Treasury to authorize the acceptance of eligible physical coupons from depository institutions for conversion to book-entry accounts under the Coupons Under Book-Entry Safekeeping (CUBES) program. This change affects those depository institutions which continue to hold definitive coupons for customers.

Appendix E: Prior Governmental Studies

Since World War II, a number of government commissions or study groups have addressed banking and financial regulation. For the most part, their reports have focused on the organization and structure of the regulatory agencies rather than on the regulations themselves. In 1949, for example, the Commission on Organization of the Executive Branch of Government (the Hoover Commission) advanced the view that most bank regulatory functions should be combined into one agency instead of the existing "crazy quilt" of supervisory authority.

In 1961, the Commission on Money and Credit made similar recommendations, concluding that there should be one examining authority for commercial banks and another for federally insured mutual savings banks and savings and loan associations. The activities and standards of the two federal agencies were to be coordinated with each other and with the respective state supervisory agencies.

The Commission on Money and Credit also made some recommendations concerning regulation of private financial institutions. The commission noted that its objectives were to preserve and increase the safety of the financial system and to provide greater flexibility for portfolio investment and increased alternatives for savers and borrowers. The commission stressed that both objectives had to be fulfilled simultaneously and that the recommendations were interrelated. In this context it recommended, among other things, liberalization of branching and geographic lending restrictions on financial institutions.

In 1971, the President's Commission on Financial Structure and Regulation (the Hunt Commission) recommended dividing the federal banking regulatory responsibilities into two agencies, according to whether regulated institutions (including mutual savings banks and savings and loan associations) had federal or state charters. Deposit insurance for banks, thrifts, and credit unions would be the responsibility of a single agency, the Federal Deposit Guarantee Administration. The commission also made extensive recommendations concerning the regulatory climate for supervised institutions, generally in the direction of permitting expanded portfolio powers.

In 1975, the House Banking Committee, in its report entitled "Financial Institutions in the Nation's Economy" (the FINE study), called for combining the functions of the regulatory agencies into a single agency. This superagency would have central jurisdiction over all federally and state-chartered depository institutions, including credit unions, and their holding companies. It would replace the existing agencies except for the Federal Reserve, which would be responsible solely for monetary policy. The FINE discussion principles would also have modestly expanded the portfolio powers of savings and loan associations to include consumer credit and would have allowed interstate branching with limitations. Recommendations included phasing out interest rate ceilings on deposits over a five-year period and expanding interest-earning deposit products by banks and thrifts.

In 1984, another government study report, Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services was completed. This was generally known as the Bush Task Force Report because George Bush, who was then Vice President, was the Chairman of the Task Force. Although the Bush Task Force Report discussed various issues and reviewed the structure of regulation in some detail, its focus also was more on the reorganization of the agencies than on changes in the regulations themselves.

The Bush Task Force Report recommended shrinking the number of federal banking regulatory agencies involved in "normal day-to-day" regulatory activities to two. In most cases, the agency that regulated the lead bank would also supervise the bank holding company. A new Federal Banking Agency, the successor to the OCC, would supervise most national banks and their parent holding companies. The Federal Reserve would continue to supervise the holding companies of the largest domestic banks as well as those with significant international activities and with foreign-owned institutions. The Federal Home Loan Bank Board would retain supervisory authority over thrift institutions. The FDIC would be solely the deposit insurance agency and would focus on administering the deposit insurance system. Also, regulation by function of the regulated institution, rather than by class of chartering agency would be emphasized.

The most recent of the government study reports, the U.S. Treasury Department's Modernizing the Financial System: Recommendations for Safer, More Competitive Banks, was completed in 1991. The study offered four fundamental reforms of the banking system. First, to increase bank competitiveness, the report recommended the authorization (with appropriate safeguards) of nationwide banking and branching, new financial activities, and commercial ownership of well-capitalized banking organizations. Second, the report advocated reforming the scope of deposit insurance and modifying the supervision of depository institutions. Third, the study reviewed the structure of the four federal banking agencies and recommended consolidating regulatory functions, with the division of responsibilities determined by charter type. Last, the study called for the recapitalization of the Bank Insurance Fund. While this study led to extensive legislative proposals, only some were adopted in FDICIA.

Appendix F: References

Carroll, Evelyn F., John P. Danforth, Carter H. Golembe, and P.Michael Laub. The Burden of Bank Regulation. Washington: American Bankers Association, 1989.

Commission on Financial Structure and Regulation. Report of the President's Commission on Financial Structure and Regulation. Washington: Government Printing Office, 1972.

Commission on Money and Credit. Review of Report of the Commission on Money and Credit. Washington: Commission on Money and Credit, 1961.

Commission on Reorganization of the Executive Branch of Government (The Hoover Commission). Report of the Task Force on Regulatory Commissions. Washington: Commission on Reorganization, 1949.

Federal Reserve Bank of Kansas City. Restructuring the Financial System. Kansas City: Federal Reserve Bank of Kansas City, 1987.

Fischer, Gerald C. American Banking Structure. New York: Columbia University Press, 1968.

Fischer, Gerald C. The Modern Bank Holding Company: Development, Regulation, and Performance. Philadelphia: Temple University, 1986.

Hahn, Robert W. and John A. Hird. The Costs and Benefits of Regulation: Review and Synthesis. Yale Journal on Regulation. (Winter 1991).

Kaufman, George G., ed. Restructuring the American Financial System. Boston: Kluwer Academic Publishers, 1990.

Spong, Kenneth. Banking Regulation: Its Purposes, Implementation, and Effects, third ed. Kansas City: Federal Reserve Bank of Kansas City, 1990.

Task Group on Regulation of Financial Services. Blueprint for Reform: The Report of the Task Group on Regulation of Financial Services. Washington: Government Printing Office, 1984.

United States House of Representatives, Committee on Banking, Currency, and Housing. Financial Institutions and the Nation's Economy. Washington: Government Printing Office, 1976.

Appendix G: Section 221 of the Federal Deposit Insurance Corporation Improvement Act of 1991[1]

SEC. 221 STUDY ON REGULATORY BURDEN.

(a) In General.-Not later than 1 year after the date of enactment of this Act, the Federal Financial Institutions Examination Council, in consultation with individuals representing insured depository institutions, consumers, community groups, and other interested parties, shall-

(1) review the policies and procedures, and recordkeeping and documentation requirements used to monitor and enforce compliance with-

(A) all laws under the jurisdiction of the Federal banking agencies; and

(B) all laws affecting insured depository institutions under the jurisdiction of the Secretary of the Treasury;

(2) determine whether such policies, procedures, and requirements impose unnecessary burdens on insured depository institutions; and

(3) identify any revisions of such policies, procedures, and requirements that could reduce unnecessary burdens on insured depository institutions without in any respect-

(A) diminishing either compliance with or enforcement of consumer laws in any respect; or

(B) endangering the safety and soundness of insured depository institutions.

(b) Report.-Not later than 1 year after the date of enactment of this Act, the Federal Financial Institutions Examination Council shall submit to the Congress a report describing the revisions identified under subsection (a)(3).

(c) Definitions.-For purposes of this section, the terms "insured depository institution" and "Federal banking agency" have the same meanings as in Section 3 of the Federal Deposit Insurance Act.

[1] Pub. L. 102-242, 105 Stat. 2236, 2305 (1991).