

**STATEMENT OF**

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**on**

**THE IMPACT OF REGULATORY BURDEN ON  
AMERICA'S COMMUNITY-BASED BANKS**

**before the**

**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS  
AND CONSUMER CREDIT**

**of the**

**COMMITTEE ON FINANCIAL SERVICES  
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Mr. Chairman, Ranking Member Sanders, and Members of the Subcommittee, I very much appreciate this opportunity to testify on the impact of regulatory burden on community banks. As a former community banker with 23 years of experience in the industry, and as the current leader of an inter-agency effort to reduce regulatory burden, I have a strong commitment to eliminate unnecessary burden while maintaining the safety and soundness of the industry and protecting important consumer rights.

After describing the vital importance of community banks, my testimony will highlight the burden imposed by banking regulations and the impact those regulations have on community banks. Next, I will outline our efforts to review our regulations and address, on an inter-agency basis, some of the existing regulatory burden, as well as the actions the Federal Deposit Insurance Corporation is taking unilaterally to reduce burdens imposed by our own regulations and operating procedures. Finally, I will discuss the need for legislative action to reduce burden.

### **The Role of Community Banks**

As Chairman Bachus noted in a recently-introduced House Resolution, community banks play a vital role in the economic wellbeing of countless individuals, neighborhoods, businesses and organizations throughout our country, often serving as the lifeblood of their communities. The definition of a community bank is somewhat fluid, but generally it is viewed as a financial institution with assets up to \$1 billion that is associated closely with the community where it is located. I will use that as a working definition for community banks overall today, while paying special attention to small community banks (those with less than \$100 million in assets).

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

Community banks are the bankers for municipalities and school districts. Community bankers generally know personally many small business owners and establish lending relationships with these individuals and their businesses. These small businesses, in turn, provide the majority of new jobs in our economy. Small businesses with fewer than 500 employees account for approximately three-quarters of all new jobs created every year in this country.

More importantly, these banks also are an interdependent part of the entire local community. The close relationship of the bank and the local community has many tangible and intangible benefits. Recently, a community banker who is also a member of the FDIC's Advisory Committee spoke about her small bank and its relationship to the community. Terry Jorde is President and CEO of CountryBank USA, a \$37 million community bank with two offices in Cando and Devils Lake, North Dakota. Here's what Terry Jorde had to say about the role of her bank and her bank's commitment to their community:

Local banks that fund local businesses are particularly attuned to the needs of their communities and are uniquely equipped to facilitate the local economic development process, which can be time-consuming and resource-intensive. Community bankers provide tremendous leadership in their communities, which

is critical to economic development and community revitalization. For example, in a recent week I spent six hours in a hospital board meeting, four hours in an economic development corporation meeting, and another four hours working with other local community bankers to develop a financial incentive package for a potential new business in our community. You could argue that this is not an efficient and cost-effective way to spend my time, but like most community banks, the very survival of my bank depends on the economic vitality of my community. I have a very real incentive to work to assure the success of Cando and Devils Lake.

The loss of community institutions can result in losses of civic leadership, charitable contributions, and local investment in school and other municipal debt.

### **THE PROLIFERATION OF REGULATIONS AND THEIR IMPACT ON COMMUNITY BANKS**

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

There are no definitive studies of the total cost of regulation. However, a survey of the evidence by a Federal Reserve Board economist in 1998 found that total regulatory costs account for 12 to 13 percent of noninterest expense, or about \$36 billion in 2003. For the banking industry, every change in reporting requirements or modification of

business practices involves new capital expenditures and increased human resources, computer programming costs and vendor expenses. The same research indicates that start up costs for new or changing regulations may be very expensive and insensitive to the size of the changes. In other words, the process of learning about and adopting regulatory changes is expensive, whatever the magnitude of the change. Frequent small, incremental changes may be much more expensive than large, one time changes.

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

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

Average compliance costs for regulations are substantially greater for banks at low levels of output than for banks at high levels of output. This conclusion has important implications. Higher average regulatory costs at low levels of output

may inhibit the entry of new firms into banking or may stimulate consolidation of the industry into fewer, larger banks.

Over the last 20 years, there has been substantial consolidation in the banking industry. This can be seen most dramatically in small community banks. At the beginning of 1985, there were 11,780 small community banks with assets of less than \$100 million in today's dollars. At yearend 2003, their number had dropped by 63 percent to just 4,390 (see Chart 1). Even more dramatically, the total market share of those institutions decreased from nine percent at the beginning of 1985 to two percent at yearend 2003 (see Charts 2 and 3). The decline had three main components: mergers, growth out of the community bank category, and failures. The decrease was offset somewhat by the creation of 2,403 new banks. In this calculation, a community bank is defined as a bank or thrift holding company or an independent bank or thrift, and bank asset size was adjusted for inflation. Thus, a bank with \$100 million in assets today is compared with one having about \$64 million in assets in 1985.

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

low is critical to ensuring that small business and consumer wants and needs are met, especially as bank mergers continue to reduce options in some local markets.

It may seem a paradox to discuss profitability concerns at a time when the banking industry is reporting record earnings. Last year the industry as a whole earned a record \$120.6 billion, surpassing the previous annual record of \$105.1 billion set in 2002. When you look behind the numbers, however, you see a considerable disparity in the earnings picture between the largest and smallest banks in the country. The 110 largest banks in the country (those with assets over \$10 billion), which represent 1.2 percent of the total number of insured institutions, earned \$87.7 billion or about 73 percent of total industry earnings, while the 4,390 banks with assets under \$100 million, which represent 48 percent of the total number of insured institutions, earned about \$2.1 billion, which represents only 1.7 percent of total industry earnings (see Chart 4). Moreover, when you further examine the data, you find that banks with assets over \$100 million had an average ROA of 1.42 percent, while those with assets under \$100 million had an average ROA of 0.95 percent (see Chart 5).

While the banks under \$100 million had the highest yield on earning assets (5.87 percent) they also had the lowest non-interest income (1.43 percent), and the highest noninterest expense to asset ratio (3.71 percent). This combination resulted in about *1 in 10 banks* under \$100 million in assets being unprofitable in 2003. This is over five to six times the ratio for banks between \$100 million and \$10 billion and almost ten times greater than the largest banks. These numbers make it clear that community banks, while healthy in terms of their supervisory ratings, are operating at a lower level of profitability than the largest banks in the country. At least part of this disparity in earnings stems

from the disproportionate impact that regulations and other fixed noninterest costs have on community banks (see Chart 6).

Community bankers have told me that regulatory burden is often a factor in their decisions to sell or merge their banks and that the cost of compliance with accumulated regulation is taking its toll. Recently, I spoke to a group of 100 community bankers from Florida, and asked for a show of hands as to how many bankers felt that the increasing cost of compliance and regulatory burden might be a factor in trying to decide whether to remain independent or to seek a merger partner. About 40 percent raised their hands and, although this was certainly not a scientific survey in any respect, it was consistent with what I have heard over the past year as community bankers have expressed growing frustration with the time, effort, and resources it takes to comply with bank regulation today. Bankers are becoming increasingly worried that their institutions—and all that they mean to their communities—may not be able to operate at an acceptable level of profitability for their investors for too many more years under what they describe as a “never-ending avalanche” of regulations.

In some cases, the cost of complying with that burden is pushing some smaller banks out of the market. One bank CEO of a consistently high performing community bank confided that at a recent meeting of his bank’s board, the institution’s directors remarked that the bank’s return on assets had been slipping in recent years, in part attributable to the increasing costs of compliance, and asked how much longer the bank can afford to remain independent without giving consideration to maximizing current shareholder value through a merger or sale. These conversations are likely occurring in community bank boardrooms all over the United States today.



An additional challenge community bankers face is maintaining the capacity to respond to the steady stream of new regulations while continuing to comply with existing regulations. Some of the new regulations and reporting requirements facing the industry include those required by the FACT Act legislation enacted by Congress last year, USA PATRIOT Act, the Sarbanes-Oxley Act, and the Check 21 Act. These laws reflect important public policy choices concerning the quality of the credit reporting system, identity theft, national security and changes in technology. However, it is incumbent upon the regulators who write implementing regulations, as well as the Congress, to be ever mindful of the need to avoid unnecessarily increasing regulatory burdens on the industry as we implement new reporting requirements and regulations required by legislation.

It is not just the total volume of regulatory requirements that pose problems for the future, but also the relative distribution of regulatory burden across various industries that could hit community banks hard in the future. For example, community bankers are increasingly subject to more intense competition from credit unions, which have, in many cases, evolved from small niche players to full-service retail depository institutions. In the past ten years, the number of credit unions with assets exceeding \$1 billion has increased four-fold, from 20 institutions in 1994 to 83 institutions today and the credit union industry continues to grow nationwide. With ever-expanding fields of membership and banking products, credit unions are now competing head-to-head with banks and thrifts in many communities, yet the conditions under which this competition exists enable credit unions to operate with a number of advantages over banks and thrifts. These advantages include exemption from taxation, not being subject to the Community

Reinvestment Act, and operation under a regulatory framework that has supported and encouraged the growth of the credit union movement, including broadening the “field of membership.” These advantages make for an uneven playing field, a condition that Congress should reexamine and seek to resolve.

I am a strong proponent of market forces determining economic outcomes. If community banks lose out in a fair and square competition with credit unions or larger banks, so be it – let the market speak and the chips fall where they may. But if smaller banks will be weakened in the market not by competition or technology, but inadvertently or unintentionally by the disproportionate effect of regulatory burden, and by competition from financial institutions not subject to the same regulations, that outcome seems to be inequitable and unacceptable. We need to think about the appropriate public policy response to prevent this outcome.

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

#### **INTER-AGENCY EFFORT TO REDUCE REGULATORY BURDEN**

In 1996, Congress passed the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). Section 2222 of EGRPRA requires the Federal Financial Institutions Examination Council (FFIEC) and each of its member agencies to review their regulations at least once every ten years, in an effort to eliminate any regulatory

requirements that are outdated, unnecessary or unduly burdensome. Last year, FDIC Chairman Don Powell, as Chairman of the FFIEC, asked me to oversee this inter-agency effort. I accepted with enthusiasm.

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

- Applications and Reporting
- Banking Operations
- Capital
- Community Reinvestment Act
- Consumer Protection
- Directors, Officers and Employees
- International Operations
- Money Laundering
- Powers and Activities
- Rules of Procedure
- Safety and Soundness and
- Securities

The agencies agreed to put one or more categories out for public comment every six months, with 90-day comment periods, for the remainder of the review period (which

ends in September, 2006). Spreading out comments over three years will provide sufficient time for the industry, consumer groups, the public and other interested parties to provide meaningful comments on our regulations, and for the agencies to carefully consider all recommendations.

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

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

pursue. Even though the second Federal Register notice contained far fewer regulations for comment than the initial notice, the agencies received over 550 comment letters.

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

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

Last year, the agencies sponsored five banker outreach meetings in different cities to heighten industry awareness of the EGRPRA project. The meetings provided an opportunity for the agencies to listen to bankers' regulatory burden concerns, hear comments and suggestions, and identify possible solutions. The outreach meetings were

held over a six-month period in Orlando, St. Louis, Denver, San Francisco and New York. More than 250 bankers (mostly CEOs) as well as representatives from the national trade groups and a variety of state trade associations participated in the meetings with representatives from FDIC, FRB, OCC, OTS, CSBS and state regulatory agencies.

The banker outreach meetings were extremely useful and productive. Following panel discussions and a question and answer period, the meeting participants were broken into small discussion groups. Senior-level regulators served as moderators of the discussion groups and regulatory staff recorded bankers' concerns and their recommendations to reduce regulatory burden. Summaries of the issues raised were then posted on the EGRPRA website. Since the banker outreach meetings were so successful last year, we decided to hold at least three more meetings this year. The first one was on April 22 in Nashville, Tennessee. The next two meetings are scheduled for June 9 in Seattle, Washington and September 23 in Chicago, Illinois.

We held an outreach meeting for consumer and community groups on February 20, 2004 in Arlington, Virginia. About 24 representatives from various consumer and community groups participated in the meeting along with representatives from the FDIC, FRB, OCC, OTS and NCUA. The meeting provided a useful perspective on the effectiveness of many existing regulations. We plan to hold at least two more consumer and community group outreach meetings later this year, with tentative plans for such meetings to take place in San Francisco on June 24 and in Chicago on September 22.

## ***Banker Comments at the Outreach Session***

Bankers have made the following comments regarding a number of regulatory burden issues that they cite as being the most costly, burdensome or otherwise competitively detrimental. While this is not a scientifically selected survey of all bankers, the most frequently listed regulations and the nature of their concerns include:

**Bank Secrecy Act (CTRs, SARs,):** Bankers express concerns that the exemptions are overly complex and the penalties for technical noncompliance are severe. In addition, bankers say they receive no feedback on their efforts.

**USA Patriot Act and Customer Identification Systems:** Bankers often asked if the Customer Identification Program requirements of the USA PATRIOT Act are truly effective in combating terrorism. Again, bankers have commented regarding lack of feedback on their efforts.

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

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

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

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

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

**Truth-in Lending and the Right of Rescission:** Bankers reported that few, if any customers had ever exercised their right of rescission and thus customers should be

permitted to waive their right. Alternatively, some suggested creating additional exemptions to this requirement.

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

**Flood Insurance and the Flood Disaster Protection Act:** Bankers strongly suggested that flood maps be kept up to date. Others felt that much of the cost of enforcing flood insurance requirements has shifted from the federal government to banks.

The list above includes some of the most frequently mentioned regulatory burden concerns expressed by bankers to us over the last year. The regulators are examining these concerns to determine whether suggested changes to our regulations are warranted and appropriate at this time. This process will continue until the end of the EGRPRA review process in 2006.

However, let me be clear about the Bank Secrecy Act and the USA PATRIOT Act. The FDIC is strongly committed to supervising and enforcing bank regulations to thwart and prevent terrorism. I believe this commitment is shared by the banking industry. In addition to protecting our country, it is in the best interests of a stable banking system and stable communities to be as vigilant as possible in our regulatory and supervisory efforts.

#### **RESPONSE BY REGULATORY AGENCIES**

The EGRPRA regulatory review project is still in its early stages, with approximately two years until completion. However, I am pleased to report that the banking and thrift regulatory agencies have been working together closely and harmoniously on a number of projects to address unnecessary burdens. In addition to



eliminating outdated and unnecessary regulations, the agencies have begun to identify more efficient ways of achieving important public policy goals of existing statutes. I think it is fair to say that although we have much work ahead of us, there has been significant progress to date. Here are some notable examples:

### ***Privacy Notices***

On December 30, 2003, the Federal bank, thrift and credit union regulatory agencies, in conjunction with the Federal Trade Commission, Securities and Exchange Commission, and the Commodity Futures Trading Commission, issued an Advanced Notice of Proposed Rulemaking (ANPR), seeking public comment on ways to improve the privacy notices required by the Gramm-Leach-Bliley Act. Although there are many issues raised in the ANPR, the heart of the document solicits comments on how the privacy notices could be improved to be more readable and useful to consumers, while reducing the burden on banks and other service providers required to distribute the notices. The basic idea is to develop a simpler, “short form” privacy notice (perhaps something akin to the nutrition information label on pre-packaged foods), that would be easier for consumers to understand and banks to distribute. Throughout the process of developing this ANPR, agency staff was mindful of the burden implications of changing the privacy notices and the requirements for their distribution. The regulatory agencies will be sensitive to this issue as they review and analyze the comments from the industry and consumers on this issue.

### ***Community Reinvestment Act Regulations***

On February 6, 2004, the Federal bank and thrift regulatory agencies jointly issued a proposal to amend the Community Reinvestment Act (CRA) regulations. The joint proposal would, among other things, reduce regulatory burden by changing the definition of “small institution” to mean an institution with total assets of less than \$500 million, without regard to holding company assets. This represents a significant increase in the small bank threshold from the current level of \$250 million which was established in the 1995. Under the proposal, just over 1,100 additional banks (those with assets between \$250 and \$500 million) would be subject to the small bank CRA test (the lending test) rather than the large bank test (lending, investment, and outreach tests).

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

agencies received more than 1,100 comment letters currently being analyzed by staff. It is my hope the agencies will consider carefully all comments and agree on a final rule before the end of this year.

### ***RESPA***

The Department of Housing and Urban Development (HUD) was, for some time, engaged in rulemaking to review and improve the process for obtaining mortgages. Given the high level of concern expressed by the banking industry about the closing process, I think it is incumbent upon the regulators to continue to play a role in the mortgage reform efforts. I agree with the basic goals of this initiative, which are to: (1) enable people to know their options so they can shop intelligently; (2) clarify and simplify the required disclosures; and (3) provide some certainty that costs won't change before closing. The FDIC has provided some input into the rulemaking process and will continue to provide whatever additional input may be necessary. I think it is important to assist in this effort to simplify and improve the closing process for consumers, while reducing unnecessary burden on the banking industry.

### ***Bank Secrecy Act***

Financial institutions and their regulators must be extremely vigilant in their efforts to implement the Bank Secrecy Act in order to thwart terrorist financing efforts and money-laundering. Last year, bankers filed over 12 million Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs) with the Financial Crimes Enforcement Network (FinCEN). Bankers reported that they believe they are filing

millions of reports that are not utilized for any law enforcement purpose and consequently a costly burden is being carried which is providing little benefit to anyone. In an effort to address this concern, the financial institution regulatory agencies are working together with FinCEN and various law enforcement agencies, through task forces of the Bank Secrecy Act Advisory Group, to find ways to streamline reporting requirements for CTRs and SARs and make the reports that are filed more useful for law enforcement.

The need to explore better, more efficient approaches to Bank Secrecy Act compliance at financial institutions is clear. At one outreach session last year, a banker reported that it cost his bank approximately \$600,000 to file 24,000 CTRs in a single year - about \$25.00 per CTR. While this may not be the cost of compliance at every bank, it does remind us that as designed, the current system may not provide an efficient way of monitoring suspect cash transactions. Although bankers repeatedly express their willingness and desire to do their part to fight terrorism and prevent money laundering, it is understandable that they are concerned about the costs and other burdens associated with the current reporting system.

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

### ***USA PATRIOT Act and Customer Identification Requirements***

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

### **FDIC EFFORTS TO RELIEVE REGULATORY BURDEN**

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

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

- 2) Implemented more risk-focused compliance and trust examinations, placing greater emphasis on an institution's administration of its compliance and fiduciary responsibilities and less on transaction testing;
- 3) Increased efficiency of the IT examination procedures and streamlined IT examinations for institutions that pose the least technology risk;
- 4) Worked with the Conference of State Bank Supervisors (CSBS) and the Federal Reserve to develop, through a Nationwide State/Federal Supervisory Agreement, a closely coordinated supervisory system for banks that operate across state lines.
- 5) Initiated electronic filing of branch applications and began exploring alternatives for further streamlining the deposit insurance application process in connection with new charters and mergers;
- 6) Simplified the deposit insurance coverage rules for living trust accounts so that the rules are easier to understand and administer;
- 7) Reviewed existing Financial Institution Letters and other directives to eliminate outdated or unnecessary documents. We are also developing a more user-friendly, web-based system for finding communications from the Corporation;
- 8) Provided greater resources to bank directors, including the establishment of a "Director's Corner" on the FDIC website, as a one-stop site for Directors to obtain useful and practical information to assist in fulfilling their responsibilities;
- 9) Made it easier for banks to assist low and moderate income individuals, and obtain CRA credit for doing so, by developing Money Smart, a financial literacy curriculum and providing the MoneySmart Program free-of-charge to all insured institutions;
- 10) Implemented an interagency charter and federal deposit insurance application that eliminates duplicative information requests by consolidating into one uniform document, the different reporting requirements of the three regulatory agencies (FDIC, OCC and OTS);
- 11) Revised our internal delegations of authority to push more decision-making out to the field level to expedite decision making and provide institutions with their final Reports of Examination on an expedited basis;
- 12) Provided bankers with a customized version of the FDIC Electronic Deposit Insurance Estimator (EDIE), a CD-Rom and downloadable version of the

web-based EDIE, which allows bankers easier access to information to help determine the extent to which a customer's funds are insured by the FDIC.

The FDIC is aware that regulatory burden does not emanate only from statutes and regulations but often comes from internal processes and procedures. Therefore, we continually strive to improve the way we conduct our affairs, always looking for more efficient and effective ways to meet our responsibilities.

#### **LEGISLATION TO REDUCE REGULATORY BURDEN**

I wish to commend you, Mr. Chairman and your colleagues on the Subcommittee and the full Committee, for your leadership in producing H.R. 1375, The Financial Services Regulatory Relief Act. The legislation contains a number of significant regulatory relief provisions, including provisions making it easier for banks to cross state lines by opening *de novo* branches, speeding the approval process for bank mergers, eliminating certain unnecessary reports on extensions of credit to insiders, giving banks greater flexibility in the payment of dividends, increasing the exemption amount for management interlocks, removing limits for thrifts on making small business and auto loans as well as allowing regulators to adjust the examination cycles of healthy institutions when there is a safety and soundness need within the banking system for greater flexibility. The bill also includes several provisions requested by the regulators, including the FDIC, to help us do our job better and we thank the Subcommittee for including those provisions in the bill.

Over the last several months, the FDIC has been working closely with our colleagues at the FRB, OCC, OTS and NCUA in an effort to identify additional legislative proposals to reduce regulatory burden on the industry. I am pleased to report

that we are making progress in our efforts and I anticipate that we will have a proposal in the near future. Over the next several months, I will brief interested Members and their staffs on the progress of our inter-agency efforts to review our regulations and the components of our proposal for additional regulatory relief. Since most of our regulations are, in fact, mandated by statute, I believe that it is critical that the agencies work hard not only on the regulatory front, but also on the legislative front, to alert Congress to unnecessary regulatory burden. In that regard, I look forward to continuing the dialogue with Congress on regulatory relief issues.

## **CONCLUSION**

Mr. Chairman, as you indicated at a hearing last year on H.R. 1375, banks should be able “to devote more resources to the business of lending to consumers and less to the bureaucratic maze of compliance with outdated and unnecessary regulations.” I couldn’t agree with you more. I believe that if we do not do something to stem the tide of ever increasing regulation, America’s community banks will disappear from many of the communities that need them most. That is why I think it is incumbent upon all of us – Congress, regulators, industry and consumer groups – to work together to eliminate any outdated, unnecessary or unduly burdensome regulations. I am personally committed to accomplishing that objective.

One possible solution to the problem of ever increasing regulatory burden on community banks would be to create a two-tiered regulatory system. From both a safety-net perspective and a regulatory burden perspective, the largest banking institutions and community banks are very different, and, as a practical matter, we already have the



beginnings of a two-tiered approach to bank supervision. Community banks, for example, are examined at specific intervals while the largest institutions are examined in real time by teams of examiners that are on site every day. Once the Basel II capital standards are adopted, the largest banks will have to adhere to the new standards, while small and medium size banks will continue to be governed by the present standards.

I think we need to consider ways to expand this two-tiered approach. We need to look for possible exemptions for community banks from the application of certain laws, where consistent with safety and soundness and consumer protection. We also need to look for ways to reduce the number of reports that community banks must file and reduce the complexity of the information demanded from these banks.

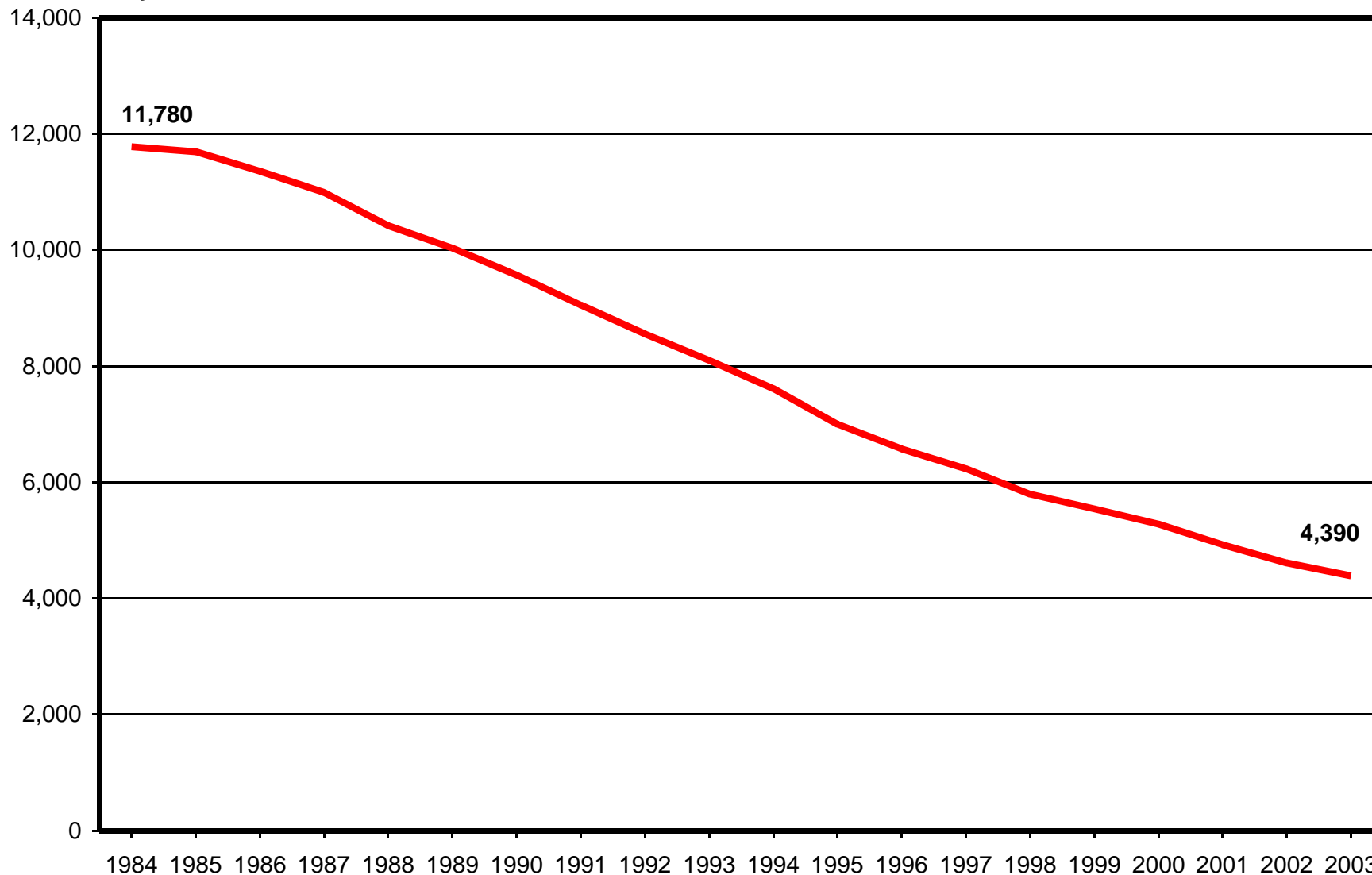
I am confident that, if we all work together, we can find ways to regulate that are both more effective and less burdensome, without jeopardizing the safety and soundness of the industry or weakening important consumer protections.

Thank you for providing me with this opportunity to testify here today.

Chart 1

### THE NUMBER OF COMMUNITY BANKS HAS BEEN DECLINING FDIC-Insured Commercial Banks & Savings Institutions with Assets < \$100 Million\*

Number at year-end

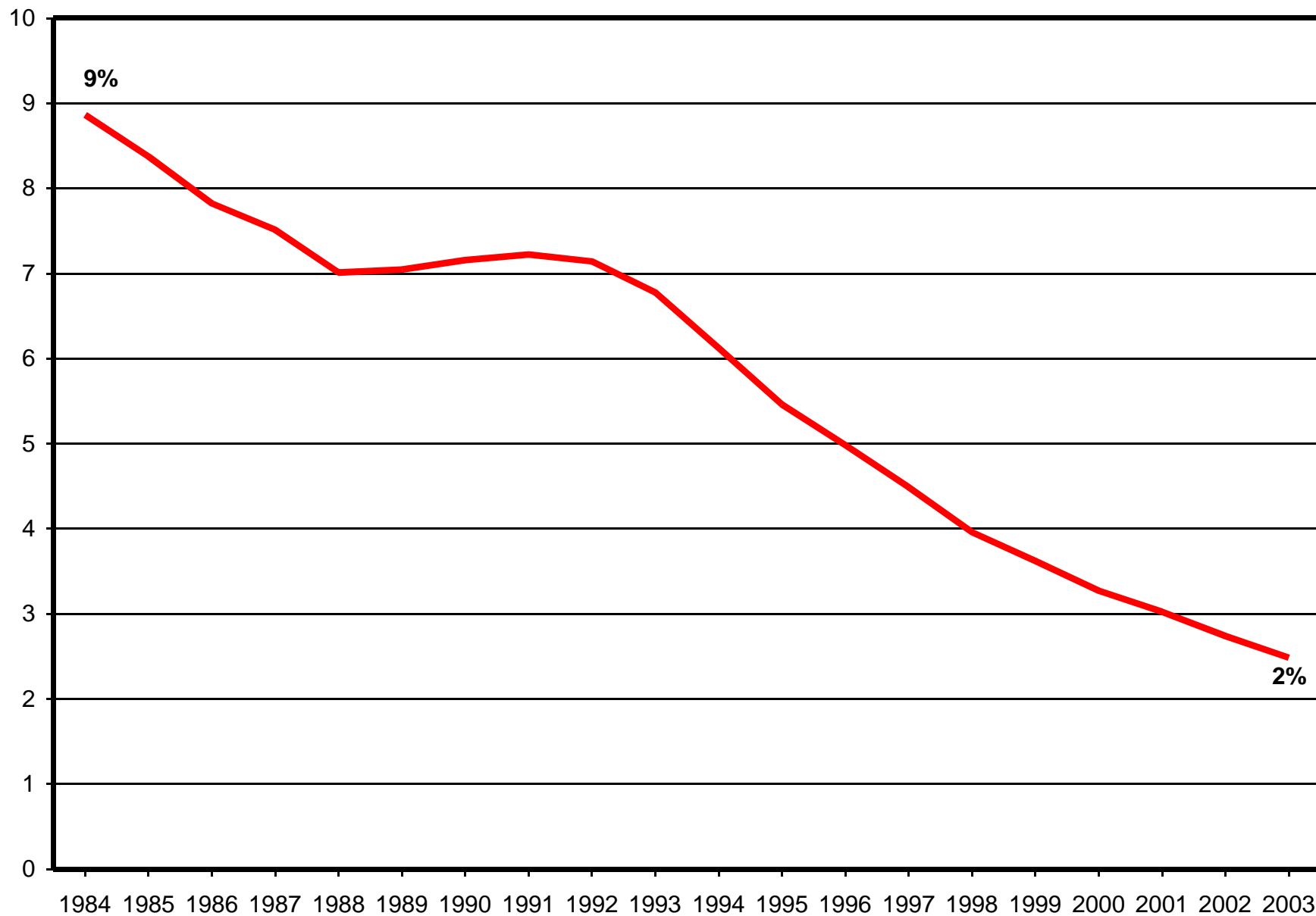


\*Based on 2003 Dollars; \$100MM in 2003 = \$63.6MM in 1984.

Chart 2

## COMMUNITY BANKS' SHARE OF INDUSTRY ASSETS CONTINUES TO FALL FDIC-Insured Commercial Banks & Savings Institutions With Assets < \$100 Million\*

Percent of industry assets

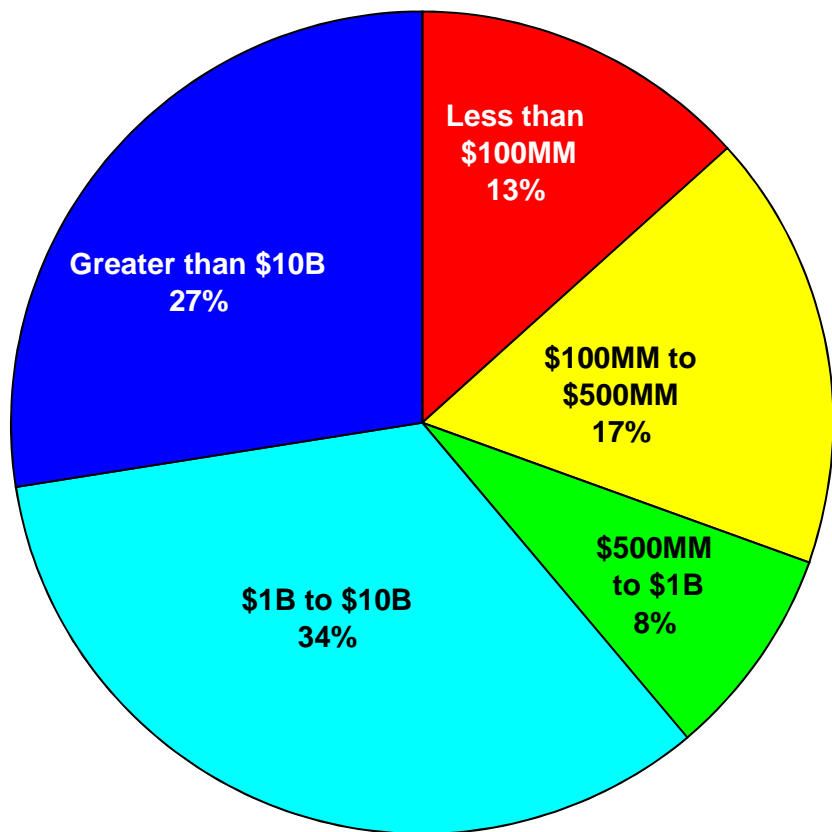


\*Based on 2003 Dollars; \$100MM in 2003 = \$63.6MM in 1984.

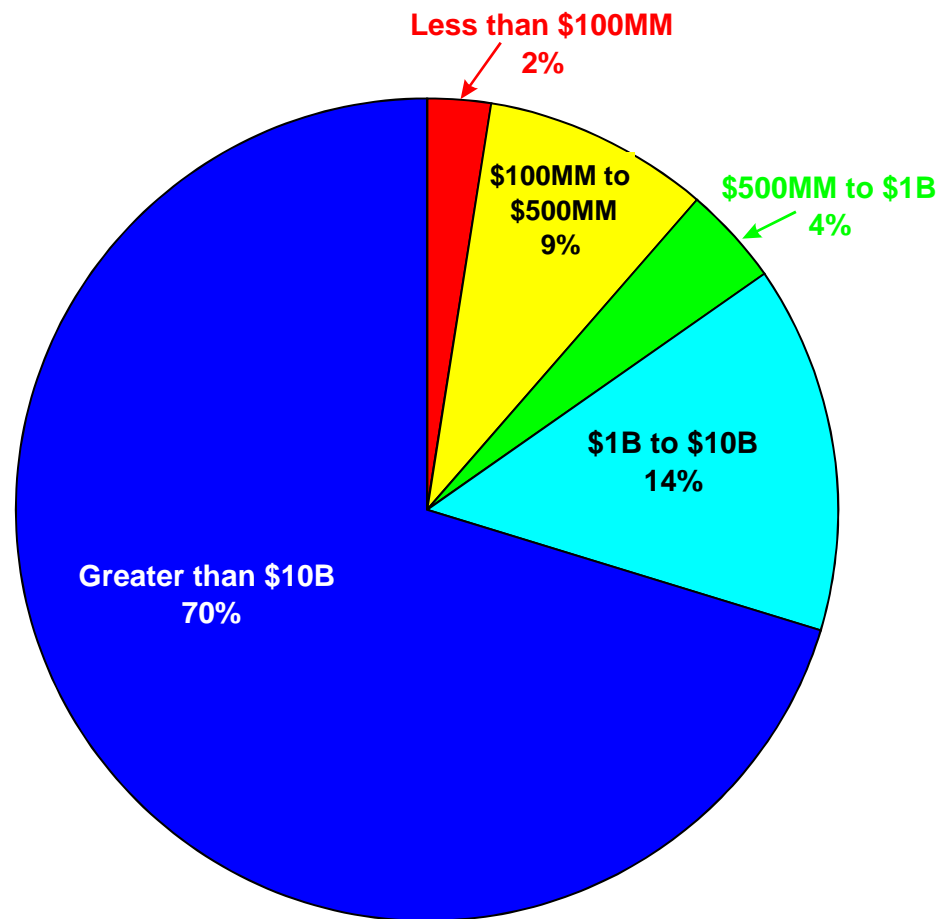
Chart 3

### Change in Shares of Industry Assets FDIC-Insured Commercial Banks and Savings Institutions

December 31, 1984



December 31, 2003



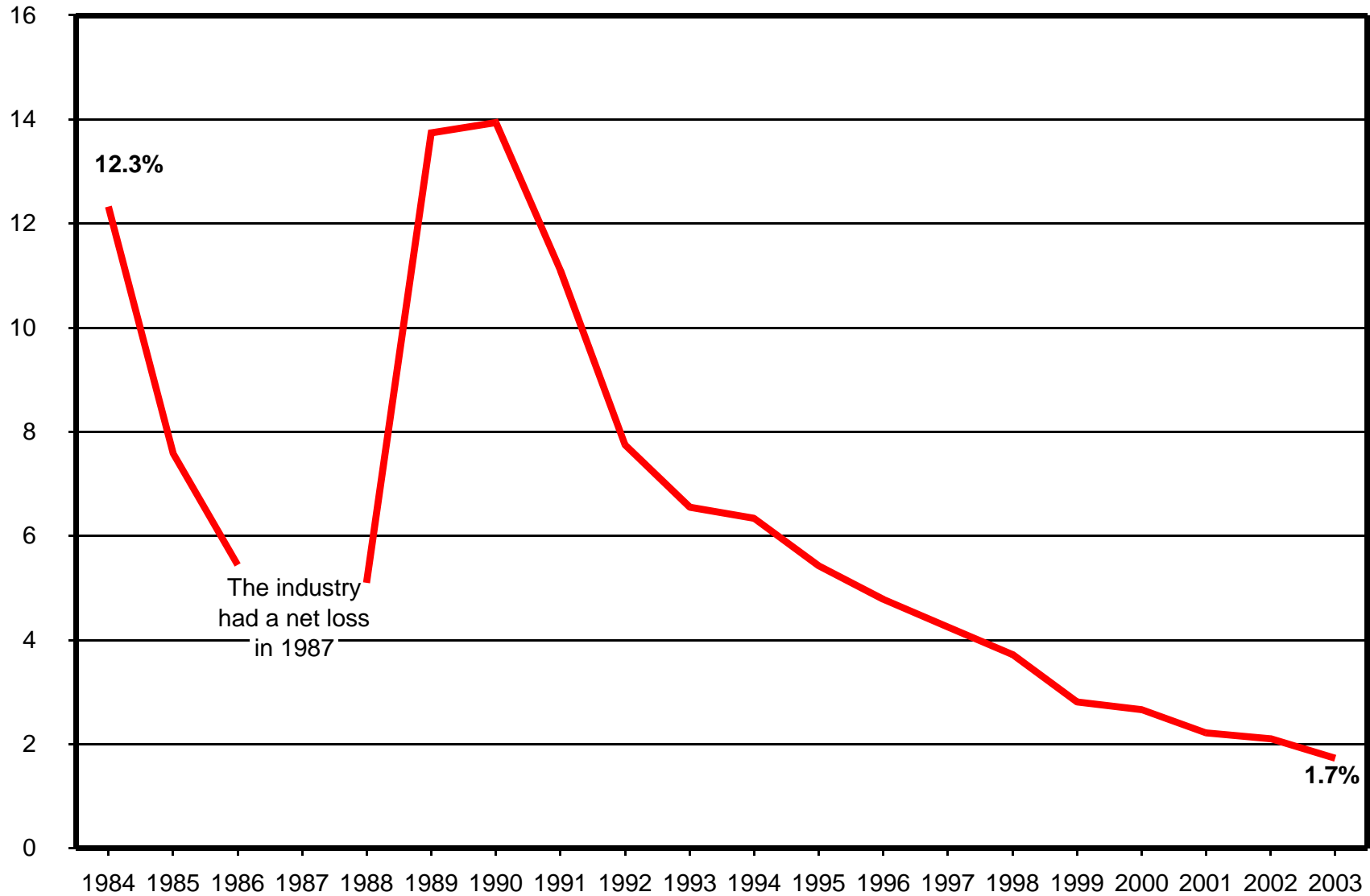
Asset sizes are not adjusted for inflation.

Chart 4

### COMMUNITY BANKS' SHARE OF INDUSTRY EARNINGS IS DECLINING

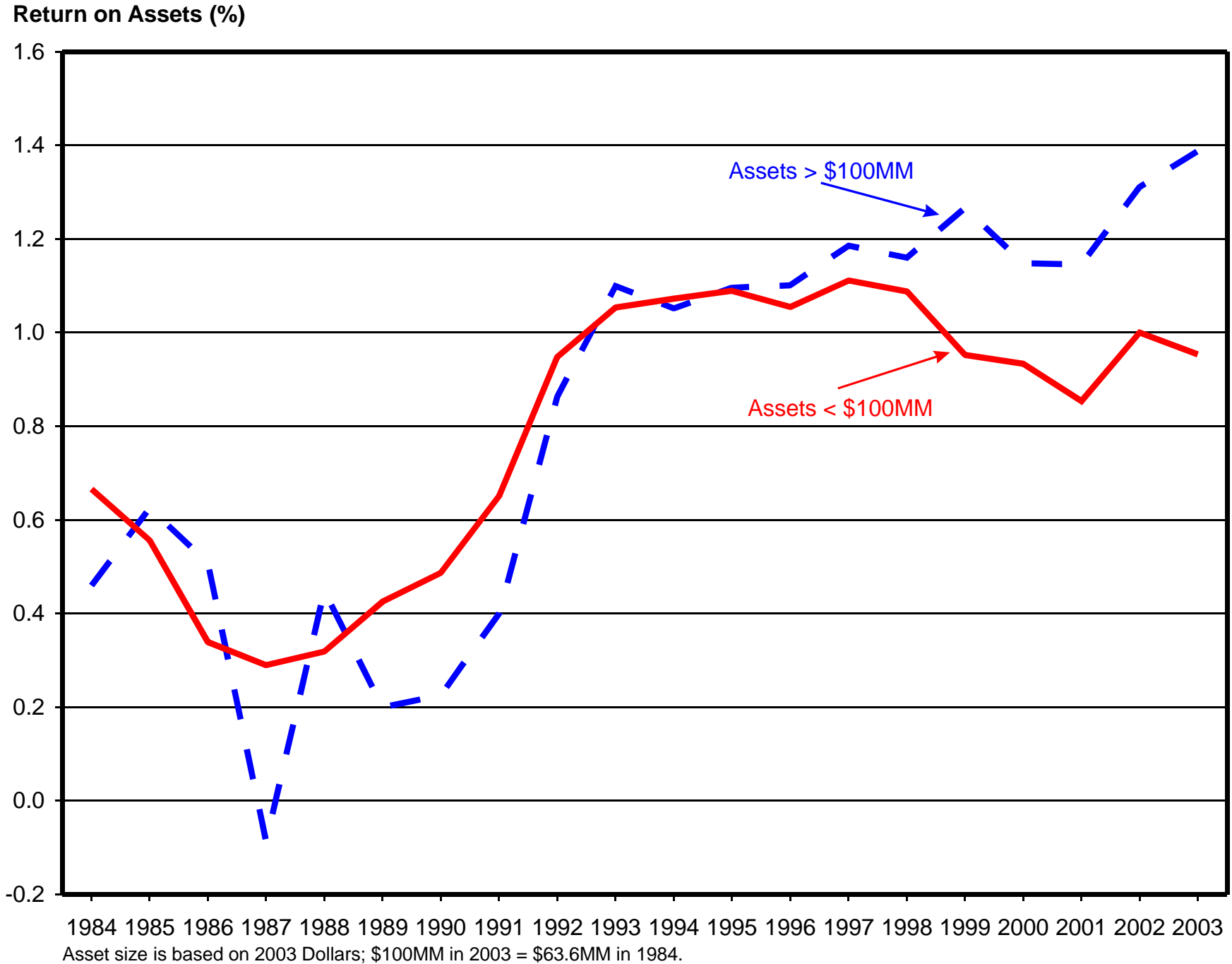
Net Income of Institutions With Assets < \$100 Million\* as a Percent of Total Industry Net Income

Percent

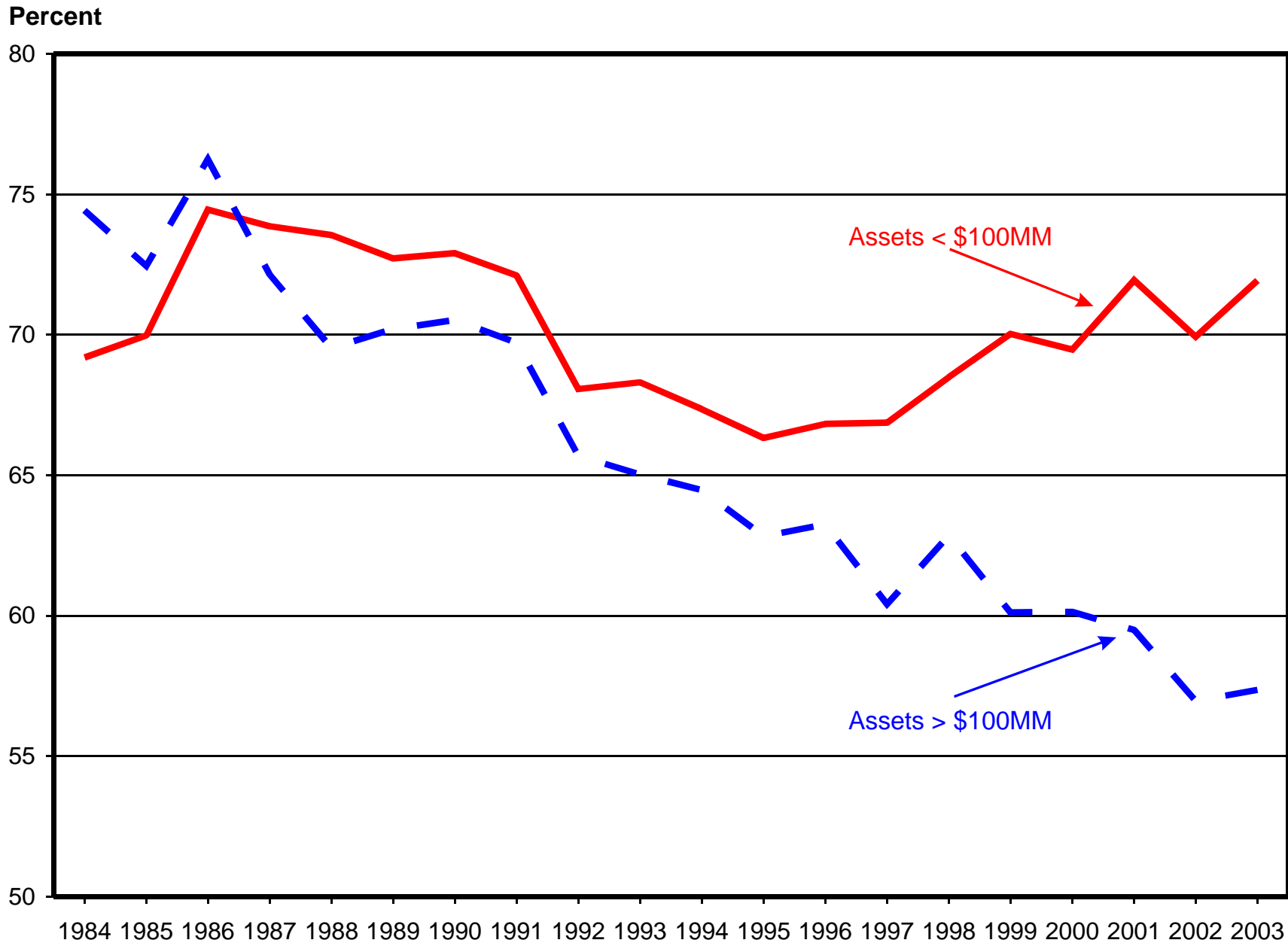


\*Based on 2003 Dollars; \$100MM in 2003 = \$63.6MM in 1984.

**Chart 5**  
**LARGE INSTITUTIONS HAVE BECOME MORE PROFITABLE THAN COMMUNITY BANKS**  
**All FDIC-Insured Commercial Banks and Savings Institutions, 1984 - 2003**



**Chart 6**  
**OVERHEAD COSTS ABSORB A GROWING SHARE OF COMMUNITY BANKS' REVENUES**  
**Noninterest Expense as a Percent of Net Operating Revenue\***



\* Net operating revenue = net interest income + total noninterest income.  
 Asset size is based on 2003 Dollars; \$100MM in 2003 = \$63.6MM in 1984.