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May 4, 2005

Public Information Room
Office of the Comptroller of the Currency
250 E Street, SW
Mailstop 1-5
Washington, DC 20219
Attention: Docket 05-01

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn: EGRPRA Burden Reduction Comment

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street an Constitution Avenue, NW
Washington, DC 20551
Docket No. OP-1220

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attn: No. 2005-02

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to offer comments on the agencies' fourth installment of the

[1] *The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 17,000 locations nationwide and employing over 260,000 Americans, ICBA members hold more than $631 billion in insured deposits, $778 billion in assets and more than $493 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

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EGRPRA[2] project. Mandated by Congress, the EGRPRA project is an overall review of agency rules to identify outdated, unnecessary, or unduly burdensome regulatory requirements. Earlier installments have examined applications, powers, international operations, consumer lending requirements, consumer protection: account/deposit relationships, and miscellaneous consumer rules. This installment reviews the rules concerning money laundering, safety and soundness, and securities rules.

General Comments

ICBA commends the banking agencies for the work that they have done under the EGRPRA project to identify outdated, unnecessary and unduly burdensome regulations. Through the public comment process, bankers outreach meetings and the EGRPRA website, the project has generated a large number of recommendations for reducing the regulatory burden on banks. Some of these recommendations require legislative action and the ICBA applauds the efforts by the banking agencies to work with the industry on regulatory reduction legislation. **However, many of the other recommendations could be implemented by the agencies through rulemaking, but few of these recommendations have resulted in regulatory changes. ICBA strongly urges the agencies to implement more of these burden reduction recommendations.**

The banking agencies have held eight banker outreach sessions over the last two years. The universal message from these meetings is that community banks are struggling under the burden and costs of regulatory compliance. This burden is eroding the ability of community banks to continue doing business. Even though the last three years have been very profitable for the banking industry as a whole, there is a gap between community banks' profitability and the rest of the industry, in part due to the disproportionate impact of regulations on community banks, causing many community banks to consider selling or merging. As FDIC Vice Chairman John Reich has stated in Congressional testimony, "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….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." [3]

Regulatory burden has increased significantly in the past few years. In particular, regulations under the USA PATRIOT Act of 2001 and the increased attention from bank examiners on Bank Secrecy Act (BSA) compliance have substantially increased the regulatory burden on community banks. **While the ICBA commends the agencies and FinCEN for working with the industry on**

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[2] The Economic Growth and Regulatory Paperwork Reduction Act of 1996.

[3] Statement of John M. Reich, Vice Chairman, Federal Deposit Insurance Corporation on Consideration of Regulatory Reform Proposals before the Committee on Banking, Housing and Urban Affairs, United States Senate, June 22, 2004

these issues, we strongly urge the regulators to continue balancing costs versus benefits in these areas and in particular, with respect to BSA administration. We also urge the regulators to consider our recommendations listed below concerning the BSA program, BSA examinations, the Customer Identification Program, and the Data Matching Program, all of which are straining the resources of community banks. We also have comments concerning the interagency safety and soundness regulations, the regulations dealing with certain securities activities of banks, and certain safety and soundness regulations issued by the Office of Thrift Supervision (OTS).

Specific Comments

Bank Secrecy Act (BSA) Program Requirements

The BSA requires all banks to implement and maintain procedures designed to ensure and monitor compliance with the BSA, a mandate that was reaffirmed by section 352 of the USA PATRIOT Act of 2001.

The current BSA enforcement environment is a serious concern for the banking industry, especially community banks.[4] While the Secretary of the Treasury and agency heads have publicly assured the industry that a policy of "zero tolerance" for BSA enforcement is a myth, field examiners continue to inform bankers that there ***is*** zero tolerance for BSA errors. **The need for specific guidance on what is expected of banks and more thorough training for bank examiners is critical.** While regional and national headquarters may see the written reports issued by examiners, many of the problems seem to arise during verbal discussions during the on-site exam. Under the current enforcement environment, bankers believe they have no option but to adhere to these verbal instructions from examiners, and rumors are beginning to surface about fears of examiner retaliation if concerns are brought to the attention of the agencies. As one banker noted, the primary problem is not necessarily with the law or regulations, but the combative attitude of some examiners that includes reminders about civil money penalties and other enforcement actions.

Community banks fully support the efforts against money-laundering and terrorist financing, but there is a serious need for common sense, better guidance from bank supervisors and FinCEN on expectations both for bankers and examiners, and much better feedback from law enforcement to confirm compliance efforts are worthwhile.

Community bankers report that the emphasis on civil money penalties and criminal enforcement of the BSA, when coupled with zero tolerance of examiners, helps enflame the current environment. There is a growing sense that it is not only the bad actors that are being punished, but that good faith compliance efforts are irrelevant. This environment fosters implementation of

[4] Concerns about the current BSA examination environment were sufficient to prompt a letter to the agencies from 46 members of the United States House of Representatives on April 8, 2005.

policies and procedures that may be unnecessary given a particular institution's size, location and operations, thereby unnecessarily adding to regulatory cost and burden.

For example, bank obligations when serving money services businesses (MSBs) are supposed to be risk-based and field examiners are treating any customer that qualifies as high risk as demanding enhanced due diligence. However, the due diligence required by examiners appears to be excessive. One examiner told a banker to monitor the volume of traffic in a customer's parking lot to assess whether the volume of business was commensurate with the activity in the bank account. As a result, community banks take the steps that they believe necessary to meet these compliance demands – including closing accounts for MSBs and filing suspicious activity reports (SARs) for any hint of suspicious activities.

The ICBA appreciates the flexibility that the current rules are intended to offer, but in many instances that flexibility creates gray areas that result in restrictive examiner interpretation. **The ICBA strongly encourages the agencies and FinCEN to develop a simple, user-friendly set of guidelines and reference tools for BSA compliance that is easily accessible in one place so that bankers – and examiners – can find answers to questions**. This is a step that is becoming increasing important.

The ICBA commends recent steps by the agencies to provide guidance and strongly encourages these efforts be continued. We hope the guidelines issued by the agencies on April 26, 2005, will help alleviate some of these problems, but the ICBA strongly encourages the agencies to continue to be sensitive to these issues. Very real concerns, as expressed by the Members of Congress, indicate that excessively rigid application of BSA requirements could actually undermine the goals of the statute.

The ICBA stands ready to work with the agencies to address these issues, and encourages the agencies to continue working with FinCEN and the Bank Secrecy Act Advisory Group (BSAAG) to strike the appropriate balance.

BSA Examinations

The nature of community banks is such that the vast majority of them know their customers, and community bankers believe there is a need for common sense in BSA administration. Administration of BSA compliance has become very labor intensive and costly and bankers have identified it as the hot button with examiners. Moreover, constant change in requirements in recent years has required constant revisions to policies and procedures as well as additional training for employees.

As noted above, final written examination reports may not include many of the "suggestions" orally advanced by field examiners that community banks take

additional steps to enhance their BSA compliance. In part, this can be attributed to the environment where no examiner wants to be criticized for being lax in BSA enforcement. However, as a result, community banks are being told that they need to take steps such as revise policies and procedures, enhance the BSA audit program (both internal and external), improve and expand the SAR monitoring process and expand employee training. **However, examiners do not provide specific guidance on what steps should be taken and bankers feel frustrated by a lack of standards. Better guidance would help alleviate this confusion and burden.**

External Audits of BSA Compliance

Many community banks report that examiners are compelling them to expend resources to engage external auditors or consultants to review the bank's BSA compliance program. While many community banks include the BSA audit as part of their overall external audit, as a result of the current environment, more and more believe that it is necessary to hire outside experts for a special BSA audit to review procedures and transactions.

In fact, a $175 million asset bank in a generally rural community was told that a $50,000 external audit lasting two days would be insufficient to meet the current demands of BSA compliance. **This type of requirement is overly burdensome and not commensurate with the bank's risk profile, operations or market. Again, better and more specific guidance from agency headquarters is needed to avoid these situations.** The ICBA hopes that upcoming uniform BSA examination procedures will help, but also urges the banking agencies to remained focused on these problems.

BSA Administration

Other particular elements of the BSA program are time-consuming and impose additional expenses for community banks.

BSA Officer. Current rules require each bank to designate a BSA compliance officer. Banks handle this responsibility in a variety of ways, usually by adding these responsibilities to those of the compliance officer, security officer, chief financial officer or cashier. However, many community bank CEOs feel compelled to assume these responsibilities due to the importance of the position. And, although regulations do not mandate that the position be an executive officer, field examiners are informing community banks that the position must be an executive of the bank.

Because the demands and responsibilities under the BSA have been expanding, community banks increasingly use a compliance team to oversee the BSA compliance program. And community banks report that bank senior management is becoming increasingly involved. The agencies must recognize that while this increasing demand on bank senior management could be

anticipated in the current environment, it also imposes an additional element of burden.

Training. The requirement for annual BSA training is also another element of the regulatory burden associated with BSA compliance. Community banks satisfy this requirement using a variety of mechanisms, increasing including the use of new technologies such as web-based training. However, the BSA requires regular and ongoing training for employees throughout the year, mandating regular annual refresher courses.

The ICBA believes that this is an area where either better guidance or a more common sense approach could be taken to alleviate burden. **While employee training is obviously appropriate, a more flexible approach to training and elimination of the annual requirement should be considered. The key element is that the bank has a BSA officer who can serve as a resource for other employees.** While all employees should be sensitive to the demands of BSA, and new employee orientation should continue to include BSA compliance, regular annual training should not be required for all employees.

Customer Identification Program (CIP)

For many years, community banks have had systems and procedures to identify customers to ensure safety and soundness. However, new requirements under section 326 of the Patriot Act added a more formal element to these procedures. As a result, each bank must have a system in place to identify customers opening new accounts. The procedures must be sufficient to allow the bank to be reasonably certain about the identity of the customer, whether the customer is an individual or an entity. The bank must also maintain records to verify compliance with these requirements.

Generally, community banks report that they have not encountered serious problems implementing the new requirements. However, a significant number of community banks have encountered issues when applying the new requirements that could be alleviated by better guidance. For example, bankers report confusion about what identification is acceptable for certain customers, such as the Amish, the extent of identification needed for beneficiaries or long-time customers. In addition, many community banks continue to be concerned about whether to accept a matricula consular as a form of identification. **Recently issued interagency responses to "frequently asked questions" on CIP should be helpful, and the ICBA strongly encourages the agencies to continue these efforts through similar releases or through a commentary similar to those offered by the Federal Reserve for many consumer compliance rules.**

Community banks also report that they have refused to open accounts or have closed existing accounts because of problems encountered with identification procedures. This is especially likely with elderly customers that

may not carry a driver's license or foreign customers that may not meet domestic identification standards. These individuals still need financial services, and so authorities must recognize that a collateral impact of the requirements is creation of a fertile environment for an underground network of financial services—a result completely at odds with the premises underlying the BSA and the Patriot Act. For example, one banker reported that a local small business was able to obtain a liquor license from the state but could not open a bank account. It would be helpful and would alleviate burden if community banks had access to databanks, such as DMV records, to confirm identification providing the appropriate safeguards could be instituted.

Finally, although many community banks report being able to implement the new CIP requirements without installing new software, a significant number did install new tracking software to assist with CIP compliance. In part, this was due to encouragement by vendors, but it was burdensome and expensive for the banks. Guidance from the banking agencies when a new regulation is adopted about the need for special software might help alleviate this burden.

Record Maintenance

Community banks generally report that they have been able to adapt to the new record maintenance requirements under the CIP rules without excessive difficulties. However, these also add a new compliance burden and risk for the bank, adding to the great variety of requirements applicable to various records banks must maintain. **Reducing the length of time that banks must maintain customer identification records would help alleviate burden, such as no more than two years after an account has been closed.**

Confusion exists as well about what types of records banks should maintain for transactions. For example, some examiners have told bankers the bank must maintain a complete log for all transactions under $3,000. **To eliminate the confusion, the ICBA recommends that the agencies propose additional guidance for public comment on the records that must be kept, not only for CIP but also for all elements of BSA compliance.**

Customer Reaction

Although some regulators disagree that customer reactions should be considered when assessing regulatory burden, the ICBA believes it is important since each customer complaint requires time and effort to resolve. Generally, the most common reaction from customers is that the new identification requirements are an invasion of privacy. Adding an abbreviated format to the regulations for long-time bank customers would help ease the problem. **While the agencies included model language for banks to use to explain CIP requirements, ICBA urges the agencies to create a government brochure—perhaps a PDF file downloaded from the Internet that banks could distribute—that would**

give an official imprimatur to explain the requirement to consumers and other bank customers.

Money Services Businesses

Banks' BSA obligations when providing financial services to companies defined as money services businesses has garnered a great deal of attention and confusion recently. In response, the banking agencies and FinCEN have issued additional guidance on this topic. While the ICBA applauds this step, we also strongly encourage the agencies to continue to work on this problem. For example, it is not clear whether a company that cashes a payroll check for its own employee is defined as an MSB, nor is it clear whether a company that installs an ATM for withdrawals only is classified as an MSB. Therefore, the critical starting point is defining with greater clarity those businesses that come under the heading of MSB.

Perhaps more important, though, **much greater instruction is needed for field examiners to ensure that they understand the new guidance.** Reports from community bankers suggest that field examiners are treating all MSBs alike, whether it is a business that is engaged primarily in check cashing activities in a HIFCA or whether it is a mom-and-pop convenience store in a rural area that cashes a check for a long-time customer as an incidental customer service. The guidelines help to address these issues, but it is also important that bankers – and examiners – understand how to evaluate and differentiate between low-risk MSBs and high-risk MSBs.

For example, anecdotal reports suggest that many examiners treat any check cashing activity, even those under the threshold, as an activity that classifies a business as an MSB. Even with the new interagency guidance, the burdens and risks associated with these accounts may continue to cause more and more banks, especially community banks, to cease providing financial services for these businesses, especially if examiners do not properly make distinctions based on risk. For example, although the banking agencies and FinCEN have stated that they do not expect banks to act as *de facto* regulators of MSBs, field examiners may continue to take a different approach. As noted, bankers are being told they need to go so far as to monitor the traffic in a MSB's parking lot.

Declining to service these accounts may be logical response by bankers and should be anticipated by the authorities, but it also helps foster a fertile environment for underground financial services that undermine law enforcement efforts against money laundering and terrorist financing. Better balance is needed to encourage companies to maintain accounts with legitimate banks, where there is a paper trail for financial transactions.

Data Matching Program

Section 314(a) of the USA PATRIOT Act requires banks to check accounts and transactions against lists of suspected terrorists and money launderers. Generally, community banks have found the process of checking for matches to be straightforward, although time consuming. Efforts by FinCEN to improve the process (e.g., automating distribution of the lists, better focus for requests) are greatly appreciated. To comply with these demands, community banks increasingly rely on software, either in-house or through a service bureau. However, many community banks must research the requests manually, which is time-consuming and burdensome. **Therefore, greater focus and clarity in the requests themselves will help ease the research process and the burdens associated with this program.**

Additional guidance on how to handle the information once the data-matching research is completed would be useful as well. For example, greater clarity is needed so banks know what documentation should be maintained to verify that the data-match research was completed and whether the lists should be maintained for future reference for possible suspicious activity assessment. Finally, because increased automation streamlines the process, the ICBA encourages FinCEN and the banking agencies to continue to collaborate with vendors to seek means to automate the process further in a manner that simplifies banks' research burden.[5]

Currency Transaction Reporting

As a general rule, banks must report any currency transactions of $10,000 or more. This amount has not changed since it was set when the Bank Secrecy Act was adopted in 1970. Current procedures also allow banks to exempt certain customers from filing.

Because this is a long-standing requirement, community banks have procedures and processes in place for tracking and reporting currency transactions, either through the operations department or through the branch network system. For larger community banks with a branch network or sufficient volume of operations, software tracking aids the process and helps reduce burden. But generally, the volume of transactions subject to CTR reporting requirements – and burdens – is somewhat reduced for community banks because they process fewer transactions subject to CTR filing. However, banks still devote significant resources to tracking, processing, preparing and filing the reports. Even when software is used, the initial reports produced by the software program must still be manually reviewed and reconciled.

[5] Similar streamlining and automation would assist community banks in meeting OFAC compliance responsibilities.

Threshold for CTR Filing

The threshold triggering a CTR filing was first established when the BSA was enacted 35 years ago. If the $10,000 figure were adjusted for inflation, the threshold would now be approaching $50,000. **The ICBA recommends that the threshold be increased to $30,000 to eliminate many unnecessary filings.**

For over ten years, regulators have been under a mandate from Congress to reduce the number of CTR filings, primarily to eliminate those that serve minimal or no purpose for law enforcement and yet which produce volumes of data that must be processed by FinCEN. A subcommittee of Treasury's Bank Secrecy Act Advisory Group has been working on this issue for some time without being able to reach a successful resolution to the problem. The ICBA believes that raising the threshold for CTR filings would be one simple means to accomplish this goal, provided that objections by law enforcement about the importance of the information provided in CTRs can be met.

Exemptions

While the current CTR regulation does permit banks to exempt certain customers from CTR filings, use of the exemption process is confusing and cumbersome. Moreover, for community banks – especially those that file a minimal number of CTRs – the exemption procedure adds greatly to the burden of the process. The bank must have policies and procedures for exemptions, implement systems for tracking and monitoring exemptions to ensure they are properly applied, develop training for employees and subject exempt transactions to audit and compliance review. Moreover, the exemption process is an added procedure for examiners to review and evaluate.

In a limited number of instances, primarily for a few large commercial accounts, community banks do take advantage of the exemption process to eliminate unnecessary CTR filings. Since many community banks operate in smaller communities, they are more comfortable in exempting certain customers when they know the customer and the customer's business operations. But even then, community banks exempt a very small percentage of customers from CTR filings, and often only exempt customers listed as a specific entity eligible for exemption, such as other banks. On the whole, community banks avoid the extra burden – and risk – of creating an exemption system. It is simply easier to file the CTRs.

The ICBA agrees with FinCEN's goal to reduce or eliminate CTR filings on routine transactions. However, to achieve this goal, the exemption process must be simplified and streamlined so that the benefits of taking advantage of the exemption process exceed the costs and risks. Currently, these costs and risks – especially for community banks with a limited number of CTR filings – far exceed any potential benefits.

Examinations

CTR filing is one area where bankers report examiners demonstrate a tendency to focus on minor technical problems. For example, one banker reported that, in order to demonstrate that CTRs were filed with the IRS Center in Detroit in a timely fashion, the bank must photocopy the envelope in which the CTR is mailed and staple that to the CTR to show the postmark for the date of mailing to prove that the CTR was completed and mailed within the appropriate timeframe. Bankers comment that they feel examiners go through the CTR filings with a fine-tooth comb to play a game of "gotcha." Bankers also report examiners tell them that there is "zero tolerance" for *any* errors on CTR filings. **The ICBA agrees that CTRs should be completed accurately and filed on time, but if BSA compliance is to be "risk-based," then better instruction and training is clearly needed for examiners so that the focus is on the process and not technical elements.**

Suspicious Activity Reporting

A key element of the BSA requires banks to report activities that are deemed suspicious. Generally, community banks do not report problems with the completion and filing of SARs. However, because smaller institutions, especially those in rural communities, tend to file fewer SARs, each time the bank completes the form, it must review the regulatory requirements to ensure the form is completed correctly.

The ICBA commends FinCEN for including general filing instructions with the form as an easy point of reference, but also **urges the regulators to continue to investigate ways to simplify the filing process. In addition, reference sources on proper completion of SARs should be made as accessible as possible and easy to use.** FinCEN has been investigating means for automating the process, something that the ICBA recommends FinCEN and the agencies continue to explore to reduce burden. For example, an automated program could be structured so that errors would be detected when a SAR is being completed, thereby reducing problems and burden.

Disclosure of SAR Filings. Although the information covered within a SAR may be disclosed, the fact that a SAR has been filed may never be disclosed. Despite agency guidance, there is still confusion about what may or may not be disclosed and discussed. For example, some consultants have told bankers that the SAR information, including names and dates, must be reported to the board of directors. And within the last year, SAR filing information was published in the media about two major east coast financial institutions**. To ensure the confidentiality of SAR filings is maintained, and to reduce the confusion – and burden – the ICBA recommends that the agencies issue a simple one-page guideline for banks about SAR disclosure, using bullet points and simple language.**

Communication

Once a SAR has been filed, the bank receives little or no feedback—a constant frustration reported by bankers. Under Director William Fox, FinCEN has improved the feedback mechanism for bankers on the success of SAR and other BSA reporting. For example, FinCEN regularly reports on the success of the Patriot Act section 314(a) data-match program on its website. And, law enforcement representatives commend the financial services industry for the cooperation and information furnished under the BSA. However, a goal of the information sharing provisions of the Patriot Act is to foster enhanced communication, not only from the industry to law enforcement, but from law enforcement to the industry. This is especially so with SAR filings.

The ICBA strongly encourages efforts be continued to expand and enhance communications with the industry. Better information about suspicious fact patterns to watch for helps community banks focus their compliance efforts. Better focused efforts helps reduce unnecessary burden. Moreover, better communication about what is considered suspicious also would help eliminate the "defensive filing" of SARs that has raised concerns in recent months.[6]

Interagency Safety and Soundness Regulations

Tthe agencies are also reviewing under this phase of the EGRPRA project the interagency safety and soundness regulations. ICBA has the following comments concerning appraisal guidelines, safety and soundness exams, real estate lending standards, bank security procedures, standards for safety and soundness, transactions with affiliates, OCC regulations on other real estate owned, and FDIC regulations on annual independent audits.

Appraisal Guidelines

Under the interagency regulations dealing with appraisal standards, an appraisal performed by a state certified or licensed appraiser is required for all real estate lending transactions. However, there are exceptions to that rule. Residential real estate lending transactions with a value less than $250,000 and business real estate loans with a value of less of $1,000,000 are exempt as long as the transactions are not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment. These exempt transaction levels were established in 1990 and have not been adjusted or indexed to reflect the current value of residential or commercial real estate. **ICBA strongly encourages the agencies to raise the exempt transaction levels to at least $500,000 for residential real estate loans and $2,000,000 for business real**

[6] See, e.g., remarks of William J. Fox, Director of FinCEN, October 25, 2004.

estate loans to take into consideration the higher amounts being financed by banks for real estate transactions.

The guidelines also include five minimum standards for the preparation of an appraisal. The appraisal must (1) conform to generally accepted appraisal standards as evidenced by the Uniform Standard of Professional Appraisal Practice (USPAP) by the Appraisal Standards Board (ASB), (2) be written and contain sufficient information and analysis to support the institution's decision to engage in the transaction, (3) analyze and report appropriate deductions and discounts for proposed construction or renovation, partially leased buildings, non-market lease terms, and tract developments with unsold units, (4) be based upon the definition of market value, as defined by the agencies appraisal regulations, and (5) be performed by state licensed or certified appraiser in accordance with requirements set forth in the regulation.

Under the appraisal guidelines, a tract development is defined as a project of five units or more constructed as a single development. As set forth above, the minimum standards require the appraiser to analyze and report deductions and discounts for tract developments since they frequently have speculative development that is difficult to accurately appraise. However, there may be situations where a tract development may involve "pre-sold" units with no speculative development, in which case, there would be no need for an appraiser to take any reductions or discounts with respect to the appraisal. **ICBA recommends that the appraisal standards for tract developments be changed to take into consideration different types of development and inventory such as pre-sold units that may be part of a tract development.**

Frequency of Safety and Soundness Examinations

Currently, the agencies conduct a full scope, safety and soundness examination on banks once every 12 months. Some smaller institutions may receive examinations every 18 months as long as they meet certain criteria: less than $250 million in assets, well capitalized, well managed, a good or outstanding rating on its last exam, not subject to a formal enforcement proceeding or order, and no other person acquired control in the last 12 months.

On site examinations require community banks to devote significant resources for days or weeks as staff are diverted from their daily tasks and serving customers in order to gather voluminous materials requested by examiners and respond to their questions.

ICBA applauded the FDIC's decision to broaden the streamlined examination program called "MERIT" (for Maximum Efficiency, Risk-Focused, Institution Targeted Examinations) so that well-rated banks with total assets of $1 billion or less are eligible for examination under a streamlined examination process. Formerly, the MERIT program was limited to well-rated banks with total assets of $250 million or less. **However, ICBA urges the agencies to also**

increase the asset test for the examination schedule from $250 million to $1 billion so that well capitalized, well managed community banks under $1 billion in assets would be examined once every eighteen months rather than once every year. An eighteen-month examination schedule for these institutions should not raise any safety or soundness concerns.

Real Estate Lending Standards

Supervisory Loan-to-Value Limits

Section 304 of the Federal Deposit Insurance Corporation Improvement Act of 1991[7] prescribes standards for real estate lending to be used by insured depository institutions. The banking agencies have adopted a uniform rule on real estate lending that sets limits and standards for all real estate-secured or real estate construction loans. The guidelines are intended to assist institutions establish a real estate lending policy that is appropriate to the size of the institution and the nature and scope of its individual operations as well as satisfy the requirements of the regulation.

Under the regulations, banks must establish their own internal loan-to-value limits for real estate loans, but the limits should not exceed the following supervisory limits:

Raw Land—65%
Land development—75%
Construction
    Commercial, multifamily[8] and other non residential—80%
    1-to-4 family residential—85%
Improved property—85%
Owner-occupied 1-to-4 family and home equity—(no specific percentage[9])

Only in rare cases can a bank exceed these limits. When they do, such loans must be reported to the bank's board of directors.

Community bankers have told the ICBA that current loan-to value limits are overly restrictive in the current market environment. Bankers find that they must loan higher amounts to be competitive. For example, in some markets, bankers find they must loan up to 80% on raw land and land development, commercial new construction, multifamily and other nonresidential. Residential 1-4 family new construction loans are made up to 90% of value. Bankers believe

[7] 12 U.S.C. 1828(o),
[8] Multifamily construction includes condominiums and cooperatives.

[9] A loan to value limit has not been established for permanent mortgage or home equity loans on owner-occupied, 1-to-4 family residential property. However, for any such loan with a loan to value ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either r mortgage insurance or readily marketable collateral.

that they can prudently lend at higher levels and must do so to meet customer needs and compete against larger regional lenders. **Therefore, ICBA urges the banking regulators to increase the supervisory loan-to-value limits in each category by 5%.**

Loans Exceeding Supervisory LTV Limits

Under the guidelines, the aggregate amount of all loans in excess of the supervisory loan-to-value limits should not exceed 100 percent of total capital.[10] Moreover, within the aggregate limit, total loans for all commercial, agricultural, multifamily or other non 1-to-4 family residential properties should not exceed 30 percent of total capital. An institution will come under increased supervisory scrutiny as the total of such loans approaches these levels.

ICBA has received a number of strong complaints from community bankers that the treatment of high loan-to-value loans as they relate to capital is overly restrictive and places community banks at a competitive disadvantage. Regulatory requirements dictate that the entire amount of a high loan-to-value loan be included in the aggregate amount to be measured against capital, not just the portion exceeding the supervisory loan-to-value limit. Community bankers have described situations where loans exceeded the supervisory loan-to-value limits by very small amounts as compared to the total loan amount, e.g. $5,000 on loans of $500,000 to $1 million, yet the entire loan amount must be measured against capital. Community banks point out that this method of calculation greatly increases the total amount to be measured against capital yet does not appropriately measure risk.

Moreover, current supervisory limits severely restrain the ability of small community banks to compete in the market place. A residential mortgage reflects a small part of a large bank's capital, so large banks are easily able to offer mortgages above the supervisory loan-to-value limit. However, such loans would represent a much larger percentage of a small community bank's capital and effectively limits its ability to compete. Not only does this hurt the community bank from a business perspective, it hurts consumers who have fewer mortgage options. First-time homebuyers or low- or moderate-income or minority homebuyers who cannot make substantial downpayments are particularly hurt. And community banks are not able to increase homeownership opportunities for these groups.

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[10] For the state member banks, the term "total capital" means "total risk-based capital" as defined in appendix A to 12 CFR par 208. For insured state non-member banks, "total capita" refers to that term described in Table I of appendix A to 12 CFR part 325. For national banks, the term "total capital" is defined at 12 CFR 3.2(e). For savings associations, the term "total capital" is defined at 12 CFR 567.5(c).

Therefore, ICBA urges the banking regulators to require that only the amount of a loan in excess of supervisory loan-to-value limits be measured against capital, not the entire amount of the loan. Community bankers feel strongly that this change would not increase risk, but would allow them to extend more credit in their communities. The tools lenders use for underwriting have become more sophisticated over the years, particularly those used for residential lending. Also, the market has changed—consumers are demanding higher loan-to-value loans, particularly residential mortgages. Community banks feel strongly that they can make good loans, using prudent underwriting, which they see as a more relevant means of controlling risk than arbitrary loan-to-value amounts.

Bank Security Procedures

All banks are required to implement a security program, which includes the designation of a security officer who must annually report to the bank's board. The program must include procedures for: (1) opening and closing for business and safekeeping cash, negotiables and other valuables; (2) identifying individuals who may commit a crime against the bank and safeguarding evidence of a crime; (3) appropriate training for employees in security procedures, including appropriate steps in a robbery situations; and (4) selecting, testing, operating and maintaining appropriate security devices. Security devices include the bank's vault, appropriate lighting, tamper resistant locks, alarm system, and such other devices as the security officer deems appropriate.

Generally, because the mandates of the Bank Protection Act have been in place for nearly 40 years, community banks are comfortable with the requirements. **Community banks position the security officer within their own organization depending on the unique operations and market of the bank. This flexibility is important, and the ICBA recommends that community banks continue to have this flexibility if any changes are made.** Because security is increasingly important, especially with concerns about data security, community banks increasingly engage an outside consultant to review their security program and to make recommendations to improve security. While this is a useful tool, **the ICBA believes that the decision to engage an outside consultant to review the security program should be left to the individual institution and not mandated by the regulators – or examiners.**

Standards for Safety and Soundness

Generally, the ICBA finds the existing guidelines for safety and soundness are appropriate. The strength of the banking industry today demonstrates that the current system is working, and the overall health of the industry without any major difficulties during the recent economic downturn further bolsters this notion.

However, in ICBA's view, there is room for improving the guidelines with fine-tuning. **For smaller, less-complex institutions, the existing guidelines**

are unnecessarily complex. Regulators should adopt a tiered approach and streamline the existing requirements for smaller community banks.

Internal Controls

The guidelines on internal controls, while generally appropriate, should be tailored to the size and complexity of the bank. For smaller institutions, with simpler operations, the current guidelines can be overly complex and cumbersome. Bankers report that since the guidelines are subject to examiner interpretation, at times examiners mandate banks to institute policies or procedures that are irrelevant to the bank's operations on the mistaken belief that they are required by the guidelines. The ICBA believes that a tiered approach would help alleviate this problem.

Recently, a great deal of attention has been given to the internal control mandates under section 404 of the Sarbanes-Oxley Act. While compliance with that provision is not within the control of the banking agencies, the ICBA recommends that the agencies work with the Securities and Exchange Commission and the Public Company Accounting Oversight Board to coordinate efforts and to reduce redundant, parallel or possibly conflicting requirements on internal control requirements.

Loan Documentation

The ICBA finds that the current guidelines for loan documentation are generally appropriate. However, it is also important that examiners not substitute their judgment for the judgment of the bank. **As long as the bank has implemented appropriate procedures to manage compliance and as long as the bank adheres to those procedures, examiners should not impose extra requirements.** For example, if a smaller community bank has a manual process for managing its loan documentation needs, an examiner should not mandate that the bank purchase and install automated loan documentation processing systems.

Risk Management

As with other areas, the ICBA believes the existing guidelines for credit underwriting are appropriate. Where terms such as "adequate" or "appropriate" are used, though, it would be helpful to provide examples for both examiners and bankers to ensure that the application of these terms are clearly understood and not misinterpreted. **The ICBA also encourages the agencies to work to develop consistent application of the guidelines, both within individual agencies so that regional offices are applying the guidelines uniformly, as well as across the different agencies.** One means to achieve this goal might be increased interagency training of examiners.

As with the credit underwriting guidelines, the ICBA finds that the current interest-rate risk, asset growth and asset quality guidelines do not need to be revised and generally are not burdensome. However, where areas are subject to interpretation, bankers report that examiners sometimes institute or "recommend" steps that are not required. Bankers feel compelled to institute these "recommendations" (frequently verbal and not part of the written examination report), which can be expensive and burdensome. **Additional guidelines in the form of examples or best practices (with the clear understanding that any best practices are not mandatory) would be useful. And, as noted above, the ICBA suggests this might be an additional opportunity for increased use of a tiered approach.**

The ICBA also believes that it is important to encourage examiners to recognize that individual institutions have unique markets and that comparison with peers should be an analysis tool and not an endpoint. And, while strategic planning is a laudable goal, **examiners should recognize that implementing new business lines or strategies may result in short term decline in capital or income and should not judge the bank deficient for a short-term downward trend, especially when the bank is otherwise well managed and well capitalized.**

Transactions with Affiliates

A significant percentage of community banks and holding companies have few affiliates. Accordingly, these institutions seldom deal with Federal Reserve Regulation W and its restrictions on transactions with affiliates. But when they do, they soon realize that the regulation is unnecessarily complex. **ICBA urges that Regulation W be simplified and that the agencies provide more examples within the regulation of the kinds of transactions between affiliates that are restricted or prohibited particularly with respect to transactions that may occur within a noncomplex bank holding company.** Further guidance should also be issued to assist family-owned community banks and holding companies from inadvertently violating the regulation. A flow chart of the questions that bankers should ask themselves before completing a transaction with an affiliate would be helpful to community banks that are unfamiliar with Regulation W.

OCC Regulations on Other Real Estate Owned

Other Real Estate Owned (OREO) is real estate, including capitalized and operating leases, acquired by a bank through any means in full or partial satisfaction of a debt previously contracted. For future expansion, the bank should use real estate acquired within five years. After holding for one year, the bank should state the purpose of the real estate. Further, when the real estate is transferred to OREO status, the bank must substantiate its market value by obtaining an appraisal or another appropriate evaluation of the value.

ICBA believes that the OREO guidelines are appropriate and flexible. However, **we suggest that the regulations provide more leeway for disposing of OREO property. For instance, bankers would find it helpful to be able to lease the property when it cannot immediately dispose of it.**

Annual Independent Audits and Reporting Requirements

Currently, banks with $500 million or more in assets—whether privately held or publicly owned—are subject to regulations under the FDIC Improvement Act of 199I (FDICIA)[11] requiring that outside auditors both review their financial statements and attest to the adequacy of management's assessment of internal controls. Banks with less than $500 million are exempt.

ICBA urges the FDIC to increase the $500 million threshold to $1 billion for internal control audits. We believe this change will provide much needed relief for those private banks under $1 billion in assets that are struggling to absorb the costs associated with FDICIA internal control attestation requirements. These costs have increased recently because in many cases, rather than applying AICPA standards described in AT 501, external auditors are applying the new PCAOB Auditing Standards Number 2,[12] the auditing standard used by auditors performing internal control audits of public companies subject to the internal control requirements of Section 404 of the Sarbanes-Oxley Act. In general, Auditing Standard No. 2 requires more work by management, audit committees and external auditors and also requires two opinions, one on management's assessment of internal controls and one resulting from an audit of internal control over financial reporting. Consequently, private banks with assets of $500 million or more have seen outside audit fees increase significantly, placing an undue burden on these institutions.

Furthermore, we believe that the requirement that banks with $500 million or more in assets must have an independent audit committee is also burdensome for these institutions. It is often very difficult for community banks to find directors who meet the qualifications for being "independent." **We recommend that the threshold for the independent audit committee be raised to $1 billion, particularly if the internal control attestation threshold is increased to $1 billion.**

Securities Activities of Banks

Confirmation of Securities Transactions Effected by Banks: These regulations require banks that transact more than a minimal number of securities transactions for customers to maintain records of the transaction and issue a confirmation to the customer. Banks are generally exempt from this rule if they

[11] See 12 CFR Part 363.

[12] *An Audit of Internal Control Over Financial Reporting in Conjunction with an Audit of Financial Statements* released by the Public Company Accounting Oversight Board (PCAOB) in March 2004.

have less than 200 securities transactions for customers over a three-year period, exclusive of transactions in government securities. Confirmations must be given to bank securities customers at or before completion of the transaction, unless the bank provides a copy of a broker-dealer's confirmation, which must be presented to the customer within one business day of the bank's receipt of the broker-dealer's confirmation.

Community banks generally find the confirmation requirements burdensome because it is often difficult to meet the strict timing requirements of the regulation. ICBA recommends that the period be extended so that confirmations could be given to the customer as late at one or two days after the completion of the transaction. Also, the general exemption from these requirements should be raised from 200 to at least 500 securities transactions for customers over a three-year period, exclusive of transactions in government securities.

OTS Regulations

Audits of Savings Associations

As was mentioned above concerning the annual independent audits of banks, ICBA urges the agencies to increase the threshold amount for an internal control attestation audit from $500 million to $1 billion for all banks, including savings associations. We believe this change will provide much needed relief for those private savings associations under $1 billion in assets that are struggling to absorb the costs associated with FDICIA internal control attestation requirements. We also recommend an increase in the threshold requirement for an independent audit committee to $1 billion in assets as was mentioned above.

OTS Appraisal Standards, Lending Standards and Exam Schedules

ICBA has the same recommendations concerning appraisal standards, real estate lending standards, and the frequency of safety and soundness exams for OTS-regulated savings associations as were made earlier in this letter. For instance, we believe that the appraisal exemptions for residential and commercial real estate lending transactions should be raised to $500,000 and $2 million respectively, that the real estate lending standards should be revised so that the supervisory loan-to-value guidelines are increased, and that well managed and well capitalized savings associations with less than $1 billion in assets should have safety and soundness exams once every eighteen months.

Conclusion

Regulatory burden and compliance requirements are consuming more and more resources, especially for community banks. The time and effort taken by

regulatory compliance divert resources away from customer service. Even more significant, the community banking industry is slowly being crushed under the cumulative weight of regulatory burden, causing many community bankers to seriously consider selling or merging with larger institutions, taking the community bank out of the community.

ICBA strongly supports the current efforts of the agencies under the EGRPRA project to reduce regulatory burden. Even though there has been some progress since the EGRPRA project was started, there is a lot more work that remains to be done. The banking agencies need to implement more of the burden reduction recommendations that have been made by the industry and Congress needs to approve legislation that will provide meaningful burden reduction for banks and thrifts. ICBA looks forward to working with the agencies and with Congress to complete the EGRPRA project and to ensure that the community banking industry in the United States remains vibrant and able to serve our customers and communities

Thank you for the opportunity to comment. If you have any questions or need any additional information, please contact me at 202-659-8111 or Karen.Thomas@icba.org.

Sincerely,

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