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Re: EGRPRA Burden Reduction: **FDIC** 12 CRF Chap. III; **FRB** Docket No. OP–1220; **OCC** Docket No. 05-01: **OTS** Docket No. 2005–02; 70 Federal Register 5571; February 3, 2005

Ladies and Gentlemen:

Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) requires federal banking agencies (Agencies) to review their regulations at least once every 10 years. The Agencies are now in the fourth phase of this review and are asking for comments on the ways in which the Money Laundering, Safety and Soundness, and Securities Regulations may be outdated, unnecessary, or unduly burdensome. The American Bankers Association (ABA) brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

Issues to consider for comment include whether a statutory change is needed to reduce the burden, whether the regulations are consistent with their statute of authority, what are the most burdensome reporting requirements and are any of them unnecessary, and how might the burden be lessened on small institutions. Specific comments on the regulations posed for comment in this fourth round of EGRPRA review are set out below, but ABA notes that the agencies have been diligent in updating a number of these regulations in the last few years.

Specific Comments

1. Money Laundering

Bank Secrecy Act and anti-money laundering regulations, policies and examinations have been consistently identified for the last five years as one of the most burdensome regulations. Since the passage of the U. S. PATRIOT Act, BSA and AML have become the single largest regulatory burden. ABA's member banks are dedicated to preventing the use of the banking and payment system by terrorists, but some parts of the BSA/AML system are simply not working. In summary, ABA proposes the following changes to BSA reporting and examination processes: (a) eliminate CTR filings for transactions conducted by seasoned customers through their bank accounts (where records of cash transactions are maintained in account activity data for five years; (b) eliminate verification requirement for purchases of monetary instruments by customers; (c) eliminate the requirement to notify directors about SAR filing; (d) establish a standard for suspending the filing of repetitive SARs on continuing activity over which law enforcement asserts no interest; (e) include a Federal Financial Institutions Examination Council ("FFIEC") exam instruction requiring examiners to contact the FinCEN helpline and incorporate the resulting staff advisory position on "contested" exam exceptions; and (f) include a FFIEC exam instruction requiring examiners to evaluate audit/testing quality of BSA compliance program before requiring banks to produce files or records for transaction testing. Discussion of these recommendations follows.

(a) CTR Filing on Customers is Obsolete

ABA notes that the purpose of Subchapter II of Chapter 53 of Title 31 establishing the BSA regulatory regime is to require certain reports or records when they have "a high degree of usefulness" for the prosecution and investigation of criminal activity, money laundering, counter-intelligence and international terrorism. ABA and its members strongly believe that the current CTR reporting standards have long departed from this goal of achieving a high degree of usefulness. ABA members believe that CTR filing has been rendered virtually obsolete by several developments: formalized customer identification programs, more robust suspicious activity reporting and government use of the 314(a) inquiry/response process.

We pressed this point in a September 2004 memo to the Treasury's Bank Secrecy Act Advisory Group (BSAAG) CTR Reduction Subcommittee and urged pertinent research on how the more robust suspicious activity reporting process has made low threshold CTR reporting redundant. We believe that maintaining the CTR threshold at the current level generates too many reports that capture extensive immaterial activity wasting banker and law enforcement time that could be spent on SAR detection and investigation.

The fact that a couple percent of reports for transactions between $10,000 and $20,000 can yield a positive match with already identified criminal subjects does not amount to reporting with "a high degree of usefulness" as mandated by the statute. In fact, it suggests that law enforcement has other preferred means of identifying persons of interest and that CTRs are, at best, lagging indicators. We suspect that this is especially the case after the introduction of 314(a) of the USA PATRIOT Act, where criminal suspects' accounts can be more precisely identified and then better directed means can be used to monitor their activity rather than sifting through the universe of CTRs.

In other words, we believe that CTRs are no longer analyzed to identify unknown criminal agents. Rather they are used, at most, to try to match already known suspects to locate account activity. As

noted above, section 314(a) is much more efficient for identifying account activity of known suspects because it has the value of capturing accounts involving more than just cash transactions. We believe that combining improved monitoring conducted by institutions as part of their suspicious activity reporting processes with better mining of SAR data by law enforcement as well as judicious use of the 314(a) process yields a more effective approach to law enforcement investigation of patterns of fraud, money laundering and terrorism funding.

Consequently, we believe that the time has come to recognize the redundancy of CTR filings for seasoned customers with transaction accounts to eliminate this inefficient use of resources by bankers and law enforcement.

It will have the following benefits:

- The vast majority of the over 13 million CTRs filed annually will stop, saving many hours a year in form filling.
- Wasteful SARs on structuring will cease. This amounts to close to 50% of all BSA SARs. Rather than file specious structuring reports, banks can focus their energies on detecting suspicious handling of currency regardless of artificial thresholds.
- Bank systems and resources can be converted from CTR monitoring to support further improvement in suspicious activity reporting.
- Regulatory criticism of technical mistakes with CTR form filings will cease.
- Issues surrounding the CTR exemption process would be eliminated.
- Law enforcement can redirect resources to better evaluate SARs.

(b) Eliminate Identity Verification Requirement for Purchase of Monetary Instruments Conducted by Customers

In view of the passage of the USA PATRIOT Act and the regulations implementing section 326 requiring a Customer Identification Program ("CIP"), we recommend that the verification requirement of 31 CFR 103.29(a)(ii) be eliminated, since bank customers purchasing these instruments will have already been identified through their institution's CIP program.

(c) Eliminate Requirement to Notify Directors or Designees of filing of SARs

The Federal banking agencies instruct a bank that "whenever [it] files a SAR …, the management of the bank shall promptly notify its board of directors, or a committee of the board of directors or executive officers designated by the board of directors to receive notice." See, e.g. 12 C.F.R. 21.11(h). No such requirement exists in FinCEN's parallel SAR regulation.

ABA believes that this expectation imposes a role on directors and executive officers (that do not serve as an institution's BSA officer) that is inconsistent with rational risk management responsibilities and compromises the board's independence in evaluating management performance under the board approved BSA compliance program. In the normal course of risk reporting and board monitoring summaries of fraud activity or BSA reputation risk experience may be appropriate for the board to receive. However, such reports will surface in the normal course of following sound risk management policies tailored to the institution's business operations. The current regulatory requirement imposes undue operational burden upon all boards in an overbroad manner. The requirement diverts scarce board and executive resources from more significant strategic and policy oversight functions. At the same time, it adds further risk to information security issues without any concomitant benefit to the bank. The board plays its appropriate role when it approves a risk-based

BSA compliance program that includes a BSA officer back-stopped by an audit/independent testing protocol and training. At that point, the board should be evaluating management's performance in executing the program—not analyzing individual SARs. Mandating notification of SAR filing to the board or executive level for all institutions is an unwarranted imposition on, and deleterious to, sound corporate governance.

ABA recommends that the banking agencies eliminate their board notification requirement for SARs. While application of this requirement has often been reasonable and modified in light of institution size and other operational realities, ABA is aware of differing examiner interpretations that have only caused conflicting advice to be given to institutions. In the end, there is simply no practical utility to this regulatory standard and it should be eliminated.

(d) Establish a standard for suspending SARs on continuing activity of the same nature by the same identified person.

There are many reasons that banks file continuing SARs when the underlying customer transaction activity is not considered inconsistent with reasonable banking behavior. For example, many institutions file SARs out of a literal interpretation of the structuring guidance and in an abundance of caution, when they have no conviction that the customer is engaging in activity that constitutes money laundering. In addition, some customers may be conducting legitimate MSB activity, but resist registration thereby precipitating continuing SAR events.

Accordingly, ABA proposes that when an institution would otherwise file serial SARs on repeatedly similar customer activity, they should be permitted by a clear regulatory interpretation to suspend further SAR filing when:

- An original and two additional SARs report continuing similar activity by the same customer have been filed;
- Law enforcement has not requested the continued reporting of the identified activity; and
- No substantively different conduct alters the nature, significance or criminality of the repeated activity, or merits a SAR identifying the activity as a different type or involving perpetrators not previously identified.

(e) Include FFIEC Exam Instruction to Invoke FinCEN Helpline

ABA considers the FinCEN Helpline to be a valuable source of BSA interpretive guidance. Many bank representatives and agency examiners utilize this service to obtain staff analysis to assist in evaluating compliance issues. This option has helped many bankers and examiners resolve their disagreements about BSA regulatory applications arising during an exam. However, other examiners resist using this resource when their interpretations are challenged by management. ABA proposes that the FFIEC agencies include in their uniform exam procedures the following mandatory instruction:

> "Whenever management submits a written rebuttal to an examiner's BSA exception pertaining to 31 CFR Part 103 and includes therein a request to call the FinCEN Helpline, the examiner shall then call the FinCEN Helpline and, in the presence of the institution BSA Officer, obtain a FinCEN staff advisory interpretation of the issue. If the advisory interpretation does not alter the examiner's judgment with respect to the exception, the FinCEN interpretation is to be recorded on the exception sheet along with any supplemental management position after the BSA Officer has heard the FinCEN interpretation."

ABA believes this process will contribute to more uniform BSA applications and expedite exam dispute resolution without requiring a banking agency to compromise its supervisory judgment. If the Helpline option does not eliminate the dispute, the bank still has the ability to pursue a formal supervisory appeal pursuant to the rules of the examining agency.

(f) Include FFIEC Exam Instruction on Conducting Transaction Analysis

Despite agency requirements for a tailored risk-based BSA compliance program and mandatory testing of bank BSA controls, agencies request transaction files and conduct transaction analyses without finding fault with the bank's audit/testing of the same processes. This is not an appropriate use of resources by agencies and is unduly burdensome for banks. The FFIEC should adopt the following uniform BSA exam instruction:

> "Examiners should not request a bank to assemble files or records for the purpose of conducting transaction testing, or engage in transaction testing, of any provision of a bank's BSA compliance program before evaluating the adequacy of the bank's audit or independent testing of the relevant program provision and concluding either (i) that the audit/independent testing is demonstrably not a reliable indicator of bank performance of the program provision being examined, or (ii) that deficiencies identified by bank audit or independent testing of the program provision have not been timely corrected."

To demonstrate that the banking agencies do endorse sound bank risk assessment and control monitoring, they must expect examiners to evaluate BSA compliance programs from the top-down and not engage in transaction testing that is redundant to what the bank has reliably conducted.

2. Safety and Soundness

(a) Appraisal Standards

Reciprocity and Temporary Practice - The burdensome restrictions placed by some states in granting reciprocity and temporary practice licenses to out-of-state real estate appraisers hinders the smooth functioning of national and regional mortgage markets. It is a common practice for banks to request appraisers licensed or certified in one state to conduct an appraisal of real estate located in another state. This occurs where the regional market encompasses several states, such as in metropolitan New York City or Washington, DC. It also occurs where a bank is best served by an appraiser knowledgeable in a specific type of property that is located in several states. In either case, the barriers erected by some states, along with the variety of fees and procedures required by others, create unnecessary delays and costs associated with obtaining either a permanent or temporary real estate appraiser's license.

The ABA recognizes that the resolution of the reciprocity and temporary practice problem rests with the states and Congress. The ABA recommends that in dealing with reciprocity the agencies include in their recommendations to Congress language that would simplify and expedite the ability of licensed and certified real estate appraisers to obtain reciprocity of practice in other states. An approach to this could be modeled on the language of "Title IV Appraisal Activities", H.R. 1295, dealing with Reciprocity which basically requires states to issue reciprocal licenses or certifications if the licensing and certification program of the home state complies with the appraisal title of the

Financial Institutions Reform, Recovery, and Enforcement Act of 1989, as amended, and the appraiser holds a valid license or certification from a state that meets the qualification criteria established by the Appraiser Qualifications Board of The Appraisal Foundation.

Professional Experience and Education - Section 1122 (c) of Title XI of FIRREA imposes a non-discrimination requirement on banks in their selection of real estate appraisers which mandates that the criteria for selection of an appraiser cannot exclude a licensed or certified appraiser solely by his or her membership or lack of membership in an appraisal organization. Such a requirement leveled the playing field at the time of the initial state licensing and certification of appraisers so that the absence of membership in a professional appraisal organization would not automatically exclude a licensed or certified appraiser from consideration for an assignment.

For over a decade, banks have had the experience of managing the appraisal process within the state licensing and certification system. Often the best person for an assignment may be someone with not only the state license or certification but also the experience and education that define his or her competency to handle an assignment. The ABA suggests that the banking agencies incorporate in their regulation language that recognizes professional appraisal accreditation as a measure of experience and education to determine competency to perform an appraisal assignment.

Contract Sales Price Information - Many community bankers have brought to ABA's attention an appraisal practice which the bankers believe undermines the independent judgment of the appraiser. In particular, appraisers are requesting from banks contract sales price information, claiming that they are required to have this information. In response, bankers believe they are compelled to provide the appraiser with the information, even though they believe the contract sales price sets a target for the appraiser, compromising the appraiser's independence.

The ABA recognizes that the Uniform Standards of Professional Appraisal Practice provides direction to real estate appraisers and requires the appraiser to obtain relevant information to support his or her analysis. The ABA recommends that the banking agencies work with the Appraisal Standards Board of The Appraisal Foundation to resolve this issue and clarify that providing the specific contract sale price information to the appraisers is not a Federal regulatory requirement and in certain instances may not be appropriate.

Going Concern - The issue of the appropriate treatment of the going concern business value of commercial real estate engenders much discussion among bankers, real estate appraisers and business valuation appraisers, as discussed further immediately below under Real Estate Lending Standards. At the same time, there is a regulatory impact if a banker's lending practices do not meet the loan-to-value ratios for real estate based on an examiner's determination of the relationship between the real estate and the going concern values of the property serving as collateral for a loan.

The ABA urges the banking agencies to work with all parties involved in this issue and prepare guidance that will clarify the role of business valuation as a component of a commercial real estate loan. In this process, banking agencies should recognize that for many loans, the burden in costs and time spent in obtaining separate real estate and business valuation appraisals on the same property for the same loan can be excessive. The banking agencies may want to consider some type of threshold at or below which such a dual appraisal approach would not be necessary.

(b) Frequency of Safety and Soundness Examination

Subsection 10(d) of the Federal Deposit Insurance Act requires each bank to have an annual on-site examination by the appropriate banking agency. Institutions below $250 million that are well-managed and well-capitalized must be examined every 18 months. We believe that the Agencies need to request a change in the statute that would allow regulators to adjust the exam cycle of insured depository institutions, or at least those institutions with less than $1 billion in assets, to a longer cycle. We believe that the current reporting and risk management systems that have been added since the enactment of Subsection 10(d) make its rigid requirement of annual audits too inflexible. Well-managed and well-capitalized noncomplex institutions under $1 billion do not need such frequent examinations. Such a change would not only reduce the examination burden on these institutions but also would free up Agency resources being spent on well-managed banks that could be better focused on any troubled institutions.

(c) Real Estate Lending Standards

The Agencies are required to establish real estate lending standards, including supervisory loan-to-value limits. Borrowers and bankers are being unnecessarily constrained in their credit arrangements by these limits with respect to financing the purchase of going concerns. Current supervisory guidance limits LTV on improved property to 85% of the land value. However, this is often only 60-65% of the going concern value. As noted above, appraisal standards require the appraiser to value the going concern in such cases, leading to the borrower not being able to finance but about two-thirds of the purchase price of a going concern. ABA understands the need to prevent artificially inflated valuations of new or even potential businesses, such as the need to prevent basing loan amounts on projected revenues. However, appraisal standards now in place limit such puffery by borrowers, while the supervisory LTV ratios now limit financing of the transfer of ownership of going concerns, many of which are established, profitable small businesses whose owners are reaching retirement. And we expect there will be many more of these transactions occurring in the next decade.

Two recent examples of this problem suggest to us that some further clarification of when "improved property" is more appropriately valued as a "going concern" rather than just the land and improvements. One banker reported to us that a borrower was purchasing a family-owned funeral home that had been in operation for over 20 years and had audited financial statements showing its income over the last five years. Going concern valuation was $4 million but the land and improvements were only $3 million. Therefore, he could only finance $2.55 million of the purchase price, which was 63.75% of the purchase price. As the borrower needed to finance 85% of the purchase price, the banker did not get the loan. This was a business in the banker's community, and the banker very much wanted the business relationship with the new owner, but he did not get it. Another example of a motel purchase, the motel having been a closely held "going concern" for over three decades, involves similar LTV, and that banker failed to get the loan. ABA believes that the Agencies need to provide for a different LTV treatment of loans for the transfer of going concerns that will be secured by real estate that will not prevent small bankers from financing their communities' businesses.

(d) Standards for Safety & Soundness

The Agencies' standards for safety and soundness set the framework for safety and soundness examinations. Our bankers report three major concerns with the current examination process. First, the examination process seems to be blurring, if not erasing, the lines of responsibility between the board of directors and management. Second, despite statements and guidance from the Agencies in Washington, examiners appear to be forcing smaller, less complex institutions to adopt monitoring and control systems that are only appropriate for larger institutions. Third, examiners seem to be taking a zero tolerance approach to more and more supervisory issues.

Blurring the line between the Board of Directors and Management – In each new guidance and embedded in virtually all the recent examinations there appears to be a blurring of the distinction between senior management and the board. While well-intentioned, this regulatory trend diverts the attention of directors from providing strategic leadership and oversight to their institutions by getting them too involved – at times unnecessarily or unproductively – in an increasing amount of operational and other business-related detail. Requiring too high a level of detail is counter-productive to the goal of effective corporate governance of banks and bank holding companies.

Here are some "Matters Requiring Board Attention" raised in recent examinations that are representative of the problems encountered by our members.

(1) "Reduce/minimize cash transaction processing errors to ensure currency transaction reports are accurate." This is clearly management's job.

(2) "Files on the X and Y drives must be reviewed and access assigned to employees based on need." Conceding the substantive appropriateness of this security recommendation, it is a management issue.

(3) "We recommend that [bank] develop structure around the processes dealing with the development, receipt and implementation of major assumptions: deposit elasticities, core deposit maturities, prepayment assumptions. Such assumptions should receive regular approval by the board or board designated committee ...." What expertise will directors possess that would allow them to regularly approve these items? The Board's role is to ensure that management puts a governance process in place so that experts evaluate such assumptions and provide transparency.

(4) "Violations were noted regarding the font size of disclosures contained in various credit card application disclosures.... The board must ensure that management revises the application/brochures to comply with regulatory requirements." Technical compliance violations should not belong at the board level unless management has refused to address the issue in a timely fashion.

A board should have a policy or approved process in place that articulates bank management and audit function responsibilities for correcting adverse exam findings. Requiring assorted violations to be elevated to the board on an *ad hoc* basis circumvents this mechanism and absorbs time that should have been used by the board to address important enterprise risk issues.

This trend of rising supervisory expectations for board involvement in senior management matters has significant adverse implications for effective corporate governance. First, the independence of the board may be compromised. Second, management has a finite amount of time with board

members. If a substantial portion of that time is spent reviewing materials that are best handled by management, then there is less time available for important risk issues that the board needs to understand.

Third, the over-specification of board responsibilities tends to convert board service into a compliance exercise of ticking off a checklist of regulatory chores rather than a broad principle-driven dynamic interaction that develops strategic direction and performance expectations tailored to the particular bank and its market. There must be latitude for directors to define their interface with management, giving due consideration to economic circumstances, regulatory standards and complexity of the bank's operations.

Because these trends have serious implications for corporate governance if uncorrected, we recommend that the banking agencies take immediate and positive steps to reverse them.

Forcing smaller, less complex institutions to adopt monitoring and control systems that are only appropriate for larger institutions – At a recent regulatory burden focus group of ABA-member community banks, ABA staff were told again and again that the minimum requirements for internal monitoring, audit and controls for community banks keeps rising, examination after examination. Part of this appears to be a reaction to the Sarbanes-Oxley Act and part to the spotlight thrown on examiners from the anti-money laundering hearings and civil money penalties. Nonetheless, ABA has had to appeal to the Agencies several times in the last year to clarify to examiners that standards and systems for larger, more complex institutions are NOT necessary for smaller, less complex institutions – such as the request for clarification that the SOX audit requirements did not apply to smaller institutions that were not publicly traded. Other examples include requiring greater scope to internal and external audit, strong recommendations for more elaborate credit risk evaluation systems, and more intensive scrutiny and proof of identity of customers. The regulatory burden is high enough without increasing it by the examiner imposition of additional and unnecessary complexity to monitoring, control and audit systems. The Agencies need to find some mechanism to actually get examiners to understand and apply the supervisory guidance already issued that reflects adjustments in such systems to reflect the size, resources and complexity of the institution.

Examiners' zero tolerance approach to more and more supervisory issues – This is clearly seen in the current CTR/SAR defensive filing issue, but bankers report that examiners are including even the smallest supervisory issues in examination reports and also raising them to the attention of the Board of Directors (see discussion above). This is making the examination so adversarial that the normal constructive dialogue on issues and concerns between examiners and bankers is in danger of disappearing. We believe that this would be a significant loss to the supervisory process, and we urge the Agencies to seek feedback on recent examinations from bankers and then to take steps to restore balance to the examination process.

(e) FDIC Annual Independent Audit and Reporting Requirements

The FDIC adopted the Part 363 regulations pursuant to FDICIA § 112 in 1993. That rule set a $500 million threshold. Banks whose assets exceed that threshold were required to:

- Have an annual audit of financial statements by an independent public accountant;
- Annually issue a report by management discussing internal controls, financial reporting procedures and compliance with laws and regulations relating to safety and soundness.

(f) FDIC Unsafe & Unsound Practices (Standby Letters of Credit and Brokered Deposits)

Brokered deposits - Given the number of questions ABA receives on brokered deposits during the year, we believe that the brokered deposit regulation is confusingly vague and unnecessarily broad. As a result, depository institutions adopt a variety of inconsistent approaches for classifying their deposits as brokered. This has resulted in a lack of uniform and accurate reporting as well as inaccurate perceptions as to whether a particular depository institution is significantly funded by brokered deposits. We believe that there are three common marketing practices that present complex questions about whether they result in acquiring brokered deposits, and for well-capitalized financial institutions, these practices should not represent the brokering of deposits. We recommend that the FDIC update and clarify the brokered deposits regulation.

Most of the FDIC's Interpretive Letters concerning deposit brokers involve scenarios where the prospective depositor knowingly receives a recommendation or referral from a third-party to consider depositing funds with a specific depository institution. In these scenarios, the depositor clearly understands that the third-party is recommending or referring the depositor to a specific depository institution. In those circumstances, the depositor is ***relying*** on the third-party's expertise or experience when deciding whether to place their funds. However, three common deposit marketing methods do not involve depositor reliance and should not raise similar safety and soundness concerns for well-capitalized financial institutions. These three marketing mechanisms are (1) affiliate assisted deposits, (2) third party servicers assisted deposits, and (3) joint marketing arrangements including deposits. Use of these methods may be captured as the placing of deposits or of "facilitating the placement of deposits" as currently interpreted by the FDIC, and we believe that the FDIC should provide exemptions for the use of these, at least by well-capitalized institutions.

Method No. 1 - Affiliate Assisted Deposits

The contact or activities of a corporate affiliate and their employees (collectively an "Affiliate") should not, alone, cause that affiliate service provider or their employees to be considered as deposit brokers. Instances where the prospective depositor has independently initiated direct contact with the depository institution but is assisted to some extent by a corporate affiliate of a well-capitalized depository institution in completing the transaction do not appear to raise safety and soundness concerns. In these instances, the prospective depositor has independently engaged the financial institution with respect to the deposit. Additionally, the depositor is not relying on the recommendation or expertise of the Affiliate. Instead, the depositor believes they are communicating directly with the depository institution, and is unaware that an affiliate of the institution may be providing back office servicing functions to assist in fulfilling the prospective depositor's request.

In this situation, an Affiliate that merely provides back office assistance on behalf of another affiliated institution is not steering the prospective depositor towards the depository institution in any meaningful sense and is therefore not raising any policy concerns underlying the regulation. The activities are activities which the institution itself could conduct, but which the company as a whole chooses to house in a separate legal entity for administrative or other important business reasons unrelated to the placement of deposits. In these cases, the use of the Affiliate does not impact the relative volatility of the deposit, which instead rests entirely with the depositor.

For bank holding companies ("BHC") that have multiple depository financial institutions under their corporate umbrella, there are potential safety and soundness risks associated with an Affiliate

Such report must be attested to and separately reported on by the bank's independent auditor;

- Establish an independent audit committee of the board of directors, all of the members of which are outside directors who are independent of management.

ABA recommends the threshold be increased to $1 billion for the management report (and the audit and attestation of the report) and independent membership (other than chairman) of the audit committee. We are not suggesting the threshold be changed for the annual independent audit requirement.

At the time the threshold was set, banks under $500 million represented 25% of total industry assets. The makeup of the industry has changed considerably since then. Concentration has greatly increased in spite of the fact that more than 1200 new banks have been chartered. Today, under $500 million institutions represent only 10.2% of total industry assets.

Moreover, in light of the structural changes which have taken place the widely-held definition of a community bank today is one with assets as large as $1 billion or even more. The views of the regulatory agencies, as reflected in actions taken, are consistent with the industry view. For example, FDIC has expanded the MERIT examination eligibility to well-rated banks up to $1 billion. In addition, the CRA threshold for the small bank streamlined exam has been proposed, by the FDIC, the OCC and the Federal Reserve, to be raised to $1 billion (OTS has already moved to that level).

The burdens of the management reports and costs of the independent auditor's attestations which frequently result in duplication of the bank's internal audit, are not necessary to safe and sound operation of institutions less than $1 billion.

Outside audit fees have increased explosively since enactment of the Sarbanes-Oxley Act. While that Act applies only to publicly traded companies, banks are reporting that even though they are not technically subject to it they are experiencing the same increased costs as public companies. It appears that at least part (if not all) of the increase is due to the accounting firms applying the Sarbanes-Oxley Act - - intended for public companies - - to all the institutions they audit. For example, one non-publicly traded bank which has not yet reached even the $500 million threshold has reported that his audit firm will be mandated to apply the 5-year rotation standard required by the Sarbanes-Oxley Act. We urge FDIC and the other bank agencies to work with PCAOB and the accounting firms to clarify what is applicable to non-public institutions. ABA has already been in direct contact with PCAOB, and discussed the cost and burdens with the SEC as well.

Multiple levels of redundant testing do not serve the best interests of shareholders or customers of non-complex community banks, but they do drive up the in costs of doing business. Moreover, safety and soundness concerns may be addressed through the supervisory examination and reporting process. In the event any weakness is suggested in an institution, remedial steps can be mandated with more than ample enforcement authority to assure adequate response.

Our recommendation would relieve these banks of the requirement that the audit committee consist entirely of outside directors who are independent of management. Community banks increasingly find it difficult to find qualified directors. We recommend that the outside and independent standards be applied only to the chairman of the audit committee, not the members. This will enable directors who have knowledge and experience but may not meet the definition of "independent" to serve as members of the audit committee.

that may "steer" deposits to a troubled institution. However, this is not an issue if every depository financial institution within the BHC is well-capitalized and the Affiliate merely provides non-discretionary administrative assistance in the placement of deposits with affiliated institutions within the BHC. For a BHC that holds one or more depository institutions, all of which are well-capitalized, an Affiliate and their employees who provide services on behalf of the depository institutions to enable the consumer to complete the transaction they desire, should not be classified as a deposit broker, nor should any resulting deposits be deemed to be brokered deposits.

Method No. 2 - Third-party Servicers

We believe the same analysis would apply equally to third-party servicers that provide back room operational assistance to well-capitalized depository financial institutions ("Servicers"). As with Affiliates, Servicers that merely provide back office assistance on behalf of a well-capitalized depository financial institution do not generate the policy concerns that give rise to the deposit broker regulation. Unfortunately, existing Interpretive Letters suggest that Servicers could be deemed to be deposit brokers depending on the precise activities being conducted on behalf of the financial institution.[1]

From a policy standpoint, we think that a Servicer or an Affiliate providing back office operational assistance for a financial institution should be treated the same as an employee performing those same services. While an employee is clearly exempt from the operation of the regulation, a Servicer or an Affiliate performing the same functions currently is not. Yet, in each case, the parties are simply performing services that the financial institution could perform on its own. While the technical legal relationships are different, the activities conducted, the amount of discretion of the parties and the relative lack of any depositor reliance on that party in placing the deposit - are identical. While the regulation contains an exception for "...[a]n agent or nominee whose primary purpose is not the placement of funds with depository institutions...," prior Interpretive Letters have generated confusion as to what constitutes the "primary purpose" as related to the placing of funds with depository institutions."[2] We urge the FDIC to eliminate this confusion particularly where, as here, no additional policy concerns would appear to be created where services are performed on behalf of well-capitalized institutions.

Method No. 3 - Joint Marketing Arrangements

Another area of confusion under the regulation is whether it applies to various joint marketing arrangements with non-affiliated third parties whose primary purpose is not the placement of funds. Such arrangements are now commonplace and are critical to the rapidly growing marketplace of consumer financial products. Joint marketing arrangements efficiently make consumers aware of more financial opportunities and create more educated financial consumers with ultimately more choices. The activities performed by a joint marketing partner may include marketing of the financial institution's own products or marketing of financial products or services offered pursuant to a joint agreement between the financial institution and the non-affiliated third-party which is itself a financial institution. Examples of exceptions already created for such arrangements are exceptions under the privacy provisions of the Gramm-Leach-Bliley Act and the non-statutory "joint user" exception to the Fair Credit Reporting Act ("FCRA") in connection with the dissemination of consumer report information.

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[1] *See* FDIC Interpretive Letter 92-91.

[2] *See* FDIC Interpretive Letter 90-21.

We believe the FDIC should reasonably accommodate joint marketing arrangements regarding deposits in a manner similar to these exceptions. The published FDIC Interpretive Letters on this topic do not provide guidance that sufficiently clarifies what conduct should reasonably be viewed as "facilitating the placement of deposits." In particular, both FDIC Interpretive Letters 02-04 and 04-04 and their consideration of so called "listing services" as deposit brokers appear to suggest that any deposit resulting from an arrangement where a referring entity is compensated on the number or volume of deposits attracted by the depository institution will almost certainly be categorized as brokered. We believe that such an approach is unnecessarily restrictive and is based upon the erroneous assumption that such a compensation structure necessarily encourages more risky behaviors with respect to the placement of deposits. In fact, such a compensation structure simply creates commercial behaviors that may – or may not – be more risky from a safety and soundness perspective. We believe, therefore, that a better approach is to focus on the resulting ***behaviors*** themselves and not on the compensation structure that may indirectly give rise to the behaviors.

To conclude, we ask the FDIC to create a better standard for determining that deposits are brokered. We believe that this standard should ultimately be based on the reliance of the depositor on the recommendations of the third-party and not on the commercial factors of a relationship between a well-capitalized depository institution and a third-party joint marketer. We believe the FDIC should consider several third-party behaviors that might increase depositor reliance and, correspondingly, deposit volatility and safety and soundness risk. Certainly, situations where the third-party joint marketer engages in the affirmative placing of deposits or confirming the placement of deposits and situations where the third-party serves as a liaison between depositors and financial institutions are two such factors. However, where the third-party referring entity makes no express recommendations regarding the deposit products or the depository institution and discloses that to the consumer in a clear and conspicuous manner and when the third-party referring entity has an exclusive joint marketing arrangement with only a single well-capitalized depository institution or with a BHC with only well-capitalized depository institution subsidiaries should be considered as mitigating factors against a determination of brokering deposits. Obviously, crafting appropriate exceptions along these lines requires full consideration of the issues and very careful drafting of the language. ABA staff members are available to discuss possible amendments to the regulation to effect these recommendations.

Conclusion

ABA appreciates the opportunity to comment on this phase of the EGRPRA regulatory burden reduction project. If there are any questions about any part of these comments, please call the undersigned.

Sincerely,

Paul Smith
Senior Counsel