2004

Policy Positions

Public Policy and Advocacy

America's Community Bankers℠ *Shaping Our Future*

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PREAMBLE

AMERICA'S COMMUNITY BANKERS® 2004

This policy book reflects the diverse and forward-looking agenda of America's Community Bankers. Our member banks pursue progressive, entrepreneurial and service-oriented strategies to provide financial services to benefit their customers and communities. These policies are designed to help achieve their goals by maximizing the operating flexibility and business options available to them.

ACB's members operate in complex economic and public policy environments. As insured depository institutions and key participants in the nation's payments system, they comply with an extensive set of government regulations and are affected by numerous public programs. As private businesses, they must offer competitive products and services to meet vigorous competition by a diverse array of financial companies. ACB's role as a national trade association is to create new business opportunities, eliminate unnecessary restrictions on its members, and work to ensure that the government's actions in the nation's financial system are equitable.

America's Community Bankers have established the following Action Priorities for 2004:

- Federal Home Loan Bank System Operation and Regulation;
- Fannie Mae and Freddie Mace Mission and Regulation;
- National Predatory Lending Standard;
- Credit Union Taxation and Regulation; and
- Capital Requirements.

ACB's members participated directly in the formation of each policy position included in this book and selected the priority objectives. The policies are based on extensive discussion and debate by the Government Affairs Steering Committee, the Board of Directors and other policy committees. While ACB's agenda is extensive, ACB remains focused on top priorities established by the Board of Directors.

ACTION PRIORITIES

Mission and Activities of Fannie Mae and Freddie Mac
ACB recommends policy makers strengthen the Congressionally mandated secondary market role for Fannie Mae and Freddie Mac. They should prevent the enterprises from entering the primary market or discourage competition by private companies in mortgage lending, servicing, and related markets.

To accomplish these goals, ACB strongly recommends the following:

- Safety and soundness regulation of Fannie Mae and Freddie Mac should be strengthened;
- A clear distinction between "primary" and "secondary" market activities should be maintained, and Fannie Mae and Freddie Mac should not enter the primary market; and
- Fannie Mae and Freddie Mac's housing goals should focus more directly on affordable housing.

Operations of the Federal Home Loan Bank System
ACB believes that the FHLBanks should continue to be cooperatives owned by their members. The FHLBanks should maintain their primary mission – housing and community development funding – while addressing their members' changing needs.

To accomplish these goals, ACB strongly recommends the following:

- Regulation of the FHLBank System should be strengthened;
- The FHLBanks' financial disclosures should be enhanced without making them subject to inappropriate SEC regulation;
- The FHLBanks' corporate governance should be improved by increasing the role of stockholders and improving the qualifications of all directors;
- A strong and effective capital structure for the FHLBanks should be maintained; and
- Industry-wide consensus on major issues should be developed.

ACB opposes proposals to revoke or limit Fannie Mae and Freddie Mac's Treasury line of credit or to eliminate their GSE status.

National Predatory Lending Standard
ACB is committed to ensuring that all Americans have fair and equitable access to credit, and that consumers have the necessary skills to make wise credit and other financial decisions. ACB also supports the development of a federal legislative response, such as provisions in the Ney-Lucas proposal, the "Responsible Lending Act" (H.R. 833), that would establish national uniform standards to combat predatory lending practices, while avoiding a patchwork of state and local legislative responses that could disrupt the critical national marketplace for real estate credit.

Credit Unions' Taxation & Regulation
Credit unions that expand beyond their traditional role and operate like banks should pay taxes and comply with the Community Reinvestment Act (CRA). Until these credit unions pay taxes and comply with the CRA, the National Credit Union Administration should stop expanding their fields of membership and lending powers. The Administration's 2005 Budget estimates that credit unions will be exempted from paying $8 billion in federal taxes between 2005 and 2009.

Capital Requirements
The Basel II capital proposal would create a new system for establishing minimum bank capital and would apply to the world's largest banks, including the top 10 to 12 U.S. banks. The rest – including thousands of community banks in the U.S. – would continue to adhere to Basel I. Among other differences, Basel II will allow large institutions to hold less capital against their mortgage assets than Basel I now requires, giving them an advantage over community banks.

Any new capital accord should treat similar risks in comparable ways, regardless of the size of the institutions involved. This will avoid creating competitive inequities. U.S. regulators should allow community banks to adopt modified capital requirements so that the benefits and incentives of more risk-sensitive capital management techniques are available to all U.S. financial institutions.

Tax Incentives for Savings and Investment
ACB strongly urges Congress to enact legislation that broadens the types of tax-favored savings vehicles available to consumers. ACB supports saving incentives such as the Lifetime Savings Account (LSA), the Retirement Saving Account (RSA), and the Employer Retirement Savings Account (ERSA) proposed by President Bush. We also support retention of the traditional deductible Individual Retirement Account (IRA) because it provides a complimentary tool to the LSA, RSA, and ERSA to attract savers who need an upfront tax deduction. ACB also supports a $1,000 tax exemption for interest on deposit accounts paid to individuals.

Bankruptcy Reform
ACB urges Congress to pass an effective and efficient bankruptcy code. Bankruptcy should not be a mere convenience or financial planning tool for the rich, but rather should be a safety net for those who genuinely need it.

ACB supports the following reforms of the nation's bankruptcy laws:

- Needs-based bankruptcy;
- A limitation on repeat filings;
- The elimination of cramdowns;
- The ability to proceed against non-bankrupt co-debtors; and
- Elimination of unnecessary creditor representation requirements.

Issue

Mission, activities and oversight of Freddie Mac and Fannie Mae.

Position Statement

ACB supports public policies that strengthen and emphasize the secondary market nature of Freddie Mac and Fannie Mae's assigned role. ACB supports policies that explicitly prevent using the benefits of the Freddie Mac and Fannie Mae's quasi-government agency status to engage in primary market activities, including eliminating or discouraging competition among private sector participants in the mortgage lending, servicing markets and ancillary markets.

ACB strongly supports Congressional efforts to strengthen the regulation of Fannie Mae and Freddie Mac. Any new regulator must:

- Be independent and not subject to the Congressional appropriations process;
- Possess similar supervision and enforcement powers to those of federal banking regulators to maintain safety and soundness and guard against systemic risk;
- Have full authority over program and mission to maintain secondary market focus; and
- Have full authority to set capital levels.

Specifically, ACB supports the following policies regarding 1) appropriate Freddie Mac and Fannie Mae activities and 2) appropriate Freddie Mac and Fannie Mae regulation, oversight and disclosure:

Freddie Mac and Fannie Mae Activities

- Freddie Mac and Fannie Mae must be prevented from expansion beyond the intended boundaries of their federal charters.
- Freddie Mac and Fannie Mae's role and mission should be clarified to (A) recognize the distinct and unique roles of both public and private sector entities; (B) acknowledge the capacity of private markets to meet particular housing and housing finance needs; (C) promote programs that do not constrict or impede traditional credit providers in meeting borrower needs; and (D) ensure that all loan purchase programs either promote home ownership or serve targeted populations.
- There should be a clear distinction between "primary" and "secondary" market activities, and Freddie Mac and Fannie Mae should not be involved in activities of the primary market. (See definition of primary market activities from which Freddie Mac and Fannie Mae should be prohibited under "Explanation.")
- Marketing to or otherwise doing business directly with consumers is inconsistent with Freddie Mac and Fannie Mae's mission and charter authority. (See *GSE Small Denomination Debt Instruments* on page 41).
- Freddie Mac and Fannie Mae should not purchase loans that are inconsistent with their federal charters or their conforming loan provisions. They should not encroach on the subprime mortgage market in the ordinary course of operations, other than as part of specific targeted programs to low-income borrowers and borrowers in underserved communities.
- There should be no change in the method of calculating the conforming loan limit to attempt to address regional variations in housing costs or set higher limits in states with high-cost metropolitan areas. (See *Conforming Loan Limits* on page 37)
- Only entities that meet high standards of financial strength and performance should be allowed to sell loans to or service loans for Freddie Mac and Fannie Mae.
- Technology developed by Freddie Mac and Fannie Mae should not be used to access the primary market. Freddie Mac and Fannie Mae should not be permitted to invest in technology development or deployment companies if that relationship would intentionally or unintentionally discourage private sector technology

innovation or be used to control or channel mortgage business to or through Freddie Mac and Fannie Mae to the exclusion of competitive market alternatives.
- Freddie Mac and Fannie Mae should be prohibited expressly from serving as "packagers" under any revised RESPA regulations.
- Freddie Mac and Fannie Mae housing goals should be structured to focus their mission more directly on affordable housing.
- There should be a consistent approach for defining what is "affordable housing" for Fannie Mae, Freddie Mac, and other government programs.

The affordable housing goals and the process of measuring achievement should be examined periodically and, when necessary, adjusted to take into account feasibility, impact and compliance.

Freddie Mac and Fannie Mae Regulation, Oversight and Disclosure

- The regulator of Fannie Mae and Freddie Mac should have authority over mission, programs and safety and soundness and have sufficient enforcement authority to carry out its responsibilities.
- The regulator must have the resources and expertise to evaluate Freddie Mac and Fannie Mae's performance, both as financially sound entities and as public purpose entities. The regulator should not be subject to the Congressional appropriations process.
- Capital requirements established for Freddie Mac and Fannie Mae should reflect the specific financial risks facing each, including realistic treatment of counter party risk. Freddie Mac's and Fannie Mae's capital requirements should be consistent with the capital requirements imposed on other federally regulated entities with similar risk profiles.
- The regulator should have authority to adjust all capital requirements, subject to rulemaking.
- ACB supports increased transparency and disclosure of Freddie Mac and Fannie Mae debt, equity and mortgage-backed securities. Generally, disclosure should meet the standards applied by the SEC to private companies that issue securities.

ACB opposes proposals to revoke or limit Fannie Mae and Freddie Mac's Treasury line of credit.

Explanation

ACB recognizes the constructive role of the federally supported components of the housing finance system, including Freddie Mac and Fannie Mae. A reliable and readily accessible secondary market for home mortgage loans is a valuable tool for the nation's lenders. One significant benefit is that insured depository institutions use this market to manage the interest rate risks inherent in their operations.

The Administration has recommended that Congress establish a new agency that would regulate all of the housing GSEs. ACB agrees that the regulatory structure for these entities should be substantially improved and supports the creation of new independent regulators for Fannie Mae and Freddie Mac and the FHLBanks. However, ACB recognizes that the legislative situation is likely to remain fluid and dynamic. If Congress decides to create a single regulator for the GSEs, it must maintain the distinct statutory systems for the enterprises. In addition, the Treasury Department has opposed the establishment of a new independent agency within the Department. ACB differs with Treasury on this issue; we believe it is essential that any new regulator within Treasury be as independent as the Comptroller of the Currency and the Office of Thrift Supervision. As an alternative way to address Treasury's concerns, ACB would support formation of a new, independent regulator as a stand-alone agency. In any case, the new agency should have full authority over the GSEs' mission and capital.

These secondary market enterprises, and particularly their affordable housing activities, are a significant part of America's housing and housing finance system. **The specific statutory purposes for which Fannie Mae and Freddie Mac were originally chartered and which continue to make up their mission today include the following secondary market activities:**

- To provide stability in the secondary market for residential mortgages;
- To respond appropriately to the private capital market;

- To provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing;
- To promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and
- To enhance the availability of financing for affordable housing.

To achieve these purposes, Freddie Mac and Fannie Mae receive significant statutory benefits, which are not available to other mortgage market participants. Congress intended these legal and financial benefits to be used for a broad range of secondary market purchase and guarantee programs, with appropriate risk-management standards in place. The stability of the mortgage lending system would be threatened if Freddie Mac and Fannie Mae used these benefits to expand their activities beyond the mandate intended by Congress. The competitive advantage could allow them to dominate the primary market for residential, multifamily and commercial lending. Therefore, Freddie Mac and Fannie Mae are not permitted to participate in the primary market for home mortgage loans.

This prohibition from primary market activities for Freddie Mac and Fannie Mae should be construed to include the full range of potential contacts and transactions between lenders, other primary market participants, borrowers or potential borrowers, their agents or representatives, and includes both loan origination and servicing functions.

ACB notes that in measuring whether Fannie Mae and Freddie Mac have met their affordable housing goals, HUD uses a different definition of that term than the one used by the federal banking agencies when measuring compliance with the Community Reinvestment Act. A consistent definition would be far more equitable and effective.

The activities listed below serve no legitimate secondary market purpose and ACB considers them outside the scope of Freddie Mac and Fannie Mae's charters:

- Identifying, soliciting, or contacting potential borrowers;
- Advising, prequalifying, and counseling borrowers;
- Negotiating and setting loan terms and options;
- Taking loan applications, obtaining third-party reports (such as appraisals), and handling all other elements of loan processing;
- Making decisions to extend credit, which may include use of an automated underwriting system;
- Providing or obtaining credit enhancement necessary for the sale of a mortgage to Freddie Mac or Fannie Mae, including but not limited to, mortgage insurance;
- Loan document preparation;
- Obtaining or providing other settlement services, including those related to loan closing or funding;
- Encouraging contact with mortgage brokers, real estate agents and developers who are the customers of mortgage lenders, or dealing directly with them as links to borrowers;
- Providing services to borrowers;
- Creation of Freddie Mac and Fannie Mae internet sites and toll free numbers targeted at consumers;
- Intentionally or unintentionally discouraging competition in mortgage technological innovation and delivery;
- Freddie Mac and Fannie Mae development of proprietary technologies as a separate for-profit business line, rather than also developing or approving third-party standards for risk management and other purposes;
- Deployment of automated valuation models which crowd out competing systems for computing appraised value; and
- Advertising and other promotional activities directed to consumers by Freddie Mac and Fannie Mae or their charitable foundations, which appear to promote their corporate "brands."

In developing secondary market purchase programs and facilities, Freddie Mac and Fannie Mae should consider the needs of all its constituent seller/servicers. These entities should avoid unnecessarily promoting the further consolidation of loan servicing and origination among community-based private market participants. Diversity, innovation and competition among originators and freedom of choice for consumers are critical elements in meeting the diverse borrowing needs of current and future homebuyers.

Since the publicly supported secondary mortgage market for conforming loans became well established in the early 1980s, researchers have found that housing credit for home purchases at market rates has been readily available in most markets for a majority of homebuyers. While a continuing role exists for specially chartered secondary market entities within the housing finance system, the primary market works with great efficiency for loans to borrowers with average incomes and above. The primary market also has consistently outperformed Fannie Mae and Freddie Mac in the percentage of loans made to low-income families and to borrowers in underserved rural and central city areas. Changing the method of calculating the conforming loan limit to address regional variations in housing costs or setting higher limits in high-cost metropolitan areas would not serve any public purpose and might further undermine the GSE's statutory commitment to finance housing for low-and moderate-income families, housing located in central cities, rural areas and other underserved areas.

Mission oversight must ensure that new or expanded activities are based primarily upon mission fulfillment and not stockholder returns.

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Issue

Operations of the Federal Home Loan Bank (FHLBank) System.

Position Statement

ACB strongly supports maintenance of a cooperatively based FHLBank System with a primary mission of providing community banks with access to advances for housing and community development lending. The FHLBanks should be responsive to their membership, developing products and expertise to address their members' changing needs.

ACB strongly supports Congressional efforts to strengthen the regulation of the FHLBank System. Any new regulator must:

- Be independent and not subject to the Congressional appropriations process;
- Possess similar supervision and enforcement powers to those of federal banking regulators to maintain safety and soundness and guard against systemic risk;
- Recognize the unique characteristics of the System; and
- Not impede or limit the FHLBanks' access to the capital markets.

ACB supports full, accurate, transparent and enhanced disclosures that are appropriate for the unique structure of the FHLBanks. ACB opposes the attempt by the Federal Housing Finance Board (Finance Board) to require the FHLBanks to voluntarily register with the SEC. Instead, the Finance Board should administer and regulate the registration and disclosure requirements for the FHLBank System consistent with its statutory safety and soundness authority, the disclosure requirements of the federal securities laws, and the unique structure and operations of the System.

ACB strongly recommends improving the FHLBanks' corporate governance by substantially increasing the role of stockholders and improving the qualifications and financial acumen of all directors.

ACB supports the retention of existing FHLBank investment authorities and the development of new and innovative products in the context of a risk-based capital structure.

ACB supports regular review of the FHLBanks' capital standards to ensure that individual FHLBanks are operating in a safe and sound manner and that potentially destabilizing competition and arbitrage of membership is not occurring. Regulation should also include analysis of the risk factors associated with concentration, collateral, and other significant matters that could introduce risk into the System.

Neither the Finance Board nor the FHLBanks' should act to diminish members' ownership rights to the Banks' retained earnings.

ACB supports developing policies based on industry-wide consensus on issues dealing with multi-district FHLBank membership (MDM) and the acquired member asset (AMA) programs, as well as new programs and products that may have a System wide impact. Any policies or regulations on these issues must:

- Be adopted only after a formal notice and comment period;
- Maintain the cooperative and risk-averse nature of the System;
- Preserve the regional structure of the System;
- Ensure member charter choice and not advantage or disadvantage any group or sub-group of eligible members; and
- In the case of MDM, preserve the local nature of the Affordable Housing Program, the Community Investment Program and similar programs.

Explanation

The core function of the FHLBank System remains to provide vital liquidity to its member financial institutions in support of residential and community-based lending. The FHLBanks should continue to focus on the funding of housing lending, while accommodating the new, expanded range of collateral and deployment of advances proceeds permitted to community financial institutions (FDIC-insured depositories under $500 million in total assets).

The Administration has recommended that Congress establish a new agency that would regulate all of the housing GSEs. ACB agrees that the regulatory structure for these entities should be substantially improved and supports the creation new independent regulators for Fannie Mae and Freddie Mac and FHLBanks. However, ACB recognizes that the legislative situation is likely to remain fluid and dynamic. If Congress decides to create a single regulator for the GSEs, it must maintain the distinct statutory systems for the enterprises. In addition, the Treasury Department has opposed the establishment of a new independent agency within the Department. ACB differs with Treasury on this issue; we believe it is essential that any new regulator within Treasury be as independent as the Comptroller of the Currency and the Office of Thrift Supervision. As an alternative way to address Treasury's concerns, ACB would support formation of a new, independent regulator as a stand-alone agency. In any case, the new agency should have full authority over the GSEs' mission and capital.

Unlike the other housing GSEs, the FHLBank System is a cooperative made up of twelve independent FHLBanks with joint and several liability. The FHLBanks, out of the proceeds from its net income, operate statutorily mandated affordable housing programs and are responsible for paying off the RefCorp bonds that were used to help resolve the 1980s savings and loan losses. Each FHLBank is primarily capitalized through the purchase of stock only by its member institutions. FHLBank stock is not available to the public and is not tradable even within a FHLBank without the express permission of the FHLBank. The stock is issued and redeemed at a par value of $100 and does not fluctuate in value.

The FHLBanks' stock and debt instruments should be subject to full, accurate, transparent and enhanced disclosures that are appropriate for this unique GSE. The Finance Board does not have the statutory authority to require the FHLBanks to voluntarily register with the SEC. Under current statutory authority only the Finance Board is authorized to supervise and administer such disclosures. Fulfillment of Congress' public mission for the FHLBank System requires that the Finance Board retain and fully exercise this authority.

ACB members believe that the FHLBanks' corporate governance should be improved. We are concerned that the voices of Bank stockholders are not always heard and heeded by the Boards. We are also concerned about the lack of financial expertise demonstrated by directors. As the financial structure of the Banks becomes increasing complex, it is essential to improve the qualifications of all directors so that they can effectively oversee the Banks' operations.

The FHLBanks should have, within the risk-based capital structure, maximum flexibility in determining the most appropriate investment strategy for their member institutions and their communities. The FHLBanks should be encouraged to be responsive to member needs, developing new products and programs that enhance their members' ability to extend competitive credit products to the communities they serve. New forms of member-created assets should evolve on the balance sheets and in the operations of the FHLBanks in a manner consistent with the statutory authority of the FHLBanks and objective risk/reward criteria. They should be governed by risk-based capital standards and cooperative, activity-based capital requirements.

The capital plans of the twelve FHLBanks have diverse and varying components designed to best meet the needs of their members. In such an environment the FHFB must, in addition to ensuring that each FHLBank operates in a safe and sound manner, analyze the impact of the plans on the System as a whole. Careful review and prudent oversight must be carried out to avoid destabilizing competition and arbitrage of membership and to preserve the cooperative nature of the System. Requiring the members of a cooperative to provide capital support for their individual activities is the best method of preserving the cooperative nature of the System. This is a better approach than supporting these activities through retained earnings that are collectively owned by all members, whether or not they participate in the activity.

The acquired member asset (AMA) programs continue to evolve, grow, and gain the interest of members across the System. The FHLBanks should continue to be innovative in ensuring that these programs and others meet the evolving needs of their members. Any changes, new product development or consideration of alternative methods of capitalizing FHLBank programs must be considered in the context of the System as a whole as well as on an individual FHLBank basis.

The issue of multi-district FHLBank membership raises many issues. ACB supports conditional MDM if the Finance Board determines it is currently authorized by statute. The Finance Board has received a legal opinion that concludes that the FHLBank Act may authorize the Board to promulgate a regulation allowing a FHLBank to grant membership to a member of another FHLBank, to the extent that the regulation furthers the mandate imposed by Congress on the Finance Board. Any policies developed must be accomplished in an environment of full industry participation and discussion. The Finance Board, FHLBanks, and members of the FHLBank System must work together to fully understand the issues and develop a consensus approach that preserves the vital functions performed by the FHLBank System and its district Banks. Preservation of the cooperative nature of the System is imperative because the relationship between the members of the System and the FHLBanks helps ensure that community-based financial institutions can continue to provide competitive housing and community-based credit.

The future of the acquired member assets programs and any resolution of the multi-district membership issue have serious implications for the future of the FHLBank System. Therefore, the Finance Board should not make any significant policy changes without using notice-and-comment procedures mandated by the Administrative Procedures Act.

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Issue

Protect consumers from unscrupulous lending practices while ensuring their access to affordable credit.

Position Statement

ACB is committed to ensuring that all Americans have fair and equitable access to credit, and that consumers have the necessary skills to make wise credit and other financial decisions. ACB also supports the development of a federal legislative response, such as provisions in the Ney-Lucas proposal H.R. 833, the "Responsible Lending Act", that would establish national uniform standards to combat predatory lending practices, while avoiding a patchwork of state and local legislative responses that could disrupt the critical national marketplace for real estate credit.

Responsible subprime lending is an important way to offer more Americans greater access to credit. Policy makers should not impose new laws and regulations that inaccurately label subprime loans as "predatory" or that stigmatize legitimate loan terms.

ACB believes that Congress should vigorously pursue national, anti-predatory lending standards. This type of standard would create uniformity and ensure consistency among state-based mortgage lending initiatives. A uniform national standard would have significant additional benefits for consumers, including:

- Curbing abusive and deceptive practices by lenders who shop for venues that lack tough laws and enforcement capability. Once exposed, under current laws these scam artists shut down, find another location and open under another name.
- Promoting efforts to educate consumers. The best defense against predatory lending is a well-informed consumer in a competitive marketplace.
- Preserving the efficiencies of a national credit market, which reduces costs for both consumers and businesses, improves consumer access to credit, permits lenders to reward good performance with lower rates and facilitates credit to higher-risk borrowers.

Explanation

ACB believes that vigorous enforcement of existing laws with respect to unsupervised lenders is critical. The joint report by the Federal Reserve Board and the Department of Housing and Urban Development issued in 1998 acknowledged this, stating: "Abusive mortgage loans are not generally a problem among financial institutions that are subject to regular examination by federal and state banking agencies. Abuses occur mainly with mortgage creditors and brokers that are not subject to direct supervision."

At the same time, ACB believes that, absent Congressional action to establish uniformity, ongoing initiatives across the country are leading to a patchwork of well-intentioned but overly burdensome state and local laws and regulations that are not benefiting consumers.

Policy makers should distinguish between "subprime lending" programs and "predatory lending" practices. These terms are often mistakenly used interchangeably. Subprime lending provides financing to individuals with credit blemishes or other risk factors, though at somewhat higher rates or under stricter terms than are available to more credit worthy borrowers. The rise of subprime lending has given many previously underserved borrowers access to credit.

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Issue

Elimination of the tax-exempt status and special regulatory treatment of complex, bank-like credit unions.

Position Statement

Complex, bank-like credit unions that seek to expand beyond their traditional role at the expense of other credit unions and community banks should lose their special tax-exempt status and comply with community reinvestment requirements. Such credit unions must operate and conduct business on a level playing field without competitive advantages.

Until such credit unions pay taxes and comply with the Community Reinvestment Act, (CRA), the National Credit Union Administration ("NCUA") should stop liberalizing its field of membership rules and should prohibit further expansion into commercial banking services. Congress should also reject proposals to give such credit unions additional powers.

Explanation

Credit unions are a $619 billion industry that earned nearly $5.6 billion in 2002, but paid nothing in taxes. Between 2005 and 2009, the credit union tax exemption will cost the federal government a cumulative total of $7.88 billion. In addition to enjoying this free ride, credit unions do not have to meet the community reinvestment obligations imposed on banks and savings institutions.

Congress chartered credit unions in 1934 to serve persons of modest means. In return, credit unions were exempted from taxation. However, an October 2003 General Accounting Office (GAO) report indicates "that credit unions served a slightly lower proportion of low-and moderate-income households than banks."

Mutual savings banks operate in a manner similar to credit unions. They have no stockholders, but lost their tax subsidy in 1952, and have been paying their fair share of taxes ever since.

Over the years, two distinct credit union industries have emerged. The first group consists of credit unions that adhere to their statutory mission. The other has expanded fields of membership, maintains extensive branch networks, and offers products virtually identical to community banks. Yet, they are still exempt from taxes and the CRA. Correcting that inequity, either by taxing bank-like credit unions or giving community banks tax relief, and ensuring appropriate safety and soundness practices in bank-like credit unions, should be a high priority for Congress.

More liberal state charters have spurred the Credit Union National Association and the National Association of Federal Credit Unions to call for new legislation to "enhance the federal charter." As a result, the National Credit Union Administration has:

- Expanded the community charter by liberalizing the definition of "local community;"
- Repealed the Community Action Plan, which would have imposed community reinvestment requirements;
- Ignored Treasury's concern that liberalized business lending regulations disregard the Credit Union membership Access Act's 12.25% cap; and
- Rejected Treasury's request to establish a credit-risk weighted capital requirement for corporate credit unions.

The NCUA's relaxed field of membership rules allow credit unions to add large communities to a field of membership and promote the development of large, commercial enterprises that are indistinguishable from banks and thrifts, except for their tax free status.

The new business lending regulation is also troubling. The Home Owners' Loan Act limits the commercial lending of federal savings associations to 20 percent of an association's assets, provided that amounts in excess of 10 percent of total assets may be used only for small business loans. Because certain business loans held in a credit union's portfolio are not required to be counted toward the statutory cap, credit unions are able to directly compete with savings associations and even exceed their business lending authority.

Even after securing these generous regulatory changes, credit unions seek to further expand their powers. For instance, provisions in the Financial Services Regulatory Relief Act of 2003, if enacted, would authorize federal credit unions to cash checks and wire funds for anyone eligible to join their credit union and would allow voluntary mergers involving multiple common bond credit unions without numerical limitations.

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Issue

Regulatory Capital Standards.

Position Statement

ACB believes that legislators, regulators and the industry should examine and evaluate, prior to implementation, the cost and complexity of the proposed Basel II capital accord, its competitive impact on banking institutions of different sizes, and the ability of regulators to properly supervise and examine the proposed new minimum capital requirements. Any new capital accord should treat similar risks comparably from institution to institution to avoid creating competitive inequities. Regulators should consider a more simplified approach to the proposed new capital requirements so that the benefits and incentives of more risk-sensitive capital requirements are made available to all financial institutions operating in the United States. If Basel II is implemented for a portion of the banking industry, alternatives must be provided at the same time under the Basel I structure to maintain similar capital requirements for similar risks.

ACB supports continuation of the current Tier 1 capital treatment of trust preferred securities to give banks and savings associations flexibility in raising additional capital when needed or when appropriate for future growth.

Explanation

In 2001, the Basel Committee on Banking Supervision (BCBS) issued a proposed new capital accord (Accord) that would establish revised minimum regulatory capital standards. The Accord is intended to replace the current version of the Capital Accord issued in 1988 that for the first time established risk-based capital requirements for depository institutions. The proposal focused on the use of banks' internal risk ratings to determine capital requirements for large, complex banking organizations and a modified, "traditional" form of capital regulation for smaller, less complex organizations. Also in 2001, the federal bank regulatory agencies considered and then withdrew a preliminary proposal to simplify capital requirements for certain "non-complex" community financial institutions.

The Accord would have three mutually supporting pillars. Pillar 1 would cover the minimum regulatory capital charge for credit, market and operational risk; pillar 2 would cover supervisory review of capital adequacy; and pillar 3 would require public disclosure of risk profile and regulatory capital information.

Pillar 1 would establish minimum capital requirements for credit, market and operational risk that more closely link minimum capital requirements with an institution's risk profile. Banks would have to meet an extensive set of eligibility standards for use of the more risk-sensitive capital requirements. Institutions would for the first time have to hold capital specifically for exposure to risk of loss arising from inadequate or failed internal processes, people, and systems, or external events. Each banking organization would be able to use its own methodology for assessing operational risk exposure provided the methodology is comprehensive and results in a charge that reflects the institution's operational risk experience.

Under pillar 2, supervisors would assess whether an institution holds sufficient capital in light of its risk profile. Extensive information about an institution's risk profile, internal ratings-based system for credit risk, and determination of capital requirements, would have to be disclosed on a quarterly basis under pillar 3.

The BCBS released for comment in April 2003 a third draft of the Accord, revised to reflect comments submitted on previous versions. ACB formed a Basel II working group to develop ACB's position on the Accord and ACB filed comments on the Accord that raised concerns about the cost and complexity of the Accord, the ability of institutions to implement and supervisors to enforce the pillar 1 minimum capital requirements, and the potential of the Accord to create competitive inequities.

The BCBS is expected to adopt a final Accord in the first half of 2004, for implementation by year-end 2006. Once the Accord is finalized, each country would need to adopt appropriate legislation or regulation to implement the Accord to govern the country's banking industry.

The U.S. banking regulators issued an Advance Notice of Proposed Rulemaking (ANPR) in June 2003 to begin the implementation process in the United States. The most important aspect of implementation would be that the Accord would apply only to the 10 to12 largest U.S. banking organizations that have total assets of $250 billion or more or total on-balance sheet foreign exposure of $10 billion or more. Other institutions can opt-in to the Accord if they can meet very strict and burdensome eligibility standards. The cost and complexity of opting in does not make this a viable option for most community banks.

As a result of the planned implementation in the United States, for the first time there would be a bifurcated regulatory capital framework. This has raised concerns that the Accord will create competitive inequities between large and small banks because of, among other things, the more favorable capital treatment of mortgage and other retail lending under the Accord.

ACB filed a comment letter on the ANPR. After raising concerns about the complexity and competitive impact of the Accord, the comment letter emphasized that alternative options should be available to smaller banks to better align capital requirements with balance sheet risk. Both the Accord and the 1991 interagency proposal start with the premise that there are differences in risk among institutions and their businesses. While ACB agrees with this starting point, we do not believe this implicates the need to create a class of "non complex" institutions that is required to maintain capital at levels significantly higher than a handful of internationally active banks employing internal risk-rating systems to achieve thinner capital margins. Rather, the financial regulatory agencies should work toward adding more flexibility to the current risk-based capital system and providing the ability to tailor capital requirements to the risk posed by individual institutions. For less complex institutions that want to develop internal risk management models, however, this option should be available.

More broadly, capital requirements, including components for interest rate risk and recourse exposure, should be uniform for commercial banks and savings institutions, should not result in significant volatility of required capital ratios, and should properly reflect the true portfolio risk exposure of an institution's asset/liability mix.

Under current capital regulations, bank holding companies generally may include trust preferred securities up to twenty-five percent of Tier I capital. Savings and loan holding companies do not have capital requirements and the OTS looks at the capital treatment of trust preferred securities on a case-by-case basis. Trust preferred securities are instruments that, despite their label, possess characteristics typically associated with debt securities. In December, the Financial Accounting Standards Board released its latest interpretation of how to account for variable-interest entities. FASB Statement 46 has implications for how trust preferred securities are reported on financial statements under generally accepted accounting principles. The new reporting requirements have raised the question of whether the Federal Reserve Board and the other agencies will continue to allow these securities to be counted as Tier 1 capital. It is anticipated that the Board will review the regulatory implications of any accounting treatment changes and will provide further guidance later this year. The OTS and the other agencies will be involved in the review.

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Issue

Tax incentives for savings and investment.

Position Statement

ACB strongly urges Congress to enact legislation that broadens the types of tax-favored savings vehicles available to consumers. ACB supports saving incentives such as the Lifetime Savings Account (LSA), the Retirement Saving Account (RSA), and the Employer Retirement Savings Account (ERSA) proposed by President Bush. We also support retention of the traditional deductible Individual Retirement Account (IRA) because it provides a complimentary tool to the LSA, RSA, and ERSA to attract savers who need an upfront tax deduction. ACB also supports a $1,000 tax exemption for interest on deposit accounts paid to individuals to give deposit accounts comparable tax treatment available to dividends and capital gains.

ACB also supports the *Community Development Home Ownership Tax Credit Act*, which would create a tax credit for developer/investors that build or substantially rehabilitate homes for sale to low-income buyers in targeted communities.

ACB urges states setting up Section 529 college savings plans to include community bank deposit accounts as approved investment vehicles. ACB also urges Congress to modify the statute to require inclusion of a broad range of investment vehicles, including depository accounts, in Section 529 college savings plans.

Explanation

Savings provide the capital that keeps the economy running. The low savings rate and decline in investments in stock have hurt economic growth in the short run and will harm the long term growth if steps are not taken to encourage savers and investors to save and invest more dollars. Increased tax incentives for savings and investment will help raise the savings rate, lead to growth in employment and increase the wealth of Americans. Increased savings and investments will help community banks fund investments in home mortgages, student loans, and small businesses in their communities.

ACB supports a tax exemption for individuals for the first $1,000 in interest earned on deposit accounts. This interest exemption for individuals will encourage savings. A tax exemption for interest earned on savings in deposit accounts also will help prevent an outflow of funds that may be caused by the tax exemption for dividends, enacted as part of the *Jobs and Growth Tax Relief Reconciliation Act of 2003*.

The *Community Development and Home Ownership Tax Credit* is based on President Bush's proposed Renewing the Dream Tax Credit. The Act would create a new tax credit to encourage investors to provide private capital to build or rehabilitate homes for sale to low-income families in lower-income and distressed communities. The credit would be worth up to 50 percent of the cost of developing each home and could be claimed over a five-year period after each home is sold to an eligible buyer.

Section 529 college savings plans have become a popular investment for parents saving funds to send their children to college. Most of the plans set up by states do not include deposit accounts of community banks or other regulated financial institutions as allowable investments. This deprives community banks of access to this source of long-term funds.

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Issue

Reform of the Bankruptcy Code.

Position Statement

ACB strongly supports the following reforms of the nation's bankruptcy laws:

- Needs-based bankruptcy;
- A limitation on repeat filings;
- The elimination of cramdowns;
- The ability to proceed against non-bankrupt co-debtors; and
- Elimination of unnecessary creditor representation requirements.

Explanation

To establish an effective and efficient bankruptcy code, the following modifications must be incorporated:

Needs-based Bankruptcy – The Bankruptcy Code should contain a needs-based system that would distinguish between debtors who have virtually no assets or earning power and debtors with the ability to repay all or a portion of their indebtedness. Debtors with no assets or earning power should receive a discharge under Chapter 7; while debtors with the ability to repay all or a portion of their obligations should be required to file under Chapter 13 and establish a repayment plan.

Repeat Filings – The Bankruptcy Code currently permits a debtor to file under Chapter 7 every six years and places no limitation on Chapter 13 filings. In addition, the Code permits unlimited conversion from Chapter 13 to Chapter 7. The Code further permits debtors to file for bankruptcy solely to delay resolution of the estate. Moreover, minimum payment requirements may be needed to reduce the number of bankruptcy reorganization plans which result in little or no payment to the creditors involved. Debtors who file for bankruptcy more than once a year should not receive the benefits of the automatic stay.

Cramdowns – Prior to the Supreme Court decision in *Nobelman* in 1993, secured lenders faced substantial uncertainty with respect to cramming down, or the diminution of the value, of their secured claims in bankruptcy. During this period, many bankruptcy courts routinely reduced the value of secured liens to an amount equivalent to the market value of the collateral (at the time of bankruptcy) and designated the remaining value as unsecured. However, the Supreme Court in the *Nobelman* case concluded that the cramdown procedure was improper in connection with a debtor's principal residence. Some district courts have started reinterpreting *Nobelman* and are holding that, under certain circumstances, the secured liens on residential real estate can be crammed down. Therefore, it is necessary to specifically incorporate the language from *Nobelman*, as well as other germane language, to ensure that cramdowns are eliminated.

Co-debtor Automatic Stay – The current Bankruptcy Code extends the benefits of the automatic stay achieved in Chapter 13 to co-debtors. Section 1301 provides that a creditor may not act, commence, or continue any civil action to collect all or any part of a consumer debt of the debtor from an individual that is liable on such debt with the debtor, unless the case is closed, dismissed, or converted to a case under Chapter 7 or 11. Creditors should be permitted to pursue co-debtors who are not involved in the bankruptcy system.

Creditor Representation – Under the Bankruptcy Code, a creditor (or an employee of the creditor) may appear at the Section 341 Meeting of Creditors. This meeting is conducted by the trustee, and the bankruptcy judge may neither preside at nor attend this meeting. The debtor must appear and submit to examination under oath. The

creditor's representatives attending this meeting need not be an attorney. However, if these cases involve less than $5,000 in assets, the creditor's representatives at the Section 341 meeting must be represented by an attorney.

This procedure should be amended to permit creditors to continue to represent themselves throughout the entire bankruptcy proceeding, including cases involving claims against the debtor that are less than $5,000.

During the past few Congresses, bankruptcy reform legislation has been passed numerous times by both the House and the Senate, but legislation was never signed into law. Shortly after the 108th Congress convened, the House of Representatives passed its version of comprehensive bankruptcy reform legislation, H.R. 975. H.R. 975 establishes a needs-based bankruptcy system, limits repeat filings, eliminates cramdowns related to residential real estate, and removes the protection for co-debtors not a party to the bankruptcy proceedings.

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Issue

The ability of depository institutions to choose the type of charter and regulatory structure under which they operate.

Position Statement

ACB strongly supports the dual banking system, which provides a choice between state and federal charters, and the ability of depository institutions to choose mutual or stock forms of organization and either bank or savings association charters. Congress and the regulators should enhance the value of these charter options by increasing their business flexibility and improving their regulatory and chartering structures. (See also *FDIC Examination Fees*, page 66.) Congress should reject proposals to restrict regulatory flexibility, such as legislation that would deny the Federal Reserve and the Treasury authority to permit national banks and financial services holding companies to engage in real estate brokerage and management. ACB opposes any legislative or regulatory initiative that would restrict the ability of savings and loan holding companies to exercise their powers and operate their businesses as effectively and efficiently as possible. Broad regulatory reorganization proposals must not reduce the ability of institutions to choose their form of organization or charter, or limit institutions' business flexibility. ACB supports efforts to improve the effectiveness of the Federal Financial Institutions Examination Council (FFIEC). ACB generally opposes any reorganization that would limit flexibility and choice.

Explanation

Charter choice promotes economic freedom and economic freedom promotes growth. Under current law, federally insured depository institutions may choose to operate under either national or state charters. At the federal level, they may choose either a national bank or federal savings association charter. Many states offer similar options, and several have created new, more flexible savings bank charters. There is a mutual charter option at both the state and federal level.

These charters each have unique characteristics and strengths, and holding company and subsidiary authorities. In addition, they are regulated by different primary regulators and have different holding company regulatory systems. Regulators serve a given charter. Distinct charters demand distinct supervisory expertise to bring value. Charter and regulatory choices give institutions the ability to pursue business strategies that best suit their strengths and the needs of their customers and communities.

For example:

- A national bank operating subsidiary may underwrite securities, sell insurance without geographic restriction, and engage in a broad range of other financial services (as well as incidental activities).
- The Comptroller of the Currency retains the authority to permit national banks to engage directly in activities that are part of or incidental to the business of banking.
- The Federal Reserve and Treasury have the authority to permit new financial activities for national banks and financial holding companies. A proposal to permit real estate brokerage and management is pending.
- Some states already permit depository institutions to offer real estate services.
- Federal savings associations have more flexible interstate and intrastate branching rules than those that govern commercial banks.
- The Office of Thrift Supervision (OTS) has broad authority to preempt state laws that may hinder a savings association's ability to offer loan and deposit products.
- Unitary savings and loan holding companies existing as of 1999, maintain exceptionally broad affiliation authority.
- While new unitary savings and loan holding companies may not affiliate with non-financial firms, they will

continue to be regulated by the OTS and may engage in the full range of financial activities.
- Mutual holding companies also have the same full range of financial authorities.
- Federal savings associations may engage in real estate development through service corporations, an activity not permitted for national bank operating subsidiaries.
- State-chartered institutions may exercise authorities beyond those permitted to national banks if permitted by the state and approved by the FDIC under section 24 of the Federal Deposit Insurance Act. These include equity investments permitted under state laws.
- Some state-chartered banks are able to participate in supplemental deposit insurance plans that offer coverage above federal limits.
- State-chartered institutions have initiated new products and services, such as NOW accounts and savings bank life insurance that have been precursors to those extended to federally chartered institutions.

At the same time, these institutions are federally insured and must meet the same capital and other safety and soundness standards.

Unfortunately, some in Congress are attempting to block the first effort to expand the list of financial activities under the Gramm-Leach-Bliley Act (GLBA). Adding real estate brokerage and management to the list of financial activities permitted for national banks and financial services holding companies would increase competition and benefit consumers. Blocking this regulatory action would be anti-competitive and set a bad precedent for future enhancements of the powers under the GLBA.

The historic benefit of a savings and loan holding company has been its flexibility. ACB led the successful opposition to a proposal that would have required certain savings and loan holding companies to notify the OTS before engaging in, or committing to engage in, certain listed transactions. ACB encouraged use of the supervisory process to address potential regulatory concerns, rather than impose unduly burdensome regulations on an entire class of holding companies.

Some policy makers have recommended a broad reorganization of the financial regulatory system. While these ideas may address serious concerns, they could result in less choice in organization or charter and reduce an institutions' business flexibility. Many of the issues raised by our diversified regulatory system could be resolved through better coordination among the agencies. This could be accomplished by broadening the scope and authority of the FFIEC, rather than attempting a wholesale reorganization of the financial regulatory system.

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Issue

Enhancement of the Mutual Form of Charter, Including Mutual Holding Companies, in Legislation and Regulation.

Position Statement

ACB adamantly supports the continued availability and vitality of the mutual form of organization for depository institutions. ACB strongly believes that management and the board of directors are responsible for determining the appropriate level of capital that should be maintained. ACB actively opposes actions that would place undue pressure on mutuals to convert, other actions that would eliminate the option of mutuality on either a state or federal level, or actions that inhibit management of a mutual institution from running the bank in a safe and sound manner. ACB supports the federal agencies' reaffirmation of mutual institutions' ability to refuse funds offered for deposit by persons outside their communities.

Explanation

ACB will continue its vigorous advocacy of the mutual charter before both Congress and the regulatory agencies, as a fundamental charter form to be accorded parity of treatment in all respects. Mutual community banks are conservative, well-run entities with strong capital levels. They are active, both as employers and as corporate citizens, in enhancing the quality of life of their communities. These institutions must have the ability to retain their mutual charters, if they so choose.

In an effort to promote mutuality as a viable charter alternative, ACB's Mutual Institutions Committee continues to support ACB's active participation in regulatory and legal matters, has sought express support for mutuality from both the Office of Thrift Supervision and the FDIC, and sponsors an annual Conference for Mutual Community Banks.

In June 2003, at the request of the Massachusetts Bankers Association, ACB testified before the Joint Committee on Banks and Banking of the Massachusetts legislature against a bill that ACB believes would ultimately force mutual institutions to convert to stock form. In 2001, ACB was the only national banking trade association recognized by the court and allowed to file an amicus brief on behalf of Gorham Savings Bank when depositors of the Maine state-chartered savings bank asserted that they had a right to a distribution of capital. ACB argued that management and the board of a savings bank are responsible for the operations of the bank, including deciding how much capital to have within the required regulatory framework. ACB also filed a letter with the federal district court on behalf of Pathfinder Bancorp, a mutual holding company that was being sued by a minority shareholder who claimed that the board of the mutual holding company had not properly exercised its fiduciary duty in rejecting an unsolicited offer to acquire the mutual holding company. In late 2003, ACB sent a letter to the members of the FDIC Board supporting the granting of a waiver of a depositor vote in a conversion of a state savings bank in a state in which state law does not require a depositor vote. ACB also testified at a hearing in support of the approval of the transaction in accordance with state law. In each of these examples, ACB participated because we believed that an adverse outcome would negatively impact the ability of mutual institutions to choose their future course of action, independent or not.

The court ruled in favor of the Gorham Savings Bank and no appeal was filed by the plaintiffs. The OTS issued an opinion which reaffirmed the position that depositors of mutual institutions do not have rights to distributions of capital. In Massachusetts, the legislation was not enacted.

Over the past several years, the OTS regulatory agenda has included modifications to the mutual holding company regulations, both to update them and implement the changes made by the Gramm-Leach-Bliley Act, and

an update to the mutual-to-stock conversion regulations. The OTS has issued supervisory guidance for examiners to use when examining mutual institutions and ACB is working with the FDIC to develop similar guidance. ACB will continue to work with the OTS and the FDIC to ensure a rational conversion process and to develop policies on merger conversions, if necessary. We will also work with the agencies to revise supervisory changes that take the unique nature of the mutual charter into account.

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Issue

Improving all consumers' financial literacy.

Position Statement

ACB strongly supports financial literacy initiatives at the local, state, and federal levels.

ACB urges that the following steps be taken to improve the public's level of financial literacy, both to improve economic opportunity and as a means of consumer protection.

- Financial literacy initiatives should focus on arming consumers with the necessary skills to avoid predatory lending practices.
- Interested affected parties should take steps to increase the levels of financial literacy among all Americans, including specifically working to increase and expand homeownership education and counseling.
- Consumer education programs should incorporate information regarding how to avoid identity theft, a key element of some abusive consumer credit practices, including routine reviews of one's credit history files [see *Identity Theft* on page 51].
- Interested affected parties should work cooperatively to improve basic financial education at every level in the education process, especially among school-aged children.
- Interested affected parties should support a National Clearinghouse repository of financial literacy initiatives, to better leverage the many individual efforts.
- The federal banking agencies should increase support of their supervised institutions' financial literacy efforts.

Explanation

Members of ACB are community-based lenders dedicated to strengthening America's communities by meeting the financial needs of customers fairly and efficiently and by fostering housing opportunities and equal credit opportunity. An informed, educated consumer is better able to make financial decisions and avoid predatory lenders and other unscrupulous providers of financial services. Education and counseling remain an important way to prevent predatory lending abuses.

In 2002, ACB launched *Money Rules*, a financial literacy program designed to provide community bankers with resources for their financial education efforts. In addition, ACB is working with a variety of federal agencies and private organizations, including the Federal Deposit Insurance Corporation, Junior Achievement, Operation HOPE, Inc., and the Jump$tart Coalition for Personal Financial Literacy, to help educate people about such topics as the importance of saving, establishing a good credit history and how to borrow wisely. These initiatives build upon similar efforts in the area of homeownership education and counseling, identity theft and checking account protection.

In 2003, President Bush has signed into law H.R. 3294, the Financial Literacy Enhancement Act, which was incorporated into H.R. 2622, the Fair and Accurate Credit Transactions Conference report. Language included in the law directs the Secretary of the Treasury to develop, implement, and conduct a pilot national public service multimedia campaign of $3 million dollars to enhance the state of financial literacy in the United States. The law establishes a financial literacy commission. The Secretary of the Treasury will serve as the Chair of the Commission, whose overall goal is to develop within 18 months a national strategy to promote basic financial literacy and education among all Americans. A toll-free 1-800 number and an internet web site will be established to provide a one-stop shop for persons and groups to access information about all Federal financial literacy programs, materials, publications and grants.

In addition, ACB is committed to the following financial literacy responsibilities:

- To work in coordination, where possible, with the other trade associations and regulatory agencies to develop and implement guidance or best practices for use by ACB members;
- To expand and grow Money Rules, ACB's financial literacy campaign, for use by our members and their customers;
- To identify and work with other business and educational groups to promote the goals established by the ACB; and
- To represent ACB membership in financial literacy forums with other groups.

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Issue

The structure of the financial regulatory agencies.

Position Statement

ACB opposes proposals to merge or fundamentally restructure the nation's banking and other financial regulatory agencies. ACB supports efforts to improve the scope and effectiveness of the Federal Financial Institutions Examination Council (FFIEC).

Explanation

Some policy makers have recommended a broad reorganization of the financial regulatory system. While a broad reorganization may seek to address real concerns, it could also result in fewer organizational or charter choices and reduced institutional business flexibility. The concerns these policy makers are seeking to address may be better addressed through improved coordination among the agencies. This could be accomplished by broadening the scope and authority of the FFIEC, rather than attempting a wholesale reorganization of the financial regulatory system.

The debate on financial modernization illustrated the benefits of the current arrangement and the pitfalls of attempting to alter it. Some in Congress attempted to combine the commercial bank and savings association charters and merge their chartering agencies, including the best features of both. However, it proved politically impossible to transfer the benefits of the savings association regulatory structure and its business flexibility to a new bank charter. Those benefits would likely have been lost, so that existing savings associations would have had a weaker charter and other depository institutions would have lost the option to become a savings association. Broader attempts to merge agencies and combine charters would likely flounder for similar reasons.

While the current system of financial regulation is complex, it also has substantial advantages over a more consolidated arrangement. Comptroller of the Currency John D. Hawke, Jr. has noted that the current system provides "a safeguard against the dangers of regulatory hegemony and abuse – and … an incentive to regulatory responsiveness and efficiency." (October 14, 2002)

This rationale applies equally to agencies that supervise other aspects of the financial system, such as the securities and insurance regulators. While depository institutions, securities firms, and insurance companies share many characteristics, significant differences remain. Agencies that regulate insured depository institutions must focus primarily on safety and soundness to protect depositors and taxpayers. Securities regulators foster maximum public disclosure. Insurance regulators emphasize both consumer protection and long-term financial capacity. A single agency that attempted to combine these missions under one roof would have to choose which to emphasize, weakening important priorities.

While maintaining separate agencies with their own focus is important, the increased integration of the financial system makes improved regulatory cooperation essential. Different types of financial firms compete against one another and now may affiliate in the same corporate structure. Thus, the Federal Financial Institutions Examination Council should be enhanced and its scope expanded to assist in coordinating the work of all the financial regulators.

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Issue

Independence of the Office of Thrift Supervision (OTS).

Position Statement

ACB strongly supports the independence of the OTS as a bureau within the Treasury Department. The OTS should continue to increase its efforts to adapt to the needs of the industry and its customers.

Explanation

The OTS regulates institutions that use a charter option valuable to our nation's diverse economy. Like the dual national/state banking system, the choice between the bank and the savings association charters gives a depository institution the ability to adopt the business organization that best suits its customers and communities. The OTS also regulates an important alternative holding company structure, and helps to support a unique tradition of regulation for mutual institutions. By retaining these options, the financial system maintains a healthy competition among regulators and charter options, and avoids the danger of consolidating too much power in a single agency.

While savings associations must meet the same capital, safety and soundness, and prompt corrective action standards as banks, key differences remain. The OTS has years of experience in regulating housing lenders and mutual institutions. It brings this experience to bear when working with the FDIC and other regulators as they deal with issues that affect those institutions.

The OTS has a comprehensive approach to federal preemption of state laws affecting core lending and deposit-taking functions. As provided in the Supreme Court's de la Cuesta decision, OTS regulations issued under the Home Owners' Loan Act occupy the regulatory field for these functions, and any state law that interferes is preempted.

The OTS has had a long and successful experience with the regulation of savings and loan holding companies, including many with diverse affiliations. The OTS should continue its fundamental approach to holding company regulation, focusing on the health of the savings association and its relationships with its holding company, and not seek to directly regulate holding company activities.

To maintain its viability as an independent agency, the OTS must continue to adapt its regulations and practices to a rapidly changing industry. While maintaining their community focus, many savings associations are increasing their commercial loan portfolios. The OTS must recognize that these loans are as important to community health as traditional home loans.

ACB supports the efforts of OTS to become recognized by the European Commission as a consolidated financial regulator. The OTS is uniquely suited among U.S. federal banking regulators to the role of supplementary supervision of financial conglomerates. For over 15 years, a wide variety of commercial, industrial and financial companies, including companies headquartered in the European Union, have been operating in the United States as savings and loan holding companies.

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Issue

Supporting minority and multi-cultural owned financial institutions

Position Statement

ACB promotes the vitality of minority and multi-cultural owned financial institutions, whose diverse customers are assets in numerous communities throughout the U.S.

Explanation

In December 2001, ACB formed the MBank Council to represent African American, Hispanic American, and Asian American financial institutions, as well as other multi-cultural financial institutions. The goal of the MBank Council is to understand the priorities and needs of these financial institutions, and identify member services and products that bring value to these members.

The MBank Council responsibilities are: to review regulatory and legislative issues that affect the ability of minority and multi-cultural institutions to serve their customers, as well as their communities; to identify educational programs to meet the needs of minority and multicultural banks, such as, customer service, management training, and continuing education for executives and boards of directors; to partner with other ACB committees and ACB Partners to develop products and services specialized to meet the unique needs of minority and multi-cultural institutions; to work with the U.S. House of Representatives' Congressional Black Caucus and Congressional Hispanic Caucus; and to serve as a clearinghouse on issues related to minority and multi-cultural financial institutions.

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BUSINESS OPPORTUNITIES

Issue

Expand federal savings associations' capacity to make commercial and small business loans.

Position Statement

ACB strongly supports eliminating the lending limit restriction on small business loans for federal savings associations, while increasing the aggregate lending limit on other commercial loans. (See also *Regulatory Burden Relief*, pages 62 and 63, for loans-to-one borrower and commercial real estate lending limits.)

Explanation

In 1996, Congress liberalized the commercial lending authority for federally chartered savings associations by adding a 10 percent "bucket" for small business loans to the existing 10 percent limit on commercial loans.

Today, savings associations are increasingly important providers of small business credit in communities throughout the country. As a result, the 10 percent limit poses a constraint for an ever-increasing number of institutions. At the end of the third quarter of 2001, for example, nearly $31 billion, or 3.2 percent of total thrift assets, were in commercial loans, half of which were made to small businesses. This represents an increase of approximately 15 percent in commercial lending by savings associations during the previous year. The importance of this line of business for savings associations was underscored by the recent actions of the Office of Thrift Supervision ("OTS"). In three separate regulatory moves, the OTS has attempted, within the statutory constraints, to provide or propose additional flexibility in the area of commercial and small business lending. While all of these changes are welcome and important – and were encouraged by ACB – legislative action is needed.

Expanded authority would enable savings associations to make more loans to small- and medium-sized businesses, thereby enhancing their role as community-based lenders. An increase in commercial lending authority would help increase small business access to credit, particularly in smaller communities where the number of financial institutions is limited. This is wholly consistent with the historical orientation of savings associations toward local markets. An increase in the small business and commercial lending limits will allow them to better serve these markets, without otherwise modifying the mission-direction underlying the qualified thrift lender test.

On July 9, 2003, the House Financial Services Committee passed H.R. 1375, the "Financial Services Regulatory Relief Act." This measure would eliminate the small business lending limit restriction on federal savings associations and increase from 10 to 20 percent the lending limit restriction for other commercial loans.

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Issue

Interest on Business Checking Deposits and Interest on Sterile Reserves.

Position Statement

ACB supports eliminating the prohibition on banks paying interest on business checking accounts and providing the Federal Reserve Board authority to pay interest on sterile reserves.

Explanation

Prohibiting banks from paying interest on business checking accounts is long outdated, unnecessary and anti-competitive. Restrictions on these accounts make community banks less competitive in their ability to serve the financial needs of many business customers. Institutions would benefit by not having to spend time and resources trying to get around the existing prohibition. Permitting banks and savings institutions to pay interest directly on demand accounts would be simpler. This would benefit many community depository institutions that cannot currently afford to set up complex sweep operations for their – mostly small – business customers.

Numerous business organizations across the nation have endorsed repealing this ban, e.g., the U.S. Chamber of Commerce, the National Federation of Independent Business, the American Farm Bureau, the Independent Insurance Agents of America, and the Association for Financial Professionals.

On March 5, 2003, ACB testified in support of the interest on business checking option. On April 1, 2003, the House of Representatives passed without objection H.R. 758, which would allow banks to use the interest on business checking option two years after the legislation's enactment. In the meantime, the allowable number of transfers between transaction accounts and interest-bearing accounts would be expanded to 24 from the current six. H.R. 758 would also authorize the Federal Reserve to pay interest on sterile reserves.

In November 2003, Senators Chuck Hagel (R-NE) and Olympia Snowe (R-ME) introduced S. 1967, which would give banks the interest on business checking option two years from the legislation's enactment.

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Issue

Savings associations lack parity with banks in offering fiduciary services.

Position Statement

ACB will work to ensure that mandated new exemptions to the broker-dealer registration requirements of the Securities Exchange Act of 1934 cover all insured depository institutions in a rational manner.

ACB strongly supports legislative amendments to the Investment Advisers Act, in addition to any administrative relief, to ensure that savings associations can offer their customers fiduciary products and services, including trust and securities products, under the same rules that apply to banks.

Explanation

The Gramm-Leach-Bliley Act ("GLBA") removed the blanket broker-dealer registration exemption previously provided to banks under the Securities Exchange Act of 1934 ("34 Act"). In its place are fifteen "safe harbors" for traditional trust activities and other services performed by financial institutions. To implement the new 34 Act safe harbors, the Securities and Exchange Commission ("SEC") in 2001 issued an interim final rule. While the SEC's interim final rule was problematic in many respects, it did propose extending coverage of safe harbors to savings associations and savings banks. ACB long has supported this approach and will work to ensure that the final rule includes this remedy. We also will work to ensure that the final rule does not impose unnecessary burdens on community banks engaged in fiduciary activities.

The SEC staff is developing a revised proposal to implement the GLBA exemptions with input from the banking industry and the regulators. It is expected that a final rule will be issued prior to the expiration of the current deadline – November 2004. ACB is providing input to the SEC staff and will work to ensure that any final rule will not include requirements that will be disruptive to the business and customer arrangements that savings banks and savings associations currently have in place.

Additionally, while the Investment Company Act of 1940 (ICA) excludes both domestic banks and savings associations (as well as insurance companies) from the definition of an "investment company," the Investment Advisers Act of 1940 (IAA) does not exclude savings associations from the definition of an "investment adviser." Banks and bank holding companies are excluded from the IAA, as well as the ICA. To remedy this disparity, the IAA should be amended to exclude savings associations from the definition of "investment adviser." Until such change, ACB also will continue to seek administrative relief.

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Issue

Sale of mutual funds and insurance by depository institutions.

Position Statement

ACB opposes any effort that would undermine the ability of depository institutions to offer the full range of permissible uninsured investment products, such as mutual funds, insurance and annuities.

While ACB generally supports appropriate disclosures under applicable regulations, we oppose any initiative that places depository institutions at a competitive disadvantage vis-à-vis non-depository institutions in selling these products.

Explanation

Banks and savings institutions should be able to deliver the increasingly broad range of uninsured investment products their customers want. Community banks should be able to do so under a scheme that balances appropriate consumer protections, including necessary disclosures, with the ability to deliver these products and services under reduced regulatory burdens.

In 2001, the federal banking agencies, in compliance with section 305 of the Gramm-Leach-Bliley Act, issued consumer protection regulations and accompanying exam procedures for the sale of insurance by depository institutions. These regulations are similar to, but separate from, the 1994 Interagency Statement on Retail Sales of Nondeposit Investment Products. There are requirements governing prohibited practices and required disclosures.

ACB will work both independently and jointly with other trade associations to assist the federal banking agencies in promulgating regulations that balance the competitive goals of depository institutions and the need for adequate consumer protections, and reasonable standardization of the rules covering sales of these services.

Contact for further information: Krista Shonk (202) 857-3187

Issue

Support of credit and other financial service needs of commercial customers.

Position Statement

ACB supports legislative and regulatory policies that allow community banks to offer competitive products and services to their commercial customers and prospects. Rules, regulations and laws that put community banks at a competitive disadvantage in offering commercial products or services to firms located within their communities will be opposed.

Explanation

ACB members must have the ability to offer competitive commercial products and services to effectively serve commercial organizations located within their market area. Commercial organizations look to our members to provide a full range of commercial products and services that meet their needs throughout their organization's life cycle. Our members are put at a competitive disadvantage by regulations and laws that restrict the ability of our members to: provide adequate levels of financing; increase the cost of offering a credit or payment systems based products; or limit the ability of our members to offer market rates of interest on deposit products.

ACB will work both independently and jointly with other trade associations to assist federal banking agencies, Congress and other rule making bodies in promulgating regulations and laws that preserve and enhance the ability of community banks to offer competitive products and services to their commercial customers.

Contact for further information: Bob Seiwert (202) 857-3125

RETIREMENT SAVINGS

LEGISLATION **RETIREMENT SECURITY**

Issue

Enhancing the ability of individuals to determine how their retirement security funds are invested.

Position Statement

ACB supports policies allowing individuals greater control in determining how their retirement security funds, including contributions to Social Security, are invested. ACB encourages Congress and the Administration to continue exploring proposals, such as transforming the current Social Security program into a system placing greater emphasis on personally directed retirement accounts. Input from community banks should be sought in the development of these policy initiatives. Community bankers understand creation of wealth and the need for investment of capital, and ACB members should take an active role in educating the public and public officials about the benefits of reform and individual investment accounts. The community bank role would be further enhanced by providing for a substantial increase in deposit insurance coverage for retirement accounts.

Explanation

Most Americans today hold a host of investment products to save money for their retirement years, including savings accounts, individual retirement accounts, and 401(k) plans. These private retirement funds supplement the public Social Security program, which is financed by mandatory payroll taxes imposed on employers and employees. While the Social Security program and its trust fund have been relatively healthy over almost two-thirds of a century, significant concerns have been raised about the future of the program. These concerns largely arise from ongoing demographic changes, specifically, the declining proportion of people in the workforce versus future Social Security beneficiaries. These trends will cause Social Security to begin running a deficit in 2017. Further, the return on Social Security taxes for retirees today is barely one percent. In view of these statistics, many policymakers have suggested that the future of retirement security could be improved if Americans were allowed to choose how their payroll taxes are invested, rather than the currently mandated system with minimum investment returns.

In December 2001, the President's Commission to Strengthen Social Security released its report outlining three proposals for transforming the Social Security program into a retirement savings system using voluntary private investment accounts. Unfortunately, events such as the terrorist attacks on 9/11/01, corporate bankruptcies, and the economic downturn preempted congressional consideration of the Commission report or the variety of plans to reform Social Security that have been proposed by think tanks, members of Congress, and by President Bush. Most of these proposals emphasize the utilization of some form of personal retirement accounts as an alternative or adjunct to Social Security. This approach would give individuals greater control over how their retirement security funds are invested. It could also provide community banks with the opportunity to provide a greater variety of deposit and investment products for people to use for their retirement plans, while increasing funding available for financing local credit needs. A substantial increase in deposit insurance coverage for retirement accounts would enhance community banks' ability to play both of these key roles.

Contact for further information: Beth Neese (202) 857-3152, Peter Hong (202) 857-3134

Issue

Limitations on employee and pension investment in employer stock.

Position Statement

ACB opposes legislative or regulatory proposals that would limit investment in or impose new diversification rules on ESOPs, place severe limitations on employee investment in employer stock, or limit employer stock as an employer matching contribution for defined contribution plans. ACB also opposes proposals that would limit tax deductions for contributions of employer stock. ACB supports legislation, such as that proposed by Representative John Boehner (R-OH) and others, that would enhance the ability of employers to provide investment advice to employees.

Explanation

During the 107th and the 1st Session of the 108th Congress, several bills were introduced that would have imposed new diversification rules on ESOPS and placed severe limits on the amount of individual investment accounts and pension funds that could be invested in employer stock. Proposals also would have limited the current 100 percent tax deduction for contributions of employer stock to 50 percent. The House of Representatives passed several versions of pension reform bills and the Senate Finance Committee considered a separate version of a pension reform bill. None of these bills have been enacted into law. The Senate Finance Committee has indicated that it will report a revised version of a pension reform bill it considered in 2003 and Senate leaders have said the Senate will consider pension reform in 2004.

While ACB members are concerned over the loss of pension and employee investments that resulted from corporate malfeasance, these unusual cases should not be used as a justification for changing current incentives for ESOPs, prohibiting or severely limiting employees' ability to choose to invest in company stock, or to limit stock contributions to employees by employers. ACB members agree that diversification of pension investments by employees is desirable, but believe that current laws and enhanced education of employees about the need for diversification are preferable to enactment of additional, rigid rules. Employee investment in company stock gives them a stake in the success of the company and a chance to benefit from the financial success of the company.

Contact for further information: Beth Neese (202) 857-3152, Diane Koonjy (202) 857-3144

GOVERNMENT SPONSORED ENTERPRISES

Issue

Raising the Fannie Mae and Freddie Mac ("the GSEs") loan limits in high-cost areas, setting the procedures for adjusting the GSEs' conforming loan limit for 1-to-4 family structures, and expanding purchase authority for loans secured by multi-family rental properties.

Position Statement

GSE conforming loan limits are intended to limit GSE secondary market activity to loans on moderate-cost homes, based on a national average. Therefore, ACB strongly opposes changes in the method of calculating the conforming loan limit to attempt to address regional variations in housing costs or set higher limits in states with high-cost metropolitan areas.

ACB supports codifying the procedures for adjusting conforming loan limits currently used by the secondary market GSEs. In addition, ACB supports a binding declaration as a substitute for the informal indications from the GSEs that they will carefully target to genuinely high-cost areas the use of their unlimited statutory multi-family purchase authority.

Explanation

Loan Limits in High-Cost Areas:

The current methodology for 1-to-4 family conforming loan limits reflects and adjusts the maximum loan purchase limit based on national trends in housing prices. However, in December 2003 Rep. Brad Sherman (D-CA) introduced H.R. 3507, the "Improving Homeownership Opportunities in High-Cost States Act," that would raise conforming loan limits in states with high-cost metropolitan areas by 50 percent of the standard limit. ACB strongly opposes such legislation, which we expect to be considered actively by Congress in 2004. For 2004 the standard GSE loan limit for one-family residential properties was raised to $333,700, while the high-cost ceiling currently in effect for Alaska, Hawaii and the U.S. Virgin Islands was raised to $500,550. Under the proposed legislation, H.R. 3507, a state would become eligible for high-cost status if any metropolitan statistical area within its borders has a Federal Housing Finance Board (FHLB) determined average quarterly home purchase price that exceeds the then applicable GSE loan limit. According to the proposed legislation, an entire state would qualify for the high-cost loan limit if any part of the state were within any of the 32 major metropolitan areas identified by the FHFB survey as high cost. Thus, applying the proposed legislation to the 2003 loan limit of $322,700, California, Massachusetts, New York, New Jersey, Connecticut, Pennsylvania, Maine, New Hampshire, the District of Columbia, Maryland, Virginia, and West Virginia would be designated as high cost states.

ACB opposes any legislation to change the method of calculating the conforming loan limit to address regional variations in housing costs or set higher limits in high-cost metropolitan areas. We do not believe that such legislation would serve any public purpose and might undermine the GSEs' statutory commitment to finance housing for low-and moderate-income families, housing located in central cities, rural areas and other underserved areas. The private market, including ACB's members, amply provides for jumbo loans to finance relatively expensive homes. The GSEs' expansion into higher cost financing would unfairly compete with the private sector, without offering any benefit to low-and moderate-income homebuyers or to the country at large.

Procedures for Adjusting Loan Limits:

One-to-four family conforming loan limits for the GSEs are based on October-to-October changes in home prices for mortgage transactions captured by the FHFB monthly survey of loan terms and rates. Statutory language indicates that the upward movement of the conforming limit will be in line with the FHFB index, but

does not explicitly prescribe a downward adjustment of the conforming limit when the FHFB survey produces a negative October-to-October change. It would be desirable to secure a firm commitment from the GSEs that upward moves in the 1-to-4 family limit will not occur until previously unreflected declines in the FHFB index are recouped.

Purchase Authority for Multi-Family Rental Properties:

The 1998 omnibus appropriations bill completely eliminated the per-unit dollar cost limits on more-than-five-unit residential properties. Neither the statute nor the legislative history contained explicit guidance on how the expanded multi-family authority is to be used. Public and private statements by the GSEs indicate that they will use this enhanced authority on a targeted basis rather than as a means to expand their nationwide penetration into the upper end of the rental market. ACB seeks a more formal commitment from the GSEs on the targeted use of this authority.

Contact for further information: Janet Frank (202) 857-3129

Issue

Imposition of "user fees" on the debt issues or retained portfolios of mortgage-backed securities and non-mortgage investments of the Federal Home Loan Banks (FHLBanks) and other housing GSEs. Removal of the current exemption from the Securities and Exchange Commission (SEC) securities registration fees for Federal Home Loan Bank and other housing GSE debt issues.

Position Statement

ACB opposes the imposition of user fees and registration fees levied on new debt issues.

Explanation

The Congressional Budget Office (CBO) frequently has recommended, as a spending and revenue option for Congress, that the FHLBanks be charged securities registration fees. In addition, the CBO has suggested that fees be imposed on their investment securities portfolios.

A faulty argument has been made that the exemptions were originally granted to help the then-new organizations gain acceptance by the securities markets and that because acceptance has been achieved, imposition of such fees would create a more level playing field between the GSEs and others in the market. This interpretation is incorrect; the purpose of these "user fees" is to cover the cost of the SEC reviews, which are designed to protect investors. Because of the government/private partnership relationship of GSEs, such reviews are not required or performed. Therefore, imposition of "user fees" or registration fees is neither warranted nor justified. Imposing this burden and cost would unnecessarily constrict funds available for housing and community lending, especially from community banks.

These fees, which would be passed on to investors, are a *de facto* tax on home ownership and community lending.

Contact for further information: Dan Berger (202) 857-5577, Janet Frank (202) 857-3129

Issue

Fundamental reforms to FHA/HUD programs.

Position Statement

ACB supports FHA's single-family and multi-family housing programs as an effective supplement to private sector efforts to meet the needs of low- and moderate-income borrowers. FHA's core mission should:

- Maintain the current indexation of the maximum FHA limits to 87 percent of the Fannie Mae/Freddie Mac limit;
- Maintain profitable opportunities for private-sector lenders of all sizes to originate and service FHA-supported loans;
- Streamline FHA loan application documents and procedures to more closely parallel standard private-sector loan processing documentation and procedures;
- Continue current securitization authority of the Government National Mortgage Association with respect to all government programs; and
- Retain an FHA individual single-family loan program to ensure that lenders have access to mortgage insurance in all submarkets within their designated Community Reinvestment Act lending area.

ACB supports maintaining current HUD/FHA programs and developing other HUD/FHA programs, subject to adequate risk controls, that provide greater access to a larger universe of lenders. ACB will encourage greater use of mortgage credit certificates (granted to borrowers by state housing agencies) rather than issuance of tax-free revenue bonds.

Explanation

Proponents of expanding the FHA program generally seek to increase the loan limits or reduce the down payment amounts. These actions increase the number of persons able to take advantage of the program. However, many in Congress and the industry complain that the expansion of this program takes away market opportunities from the private sector. ACB does not support proposals that increase the national conforming loan limits due to the average home price of individual states.

In addition, ACB will continue to work with HUD and the Appropriation Committees to ensure that the single-family housing subsidy remains targeted as an effective supplement to the private housing market.

Contact for further information: Priya Dayananda (202) 857-3130, Janet Frank (202) 857-3129

Issue

The issuance by Fannie Mae and Freddie Mac (the GSEs) of debt instruments in forms and amounts that compete with instruments and accounts offered by insured depository institutions.

Position Statement

ACB believes it is inappropriate for the GSEs to sell debt instruments to consumers, either directly or through intermediaries. The sale of such debt instruments is inconsistent with the purposes for which the GSEs were chartered. ACB is particularly opposed to the sale of small denomination GSE debt instruments to consumers. If the sale of such instruments is allowed to continue, the minimum amount of the instrument should be $100,000, or the prevailing single account deposit insurance maximum. Additionally, full disclosure of the nature of the risks of repayment and early call provisions should be mandated.

Explanation

In 2001, debt instruments issued in denominations of as little as $1,000 accounted for less than two percent of the long-term funding sources of the two secondary market GSEs. By 2002, this amount increased to approximately five percent. As the GSEs increase the sale of these debt instruments, they could grow to represent a substantial share of GSE funding. Also, continuation and expansion of these sales may materially harm the deposit base for insured depository institutions, and thus weaken their ability to meet housing finance and other community credit needs. ACB also believes that the sale of this debt represents an attempt by the GSEs to establish retail brand recognition.

These debt instruments have been marketed to consumers with considerable emphasis on their implied federal government backing. As a result, members of the public may believe that they are buying federal agency debt with some form of government guarantee. In fact, no such guarantee exists. Relatively unsophisticated purchasers of this debt are largely unaware of the nature of the interest rate and call risks that they are assuming because such provisions are not common to traditional consumer depository accounts.

The statutory mandate of the GSEs is to operate in the secondary market for residential mortgages. The sale of small denomination debt to individuals is inconsistent with the purpose for which the GSEs were established. It also results in the further development of retail name brands. Although retail presence in the market for small debt instruments is not immediately related to possible primary mortgage market activities, it would greatly facilitate such activities in the future.

ACB formally has expressed these concerns about competition for funding sources and misleading information for consumers to the GSEs, the Treasury Department and the Securities and Exchange Commission. No formal changes to these practices have been made.

The issuance of small denomination debt to the retail public can and should be eliminated, curtailed or restricted.

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SAFETY AND SOUNDNESS

Issue

Reauthorization of the federal flood insurance program.

Position Statement

ACB strongly supports a permanent reauthorization of the National Flood Insurance Program (NFIP) that is administered by the Federal Emergency Management Agency (FEMA). ACB also supports legislative or regulatory changes that limit the NFIP and taxpayers' responsibility for properties that are subject to repetitive loss claims. The legislation and regulation must also provide for notification to lenders in the event of adverse action on the property such as dropped coverage or offers of mitigation.

Explanation

In 1999, FEMA proposed and has yet to withdraw a plan that would reform the NFIP by dealing with severe repetitive loss properties. It has been estimated that the average annual flood insurance premium assessed for these targeted properties would increase from approximately $600 per year to $10,000 per year. Such an increase would not only represent a financial hardship on the property owner, perhaps beyond his or her capacity to pay, it also likely would affect the value and marketability of the property. The mortgage lender that extended credit based upon the borrower's ability to pay and the property's market value should be formally notified of the planned premium increase in advance and at a time when intervention might still be possible. For similar reasons, prospective purchasers and mortgage lenders should also be made aware of the proposed premium increase.

At the beginning of the 108th Congress, Rep. Doug Bereuter (R-NE) introduced a major reform bill, H.R. 253, to the Committee on Financial Services to amend the National Flood Insurance Act of 1968 to reduce losses to properties for which repetitive flood insurance claim payments have been made. ACB participated in the intense negotiations with Rep. Doug Bereuter and Rep. Richard Baker (R-LA) and had language added that required lender notification in the event any adverse action or mitigation occurred to the property. The comprehensive reform bill passed the House in late 2003. However, the Senate only reauthorized the flood insurance program for a year and did not take up any of the House's reforms. In the waning days of the 108th Congress, a three-month extension was passed by both chambers to give the Senate time to hold hearings and to research the proposed reforms in the early part of 2004.

ACB will continue to participate in the formation of the final product and urge Congress to make the flood insurance reauthorization permanent.

Contact for further information: Dan Berger (202) 857-5577, Janet Frank (202) 857-3129

Issue

Natural disaster insurance loss mitigation.

Position Statement

ACB supports development by the federal government of a mechanism for spreading the risk of major natural disasters (including earthquakes, hurricanes, tornadoes and volcanic eruptions) over a risk pool including all holders of improved real property. The federal program should recognize the critical role that insurance plays in mortgage transactions and the need to preserve insurance availability to assure an orderly real estate market. The federal program also should recognize the need to educate the public about sound real estate development practices in disaster-prone areas to help prevent losses.

Explanation

In recent years, various parts of the United States have suffered unexpected massive damage as the result of natural disasters. Few, if any, parts of the nation are immune from the possibility of a natural disaster. Congress and the Administration periodically have considered a program that would require all mortgages on newly constructed 1-to-4 family dwellings to carry insurance protection against all natural hazards. This requirement would be extended to all new purchase money mortgages within four years, and all new mortgages (including refinances) after seven years. The new mandate would be coupled with a new federally-assisted program, new limits on federal post-disaster assistance, and specific pre-disaster steps to encourage loss mitigation. The details of how such a program is constructed are important and deserve close attention.

Clearly, the federal interest is implicated in any domestic natural disaster mitigation effort. Natural disasters, such as those that have occurred in recent years in Florida, South Carolina, Virginia, North Carolina, and California, demonstrate that natural disasters can overwhelm the capacity of private industry and local governments. These and other disasters have cost the federal, state, and local governments billions of dollars. To make a disaster program effective, however, very broad coverage is necessary. In particular, all types of improved residential properties—whether mortgaged or unmortgaged—should be included in the Natural Disaster Insurance Program.

Contact for further information: Dan Berger (202) 857-5577

Issue

To encourage the adoption of good corporate governance practices and complete and accurate disclosure of financial information.

Position Statement

ACB supports the adoption of good corporate governance practices by both public and private community banks. In determining appropriate "best practices" in corporate governance, the different organizational, capital and ownership structures of ACB members should be taken into account. ACB will support legislative, regulatory and private initiatives to promote "best practices" in corporate governance, but will argue for appropriate exceptions and refinements when necessary to account for the more limited resources of small- and mid-size community banks. ACB will continue to oppose unreasonable requirements that will not lead to better corporate governance practices or that unduly impede the ability of public and private companies to access the public markets to obtain capital for future growth. ACB recognizes that laws and regulations cannot, on their own, substitute for the voluntary adherence to ethical principles of corporate conduct and establishment of a corporate culture that promotes honest behavior.

To promote financial transparency, ACB supports the disclosure of accurate and complete information about financial performance and business operations in a timely manner. Rules, regulations and private initiatives that accelerate reporting deadlines for information should take into account the interests and needs of smaller companies that have fewer resources at their disposal. Unreasonable filing deadlines could lead to the reporting of inaccurate or incomplete information.

ACB specifically supports the following corporate governance and disclosure principles:

- A strong and independent-minded board of directors.
- A strong and independent-minded audit committee, knowledgeable about banking and financial matters.
- A strong and independent-minded nominating and compensation committee.
- Initial and continuing director education and training.
- Adoption of a code of conduct and ethics covering directors, officers and employees.
- Promotion and enforcement of a corporate culture that expects honest and ethical conduct.
- Prohibition on the adoption of equity compensation plans without shareholder consent.
- Revision of periodic reporting requirements to promote better organization and presentation of information material to investors.
- Reporting of financial information within reasonable time frames.
- Accurate disclosure of critical accounting policies.

Explanation

President Bush signed the landmark Sarbanes-Oxley Act of 2002 on July 30, 2002. This legislation was the most significant overhaul of the securities laws since the 1930s and established federal government involvement in areas such as accounting firm oversight and corporate governance that traditionally have been left to the states.

The Securities and Exchange Commission (SEC) issued final rules to implement many of the Sarbanes-Oxley provisions. These rules addressed a broad spectrum of corporate governance structure and operations, including CEO/CFO certification of financial reports, auditor independence, audit committee duties and responsibilities, code of ethics disclosure, and internal control evaluation and disclosure. ACB provided comments on the SEC - proposals and the final rules were responsive to many of ACB's comments and concerns.

As it monitors the impact of these rules, the SEC will be considering additional corporate governance initiatives and financial disclosure requirements. Also, Sarbanes-Oxley called for studies on a variety of corporate and securities matters, so it is likely that additional laws and regulations will be enacted to address any remaining issues or concerns.

The stock exchanges, with the encouragement of the SEC, also addressed corporate governance at listed companies. The New York Stock Exchange, the NASDAQ Stock Market and the American Stock Exchange adopted additional corporate governance-related listing requirements that go beyond the requirements of Sarbanes-Oxley. The new standards address, among other things, director independence by requiring that a company have a majority of independent directors. The exchanges adopted stringent criteria for establishing "independence."

The federal banking regulators have issued guidelines on how Sarbanes-Oxley and the SEC's implementing regulations affect insured depository institutions. Private and mutual institutions with $500 million or more in assets will have to comply with the auditor independence standards. The agencies currently do not intend to require smaller private and mutual institutions to comply with the board of director composition, director independence, audit committee, auditor independence and other corporate governance requirements of Sarbanes-Oxley or the stock exchange rules. The agencies, however, will continue to review corporate governance practices at institutions and will establish additional guidelines when those actions are deemed necessary or appropriate.

Contact for further information: Diane Koonjy (202) 857-3144

Issue

Meeting new anti-money laundering compliance obligations.

Position Statement

ACB recognizes the important role community banks play in the fight against terrorist financing and other financial crimes. We support government efforts to effectively track financial transactions by terrorists and criminals; nevertheless, community banks should not be burdened by extraneous information requirements.

As institutions are examined for Patriot Act compliance, ACB strongly urges the federal banking agencies to consider a community bank's limited resources when considering its commitment to an anti-money laundering program.

Explanation

Prior to September 11, 2001, the Bank Secrecy Act's ("BSA") reporting requirements were considered by many as posing significant regulatory burdens while offering limited law enforcement value. Today, the BSA is viewed as another important tool in the nation's fight against terrorist financing.

With the dramatic change in the political landscape of this issue, efforts to reduce reporting obligations (outside of current exemptions) have given way to the goal of exploring opportunities to support law enforcement while minimizing the regulatory burdens associated with these new requirements.

In 2003, Treasury issued final customer identification regulations requiring institutions to verify and maintain records of a new customer's identity. Also in 2003, FinCEN improved the process by which financial institutions are required to search their records for names of suspected money launderers or terrorists. ACB will monitor these and other anti-money laundering regulations to ensure that they provide value to law enforcement and enhance our nation's security.

Recent anti-money laundering exams have placed renewed emphasis on suspicious activity reporting (SAR) and currency transaction reporting (CTR). In addition, FinCEN is evaluating the CTR exemption process because financial institutions are unnecessarily filing CTRs. ACB will work to ensure that regulatory enforcement of BSA reporting requirements does not unfairly burden community banks. As a member of FinCEN's CTR Exemption Committee, ACB will work to ensure that any changes to the exemption mechanism are consistent with community banking operations and are not unreasonably burdensome.

Contact for further information: Krista Shonk (202) 857-3187

Issue

Use of financial instruments to pay Internet gambling debts.

Position Statement

The government should not require banks to determine if a customer is attempting to pay an Internet gambling debt with a check, credit card, or other financial instrument. Banks should not be required to block such payments unless regulators or law enforcement authorities provide clear and specific instructions.

Explanation

H.R. 2143, sponsored by Rep. Spencer Bachus (R-AL), and passed in June of 2003in the 108th Congress, would require payments system operators to adopt policies and procedures designed to block Internet gambling transactions. Banks and other regulated institutions that comply with these policies and procedures would be deemed to be in compliance with the legislation. This appears to avoid requiring that banks independently determine whether or not a specific transaction is in violation. Given the vast daily volume and speed of the nation's payments system, it is virtually impossible for banks to determine with certainty the purpose of a given financial payment. Banks are not and should not become law enforcement and investigative agencies. The burden of identifying illegal transactions must fall on law enforcement officials. Therefore, banks should not be held liable for taking actions that are beyond their ability and expertise.

In August of 2003, the Senate Banking Committee reported out S. 627, an amended Internet gambling bill. Similar the House version, S. 627, requires payments system operators and banks to adopt and implement policies and procedures designed to block prohibited transactions. The bill is expected to pass the Senate in mid-2004.

ACB continues to believe that banks should comply with legal orders to block specific transactions or dealings with particular payees. These orders must clearly identify the transactions or payees so that banks will be able to reliably comply.

Contact for further information: Dan Berger (202) 857-5577

Issue

Treatment of independent contractors as an institution-affiliated party for enforcement purposes.

Position Statement

ACB supports retaining the standard that an independent contractor be found to have acted "knowingly or recklessly" before being prosecuted as an institution-related party.

Explanation

The law gives the federal banking agencies the power to assess civil money penalties of up to $1 million per day against institution-affiliated parties, e.g., a director, officer, employee, or controlling stockholder. The current standard enacted in FIRREA requires "knowingly or reckless" conduct on the part of outside attorneys and other independent contractors before these penalties apply to them. The FDIC has proposed legislation that would hold outside attorneys and other independent contractors liable in administrative actions to the same standard as bank insiders.

Congress expressly decided to treat independent contractors, such as attorneys, differently than others associated with financial institutions for a variety of important public policy reasons. First, attorneys do not have the same relationship to the insured institution as other insiders; they are not part of the management of the institution nor do they benefit from the institution's access to federally insured funds (which are guaranteed by the full faith and credit of the United States) to run their law firms. Second, Congress also recognized that attorneys were already accountable to the institution under applicable professional standards. Finally, there were concerns expressed that the lack of any meaningful scienter standard would subject an attorney's good faith advice to administrative enforcement actions unilaterally initiated by the federal banking agencies, thereby causing the most highly trained and capable professionals to decline to become associated with troubled institutions. These institutions typically are those with the greatest need for sound professional advice.

The current standard does not undermine in any way the ability of the FDIC to pursue monetary damages against independent contractors whose misconduct contribute to the failure of an insured institution. The record is clear that the civil judicial system has provided a meaningful forum for the FDIC to pursue aggressively remedies against independent contractors whose conduct is alleged to have harmed failed financial institutions. And in the most egregious cases, the agencies have not been reluctant to use their administrative enforcement authority to pursue claims as is currently provided for under existing law.

Contact for further information: Peter Hong (202) 857-3134

Issue

Designating the Office of Thrift Supervision as a consolidated financial regulator in the European Union.

Position Statement

ACB urges the European Commission to designate the OTS as a consolidated financial regulator under Directive 2002/87/EC.

Explanation

The OTS regulates some of the most diverse providers of financial services in the United States. Prior to 1999, the U.S. banking laws did not restrict financial or non-financial companies from owning and operating federal savings associations. Since 1999, any financial company can acquire a federal savings association. As a result, the OTS has a long track record of regulating across a broad spectrum of businesses, including securities firms and insurance and commercial companies, while working to ensure safe and sound operation of its regulated entities. Since the passage of the Gramm-Leach-Bliley Act, newly formed savings and loan companies have more restricted powers. Nevertheless, today, the federal savings association charter remains the most flexible and adaptive vehicle for delivering banking products and services to consumers and small businesses nationwide.

The OTS currently performs all of the functions (or substantially similar functions) contemplated by the Directive, including:

- Coordination of the gathering and dissemination of relevant or essential information in going concern and emergency situations;
- Assessment of compliance with the rules on capital adequacy and of risk concentration and intra-group transactions;
- Assessment of the financial conglomerate's structure, organization and internal control system; and
- Planning and coordination of supervisory activities in a going concern, as well as in emergency situations, in cooperation with the relevant competent authorities involved;

As a regulator, the OTS is uniquely suited among U.S. federal banking regulators to the role of supplementary supervision of financial conglomerates. For over 15 years, a wide variety of commercial, industrial and financial companies, including companies headquartered in the European Union, have been operating in the United States as savings and loan holding companies for savings associations. Given this history, ACB believes that the OTS has the necessary background to enable the agency to operate effectively as a consolidated financial regulator.

In addition, the OTS has approved and has been regulating a number of insurance companies and securities firms that established or acquired savings associations, thereby becoming holding companies. In particular, the regulatory approval process – and ongoing reporting requirements – directs the submission of financial, managerial and operational information and data. In addition, the OTS has a long history of working collaboratively with other regulatory bodies, including the U.S. Securities and Exchange Commission, the National Association of Securities Dealers, the Federal Reserve Board and state insurance regulators in forty-six of the United States.

Contact for further information: Michael Briggs (202) 857-3122, Charlotte Bahin (202) 857 3121

CONSUMER ISSUES

Issue

Customer Information Privacy.

Position Statement

ACB supports efforts to protect the nonpublic, personal information privacy of consumers of financial services. ACB supports public policies that properly balance the legitimate information sharing needs of a financial institution with the obligation to protect customer information privacy.

ACB strongly discourages Congress and state governments from placing any additional restrictions on the information sharing activities of financial institutions. ACB supports legislative efforts to delay or prohibit state governments from further restricting information sharing activities. (See *Credit Reporting/FCRA* on page 52.)

Explanation

Initial compliance with the 1999 financial privacy protection law was completed on July 1, 2001. ACB will work with its member institutions and regulatory authorities to ensure continued compliance with customer information privacy requirements.

ACB will focus its efforts on ensuring that legislative or regulatory action relating to customer information privacy: (1) does not put smaller community institutions at a competitive disadvantage vis a vis larger institutions; (2) gives financial institutions the necessary flexibility to conduct their current and future information sharing activities without undue interference; and (3) properly balances the legitimate information sharing needs of a financial institution with the goal of enhancing consumer privacy protection.

In 1999, as part of the Gramm-Leach-Bliley Act (GLBA), Congress passed the most sweeping law in American history to protect the privacy of consumers' financial information. The legislation requires each financial institution to disclose to its customers its privacy protection policy; gives a consumer the ability to prevent a financial institution from sharing his or her nonpublic information with nonaffiliated third parties (with some exceptions); prohibits the disclosure of account numbers or access codes to nonaffiliated third parties for marketing purposes; and bans the fraudulent practice of "pretext" calling. The law also requires that a study on financial information privacy, including the consequences of restricting information sharing activities between affiliated firms, be conducted. It also requires financial institutions to establish comprehensive information security programs for safeguarding customer records (the "501(b) standards").

GLBA also includes a potentially explosive provision, which could allow more onerous state privacy laws to preempt the federal statute. In order to avoid unintended consequences that could result from a patchwork of differing state laws, both Congress and the state governments should refrain from enacting new laws until the intended federal protections can be implemented and evaluated.

The 1999 privacy protection law is the latest in a collection of statutes and regulations providing broad protection for the financial privacy of consumers, including the Fair Credit Reporting Act, the Bank Secrecy Act, the Electronic Communication Privacy Act, and the Right to Financial Privacy Act.

In the 108th Congress, House Financial Institutions Subcommittee Chairman Spencer Bachus said his subcommittee will hold oversight hearings in 2004.

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Issue

Combating identity theft.

Position Statement

ACB supports reasonable implementation of the strong new identity theft protections provided by the Fair and Accurate Credit Transactions (FACT) Act of 2003 and the strengthening of the criminal penalties associated with identity theft. In addition, ACB supports the continuing efforts of government entities to develop educational materials to support identity theft victims and promote greater awareness of measures consumers can take to minimize the risk of becoming a victim.

Explanation

The FACT Act, enacted in 2003, created a strong, new, uniform federal standard for the prevention and combating of identity theft. Identity theft is broadly defined as the criminal takeover of another person's identity attributes (e.g., name, social security number, bank account numbers, etc.) for fraudulent financial gain. The rising number of identity theft cases reported each year in the United States wreaks havoc on victims and contributes to increasing costs banks must face in terms of monetary losses and fraud prevention investments. The FBI estimates that between 500,000 to 750,000 Americans become a victim of identity theft each year, with the losses in the hundreds of millions of dollars.

Legislation has been introduced in Congress to increase minimum sentencing standards judges would be required to impose in identity theft cases and to lessen the legal threshold in identity theft cases. By strengthening sentencing standards and making it easier for prosecutors to prove identity theft, Congress can help law enforcement target identity thieves and establish a legal framework that serves as an effective deterrent to this crime.

The banking regulators, Federal Trade Commission, other law enforcement agencies, and private sector entities have been actively working on education and outreach initiatives to help the victims of identity theft and to inform consumers of actions they can take to minimize the risk of becoming a victim. The FTC's identity theft web site provides a centralized source for information on prevention, victim assistance, legal resources, and other related information. Federal banking regulators have also stepped in to provide resources for consumers and banks to help combat identity theft. These resources have been an invaluable resource for educating customers, staff training, and helping customers who become a victim of identity theft. ACB supports and encourages the continuation of these initiatives and commits to support these efforts wherever possible.

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Issue

Strengthening the role of credit reports in our national system of credit by preserving Fair Credit Reporting Act (FCRA) preemption of state laws and ensuring credit report information is accurate.

Position Statement

ACB supports reasonable implementation of the Fair and Accurate Credit Transaction Act of 2003. Regulations and guidelines should minimize the potential compliance burden on community banks.

Explanation

On December 4, 2003, the President signed into law (PL 108-159), the "Fair and Accurate Credit Transactions Act of 2003. The new law:

- Permanently reauthorizes the uniform, national standards of the FCRA that were first established on a temporary basis in 1996. Among the areas governed by these standards are adverse action notices, circumstances under which credit-related information may be shared between affiliates, and procedures for consumers to dispute the accuracy of information on their credit reports and to remove or correct inaccurate or unverified information.
- Establishes a comprehensive, federal framework for preventing and combating identity theft, including the codification of current industry practices, such as fraud alerts;
- Requires that adverse action notices be provided when credit report information is used in connection with an application, grant, or extension of credit on "material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers" from or through a specific creditor;
- Provides consumers with access to a free, annual credit report and access to their credit scores;
- Imposes new duties on credit bureaus, furnishers of credit report information, and users of credit reports;
- Creates an opt-out requirement when credit report information is shared between affiliates to make a solicitation for marketing purposes; and
- Establishes a new Financial Literacy and Education Commission.

Both the Federal Trade Commission and the Federal Reserve are required to issue regulations implementing the changes made to the FCRA by the new law in 2004.

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Issue

Reforming the mortgage origination process.

Position Statement

ACB supports enhancement of a consumer's ability to shop for, obtain and understand the terms of a mortgage loan. ACB supports comprehensive reform of the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) developed after consultation with the industry and both HUD and the Federal Reserve Board. Such comprehensive reform should include a reasonable transition period. ACB also supports enabling the use of technology in the mortgage process and the removal of regulatory barriers to using technology.

ACB generally supports RESPA-TILA reform through the rulemaking process, rather than by Congressional action. Congressional action should be considered only in light of the results of the rulemaking process.

Explanation

Over the past five years, there have been a number of initiatives addressing possible reform of the mortgage settlement process. During 1998-1999, the ad hoc Mortgage Reform Working Group, made up of persons representing all aspects of the mortgage process, met for over a year with a goal of developing a proposal to update and reform the process. Among the proposals was the suggestion that the packaging and guaranteeing of mortgage settlement costs be mandated. While this group has not met since 1999, a major portion of the proposed regulation issued by HUD in 2002 to reform and simplify the mortgage process was a proposed guaranteed closing cost package. The concept of the package has become more popular as groups try to develop a less expensive, more efficient option for consumers.

In addition to the general mortgage reform debate, as a result of litigation, a number of related issues have been under discussion, including yield spread premiums, mortgage broker fees and referral fees. As a result of several court decisions during 2001, HUD issued an amended policy statement on mortgage broker payments and unearned fees. The Statement of Policy reaffirms HUD's position that yield spread premiums are not per se illegal, but that it is necessary to look at the two-pronged test established in the policy to determine the legality. The Statement of Policy also addressed the issue of unearned fees under RESPA Section 8(b). Court decisions in each of these issues generally have been resolved.

If the proposed regulation issued by HUD to reform RESPA is adopted, many of the remaining issues will be resolved. ACB filed a comment letter with HUD making the following points, and continues to work with HUD and other groups to reform the mortgage process in a manner that does not disrupt the mortgage origination business.

- ACB suggested that HUD divide the proposal into more manageable pieces, rather than issuing a final rule that would simultaneously change every aspect of the mortgage origination process. We suggested that HUD go forward with an amended Guaranteed Mortgage Package, but reconsider the proposed changes to the good faith estimate (GFE).
- While ACB supported the Guaranteed Mortgage Package, we suggested a number of amendments that must be made to ensure this alternative is truly viable for all lenders;
- ACB stated that the proposed changes to the GFE are not a workable option in the current form. We questioned HUD's authority to make some of the changes. We suggested that HUD delay these proposed changes and take the time to study the issue, including analysis of the legal authority that would permit such changes. We urged HUD to repropose this piece of the proposal after taking the comments into account.

- ACB suggested that HUD include a reasonable transition period in any changes that are made.
- There are a number of consumer protection laws that contain requirements that are duplicative of or conflict with the proposal. We suggested that HUD work with the other agencies, especially the Federal Reserve, to ensure that the requirements of other consumer protection laws are met and that the requirements are not in conflict.
- ACB suggested that HUD work with the federal banking agencies to ensure that supervision, examination and accounting concerns can be addressed without adversely affecting the ability of insured depositories to offer mortgage products.
- ACB stated that mortgage broker disclosures must be included in any final rule.
- ACB urged that any new forms be tested with consumers to ensure that they are understandable. ACB offered to work with our members and their customers to have them assist in HUD's testing effort. The testing should include education and a transition period.
- ACB urged that RESPA be enforced vigorously by HUD uniformly across affected institutions.
- ACB insisted that the secondary market housing government sponsored entities should not be permitted packagers.
- ACB urged that a strong emphasis on financial literacy must be included in any initiatives.

Since the close of the comment period, in October 2002, there have been a number of developments regarding the details of the guaranteed mortgage package. A dual package and a sub-package concept has been developed by certain industry groups and a number of groups stated opposition to the proposal during the second half of 2003. In November 2003, ACB formally reaffirmed support for the RESPA reform process and asked HUD to publish for an additional brief comment period any proposed revisions to the regulations that implement RESPA.

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Issue

Class-action litigation reform.

Position Statement

ACB supports legislation to reform class-action litigation to simplify removal of multi-state class actions from state to Federal court jurisdiction.

The legislation should also include language to clarify that savings associations operating in multiple states are – for purposes of federal court jurisdiction – citizens of the state where their home office is located.

Explanation

Many firms, including a number of financial institutions, have been subjected to class-action suits in state courts, even though many of the plaintiffs resided in more than one state. For example, Chase Manhattan Mortgage was sued for allegedly charging late fees to some borrowers. MassMutual was accused in a suit of failing to disclose adequately the fees that its policyholders would incur if they chose to pay their premiums on a monthly, quarterly or semiannual basis, instead of a yearly lump sum.

These suits typically benefit the plaintiffs' attorneys far more than the actual plaintiffs. The Bank of Boston was particularly egregious. There, escrow account holders received somewhat quicker access to their funds and received small awards. However, their accounts were docked over $91 each to pay the $8.5 million attorney's fees. In cases involving consumer goods, plaintiffs often receive coupons toward the purchase of additional products from the sued company.

Businesses believe that these kinds of abusive results would be less likely if the suits were removed to federal jurisdiction. The House passed a reform bill in 2003 and a compromise is pending in the Senate.

To make this legislation effective for multi-state federal savings associations, it should include language that ensures that they, like other multi-state corporations, are considered located in a specific state for diversity purposes. This is necessary because the courts have found that a federal savings association is a citizen of a single state only if the association's operations are localized in one state. Courts have decided that multi-state associations are citizens of any state where they do business, and so there is often no diversity of citizenship when they are sued. The language ACB recommends would provide that for purposes of diversity jurisdiction, a federal savings association is a citizen of the state in which it has its home office.

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Issue

Implementation of Community Reinvestment Act.

Position Statement

ACB believes it is appropriate to have a legal framework to guide financial institutions in community investment activities. ACB will continue to work with the Congress and regulators to ensure that the intent of the Community Reinvestment Act (CRA) is not lost in its implementation.

Beyond congressional oversight, ACB urges the regulators to accelerate their review of actual experience under the most recent revisions in CRA rules. ACB also requests the following areas of emphasis as part of that review process:

- Institutions of a billion dollars in assets or less should be eligible to use the small institution examination procedures;
- Incentives for both large and small institutions to achieve higher ratings;
- Reduction of burdensome recordkeeping requirements for all institutions;
- Acknowledgment of the use of alternative delivery systems by all institutions and a further acknowledgement of the role of technology in the fulfillment of CRA;
- An expansion of the degree of favorable consideration received by institutions for out-of-assessment-area provision of lending and other financial services; and
- Provision should be made for banks facing difficulty obtaining necessary CRA credit as a result of abnormal competition for CRA credits in their assessment areas.

Explanation

Fostering the economic health of communities is a legitimate goal about which there should be no debate. However, in striving to meet this goal, the development of new technologies, delivery systems, and methods of operation continue to present challenges for institutions and regulators alike. The current regulation implementing CRA is the subject of a comprehensive review that began with the issuance of an advance notice of proposed rulemaking in 2001. It is unclear at this point whether any changes suggested by the review will be proposed. Issues and questions continue to arise in the context of the application approval process for new institutions. More traditional institutions entering new lines of business or using new methods to conduct business also are challenging regulators with CRA questions.

In addition to requiring full disclosure of certain CRA agreements between institutions and community groups, the Gramm-Leach-Bliley Act limits CRA exam frequency for most institutions with assets of $250 million or less. While limitations on examination frequency are helpful, ACB welcomes a review of the current examination procedures and guidance as a means to critically assess the issues that are highlighted in a debate of Internet banking, nationwide operations, assessment area, expanded service offerings and other developments.

ACB is working with congressional staff and regulatory staff to develop a better understanding of the role ACB members play in community reinvestment, and to create effective incentives for CRA performance and to reduce the CRA regulatory burden.

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Issue

Retention of the ability to provide protection to customers who write checks on accounts with insufficient funds

Position Statement

ACB supports the ability of community banks to choose to provide overdraft protection for customers within a rational regulatory scheme that uses an optimal practices approach. ACB also supports efforts to fully inform and educate consumers regarding appropriate use of such services.

Explanation

Many community banks have made the decision to provide overdraft protection for their demand deposit accountholders. Some community banks that have these arrangements do not consider them to be programs in the sense that they do not market them to customers and they only pay checks at the institution's discretion. At many community banks, not every account or customer can count on benefiting from the arrangement. These arrangements are considered to be a customer service by the bank and the customer alike. The customer benefits because he/she does not have to pay a fee to the merchant and the bank's NSF fee, and he/she is not embarrassed by having the check returned.

In addition to these arrangements, there are several vendors that have developed more formal programs for community banks. These programs generally are marketed to customers.

As a result of inquiries from consumers and requests for opinions by companies that develop programs for community banks, the federal banking regulators have been looking at whether these arrangements should be covered by Truth in Lending and Regulation Z. There has been much discussion as to whether such an arrangement is a credit transaction. The OCC issued an Interpretive Letter in 2001outlining the compliance risks and responsibilities for national banks that offer these types of arrangements. In late 2002, the Federal Reserve, in a proposal that would amend Regulation Z, asked a question about these arrangements. As a result, hundreds of comment letters were submitted describing abusive programs that consumers believe the Federal Reserve should regulate.

The federal banking regulators have indicated that they are working on guidance for insured institutions to use in developing and implementing these arrangements and programs. Although the guidance has not been completed, it likely will not look at these arrangements as credit transactions requiring compliance with Regulation Z. It will cover a number of issues including consumer protection regulations and safety and soundness. In addition to the banking regulators, the Federal Trade Commission is looking at these programs as unfair and deceptive practices. Finally, the Federal Reserve is performing a top to bottom review of Regulation Z and it is likely that these programs and arrangements will be looked at.

Among the factors that ACB believes are important for community banks that offer overdraft protection programs are:

- Consumers must be given complete and accurate materials describing the program, its risks to the consumer, and fees involved;
- Educational materials about financial management must be available to consumers;
- Balance information on ATM screens and on balance inquiry documents must clearly indicate actual amounts on deposit;
- Supervisory concerns must be addressed within the institution's policy and the parameters of the program; and
- Compliance must be maintained with appropriate consumer protection laws and regulations.

ACB will provide input to the federal banking regulators on the practices of ACB members.

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Issue

National Standards for community banks that offer consumer financial services and lending across state lines

Position Statement

ACB continues to support the dual banking system, however, we support the ability of community banks to offer home mortgage loans and other financial products to consumers without having to comply with varying state and local requirements that may diminish the efficient provision of credit to consumers.

Explanation

As a result of improvements in technology, changes to the interstate branching laws and consolidation of the financial services industry, community banks to a greater extent are offering products and services across state lines. More and more banks are becoming regional or nationwide financial services providers. As this happens, variations in required state and local disclosures and compliance requirements may negatively impact the ability of community banks to offer an array of products or to do business in certain geographic areas. Further, the cost of products may be higher to the extent that multiple compliance requirements must be met. These additional costs will be borne by the consumer.

Community banks with a national charter, either national banks or federal savings associations, are able to rely, to varying degrees, on federal laws in their lending and other business lines. Federal savings associations are able to rely on a broader array of federal laws than national banks, but the OCC recently has issued regulations that may provide a uniform standard for national banks in the area of real estate lending. In each case, the OCC and the OTS have not issued regulations to create a national standard for specified state laws, including laws covering contracts, torts, foreclosures, bankruptcy and other laws that do not effect the bank's ability to lend or offer deposits.

Consumer advocates, state banking authorities and other state officials are concerned that a uniform national standard will not provide enough protection for the consumers in the state. It will be important for the federal banking agencies to provide a forum for consumer complaints and a mechanism for resolving the consumer concerns.

ACB has supported the OTS and the OCC in their efforts but we will work with state authorities to ensure that the value of the state bank charter is not diminished and that consumers are protected.

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REGULATORY BURDEN

Issue

Reduction of regulatory burden.

Position Statement

ACB strongly supports further efforts to reduce the regulatory burden on depository institutions, consistent with safety and soundness. Among the specific areas Congress should consider are:

- Easing restrictions on interstate banking and branching;
- Eliminating unnecessary branch applications;
- Clarifying examination authority for state-chartered banks operating on an interstate basis;
- Reducing regulatory costs for smaller institutions;
- Providing equitable treatment for institutions offering fiduciary services;
- Eliminating small business lending limits and increasing commercial lending authority for savings associations (see *Commercial and Small Business Lending Limits* on page 30);
- Reducing burdens to debt collection;
- Eliminating the special limit on the amount of "other purpose" loans for executive officers;
- Increasing the small-institution exemption under Depository Institutions Management Interlocks Act;
- Repealing overlapping rules governing purchased mortgage servicing rights;
- Permitting savings associations to invest in bank service companies;
- Eliminating geographic limits on savings association service companies;
- Removing limitation on investments in auto loans;
- Providing reimbursement for the production of records; and
- Amending certain parts of the Home Owners' Loan Act.

Explanation

ACB has suggested the following proposed specific components for regulatory relief legislation:

- Easing restrictions on interstate banking and branching.

Currently, national and state banks may only engage in de novo interstate branching if state law expressly permits. ACB recommends eliminating this restriction. The law should also clearly provide that state-chartered Federal Reserve member banks may establish de novo interstate branches under the same terms and conditions applicable to national banks. ACB recommends that Congress eliminate states' authority to prohibit an out-of-state bank or bank holding company from acquiring an in-state bank that has not existed for at least five years. The new branching rights should not be available to newly acquired or chartered industrial loan companies with commercial parents (those that derive more than 15% of revenues from non-financial activities).

- Eliminating unnecessary branch applications.

Various application procedures could be eliminated or replaced with expedited notification requirements. Many of the application requirements have been replaced with notification requirements in some areas, but many current application requirements remain untouched (e.g., branch applications).

- Clarifying examination authority for state-chartered banks operating on an interstate basis.
- ACB recommends that Congress clarify home- and host-state authority for state-chartered banks operating on an interstate basis. This would reduce the regulatory burden on those banks by making clear that a

chartering state bank supervisor is the principal state point of contact for safety and soundness supervision and how supervisory fees may be assessed. Reducing regulatory costs for smaller institutions.

ACB supports measures to reduce the regulatory costs and fees for well-run community banks, particularly for examinations. This will be especially important as the Office of the Comptroller of the Currency and the Office of Thrift Supervision consider increased fees to offset reduced revenues.

- Providing equitable treatment for institutions offering fiduciary services.

ACB will work to ensure that mandated, new exemptions to the broker-dealer registration requirements of the Securities Exchange Act of 1934 cover all insured depository institutions.

ACB supports legislative amendments to the Investment Advisers Act, in addition to any administrative relief, to ensure that savings associations can offer their customers fiduciary products and services, including trust and security products, under the same rules that apply to banks.

- Reducing burdens to debt collection.

Section 809 of the Fair Debt Collection Practices Act (FDCPA) requires a debt collector to communicate to a debtor that he or she has 30 days in which to notify the collector that the debtor disputes the debt, and that upon such notice the collector will verify the debt. The FDCPA should be revised to clarify that until the debt collector receives such notification from the debtor, the debt collector may continue to attempt to collect the debt.

A debt collector's activities should not be put on hold while waiting for up to 30 days for a debtor's decision whether to dispute the debt. During this time, valuable assets which may be sufficient to satisfy the debt may vanish.

Section 807 of the FDCPA requires a debt collector to issue a "mini-Miranda" warning when it begins to attempt to collect a debt. This alerts the borrower that his debt has been turned over to a debt collector. However, the requirement also applies in cases where a mortgage servicer purchases a pool of mortgages that include delinquent loans. This is not appropriate, since a mortgage servicer will have an ongoing relationship with the borrower. This contrasts with the case of a debt collector whose aim is to quickly collect an individual debt and move on to the next case. Therefore, the formal warning should be eliminated for mortgage servicers.

- Loans to officers.

Amend Section 22(g) of the Federal Reserve Act by eliminating the special limit on the amount of "other purpose" loans (i.e., loans other than home loans, education loans for the officer's children and certain secured loans) now provided in Section 22(g)(4) by regulation which is contained as a $100,000 limit in Section 215.5(c)(4) of Regulation O. Only executive officer loans are so limited. Loans to other insiders (i.e., directors, principal shareholders and the related interests of executive officers, directors and principal shareholders) are simply based on the loans-to-one borrower limit.

- Increasing the small-institution exemption under Depository Institutions Management Interlocks Act.

The Depository Institutions Management Interlocks Act prohibits depository organizations from having interlocking management officials, if the depositories are located or have an affiliate located in the same metropolitan statistical area, primary metropolitan statistical area, or consolidated metropolitan statistical area. This statutory prohibition does not apply to depository organizations that have less than $20 million in assets. This section increases the exemption limit to $100 million in assets.

- Repealing overlapping rules governing purchased mortgage servicing rights.

ACB recommends that Congress eliminate the 90-percent-of-fair-value cap on valuation of purchased mortgage servicing rights. Eliminating this arbitrary cap would permit PMSRs to be valued up to 100 percent for certain capital and leverage purposes. The banking agencies would have to find that doing so would not adversely affect the insurance funds or the safety and soundness of insured institutions.

- Permitting savings associations to invest in bank service companies.

The Bank Service Company Act permits national and state banks to invest in companies that may provide clerical, administrative and other services that are closely related to banking to depository institutions. The law should be updated to include savings associations in this investment authority.

- Eliminating geographic limits on savings association service companies.

Currently, savings associations may only invest in savings association service companies in their home state. They should be permitted to invest in those companies without regard to the current geographic restrictions.

- Removing limitation on investments in auto loans

Federal savings associations are currently limited in making auto loans to 35 percent of total assets. Removing this limitation will expand consumer choice by allowing savings associations to allocate additional capacity to this important segment of the lending market.

- Providing reimbursement for the production of records.

The Right to Financial Privacy Act (RFPA) provides that the government will reimburse banks for the cost of assembling and providing records of individual bank customers the government is investigating. This should be extended to corporate bank customers. If necessary, the RFPA should be clarified to ensure that records provided pursuant to the USA PATRIOT Act are covered.

The following are some of the amendments to the Home Owners' Loan and Act and authority of savings associations that ACB supports:

- Streamlining the notification process for savings associations engaging in new activities in operating subsidiaries.

Current law requires all savings institutions to give the Federal Deposit Insurance Corporation and the Office of Thrift Supervision thirty days notice prior to establishing or acquiring a subsidiary or conducting a new activity in an existing subsidiary. ACB supports eliminating the requirement that savings associations provide this notice to the FDIC. It is duplicative and unnecessary for safety and soundness purposes.

- Providing parity for savings associations acting as agents for affiliated depository institutions

This recommendation provides savings associations the same authority that banks have under section 18(r) of the Federal Deposit Insurance Act to act as agents for their affiliated depository institutions.

- Updating the authority for savings associations' community development investments.

Unlike national banks and state member banks, which are specifically authorized by statute to make direct equity investments in entities such as community development corporations (CDCs), there is no parallel statutory authority for federal savings associations. This means that an association that wants to invest in a CDC must do so through a service corporation. Many savings associations do not have a service corporation, which limits their ability to fully serve their low- and moderate-income communities.

A CDC is a corporation established by one or more insured depository institutions, sometimes in concert with other investors, to benefit low- and moderate-income individuals or areas, or other areas targeted for

redevelopment by the local, state, or federal government.

ACB supports authorizing federal savings associations to invest in community development entities such as CDCs to the same extent as national banks. The aggregate investment limits in these entities for federal savings associations would be the same as currently apply to national banks.

- Exempting well-capitalized savings associations from dividend notice restrictions.

Current law requires savings associations in savings and loan holding companies to give the OTS thirty-day's notice before declaring a dividend in order to allow the OTS to consider whether the dividend will impair the safety and soundness of the savings association. The notice period, in addition to capital-based dividend restrictions, imposes a compliance burden without a regulatory benefit when applied to well-capitalized institutions.

ACB supports exempting savings associations that are well-capitalized and will remain well-capitalized after the payment of the dividend. This will allow well-capitalized savings associations to conduct routine business without regularly conferring with the OTS.

- Helping to prevent savings and loan holding company "fire sales."

If a company becomes a multiple savings and loan holding company, it has a two-year period to divest non-conforming activities under current law. This is inconsistent with the ten-year divestiture period for non-conforming activities that applies to companies seeking to become financial holding companies under the Gramm-Leach-Bliley Act.

ACB supports language that provides unitary holding companies that become multiple holding companies with the same ten-year divestiture period that applies under the Gramm-Leach-Bliley Act. This change will ensure that divestitures do not occur at "fire sales" prices.

- Clarifying rules governing interstate acquisitions by savings and loan holding companies with operations in multiple states.

Subject to specific exemptions, current law prohibits a savings and loan holding company from acquiring a savings association if such acquisition would cause the holding company to become a multiple savings and loan holding company controlling savings associations in more than one state.

ACB supports language permitting interstate acquisitions by savings and loan holding companies under the same rules that apply to bank holding companies under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

- Providing for the qualified thrift lender requirement to apply to an association's multi-state operations as a whole.

Under current law, Federal savings associations must meet the qualified thrift lender (QTL) test both as an entity operating regionally or nationally and in each state where there are branches. ACB recommends eliminating the requirement to meet the QTL test on a state-by-state basis. This better reflects the business operations of savings associations operating in more than one state.

- Loans-to-one-borrower (LTOB) domestic residential housing unit development exception.

Savings associations regulated by the OTS have access to a LTOB residential housing development exception in the Home Owners' Loan Act [12 USC 1464(u)(2)]. However, the $500,000 per unit limit in this exception frustrates the goal of advancing residential development within an overall limit – the lesser of $30 million or 30 percent of capital. This overall limit is sufficient to prevent concentrated lending to one borrower/housing developer. The $500,000 per unit limit should be eliminated because it is an excessive regulatory detail that creates an artificial market limit in high price areas.

- Statutory limit on commercial real estate lending.

  Savings associations regulated by the Office of Thrift Supervision are not permitted to hold loans secured by non-residential real property in amounts exceeding 400 percent of the association's capital, unless permitted by the OTS Director. In practice, such exceptions have been rare. Institutions with expertise in non-residential real property lending generally have the ability to operate in a safe and sound manner, and consistent with prudent operating practices, should be allowed to have loan concentrations exceeding the statutory limit. The current statutory limit should be increased, and/or the OTS should be directed to establish practical guidelines for non-residential real property lending at levels exceeding 400 percent of capital.

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Issue

Reducing the regulatory burden.

Position Statement

ACB strongly supports efforts to reduce the regulatory burden without impairing the safety and soundness of institutions.

Explanation

Since the mid 1990's, the federal banking agencies have had several regulatory burden projects underway. At the same time, Congress has enacted a number of laws that have increased the regulatory burden on insured depositories without eliminating other regulations. The Gramm-Leach-Bliley Act of 1999 imposed substantial rulemaking responsibilities on the federal banking agencies, other federal agencies, including the FTC, Treasury, and SEC, and the state banking and insurance regulators. Regulations were promulgated in the areas of CRA, privacy, FHLBank System modernization, and sales and underwriting of securities, insurance, and new financial products. In some areas, the regulations continue to be developed. Moreover, substantial revisions to existing application and disclosure requirements have been necessary. In 2001, Congress enacted the USA PATRIOT Act and in 2002, Congress enacted the Sarbanes Oxley Act of 2002. Each of these statutes imposed significant additional burdens on insured institutions in the areas of Bank Secrecy Act compliance and corporate governance.

During 2002, the Chairman of the FDIC announced a regulatory burden relief project. In mid 2003, the project began in earnest. Required in 1996 by the Economic Growth and Paperwork Reduction Act (EGPRA), the federal banking agencies must review all applicable regulations every ten years. The FDIC's Vice Chairman John Reich has taken the lead on this project, but all of the banking agencies are working together. During the summer and fall of 2003, five outreach sessions were held with bankers to get ideas about what regulations can be eliminated. Outreach sessions also were held with consumers.

The agencies have divided all of the regulations affecting insured depository institution into 12 categories and are issuing one category every six months for a 90-day comment period. In addition, as part of the project, the FDIC has established an EGPRA Web site on which insured institutions can provide input or request regulatory changes that would result in regulatory burden relief. The comments of bankers and others at the outreach sessions can be viewed on the EGPRA Web site. ACB is working with the federal banking agencies and ACB members to provide input to the agencies.

A number of ideas for regulatory burden relief that resulted from the outreach sessions are changes that must be made by legislation. While ACB seeks additional legislative changes, ACB will seek reductions in regulatory burden through the agencies in the following areas:

- Regulations that provide less burdensome requirements for well-performing institutions and a reasonable "economies of scale" balance for small institutions;
- Providing an annual summary by each agency of approvals and denials of new powers and activities acted upon through the application process or by legal opinion;
- Urging a careful cost/benefit analysis by any agency whenever it promulgates a regulation , taking full account of the different sizes and complexities of institutions in doing such analysis;
- Amending the definition of "savings deposit" in Regulation D to allow for an expanded number of transfers;
- Creation of an OTS safe harbor regulation similar to that available for banks addressing premiums on demand accounts, i.e., the $10/$20 de minimis rule;

- Standardization of the definition of credit "application" in consumer protection regulations;
- Uniformity of record retention requirements in consumer protection regulations;
- Liberalization of the ability to waive the right of rescission under Regulation Z (Truth in Lending Act);
- Reduction in examination fees for CAMELS 1-rated small institutions (less than $100 million in assets); and
- Streamlining the CTR and SAR reporting requirements of the Bank Secrecy Act and the Patriot Act.

As the agencies continue to implement Gramm-Leach-Bliley, the Patriot Act and Sarbanes Oxley, ACB will continue to work to reduce the regulatory burden of compliance with these laws. In addition ACB looks at every regulatory proposal with a view to reducing the overall regulatory burden on community banks.

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Issue

FDIC examination fees for state non-member banks.

Position Statement

State banks should not have to pay the cost of their FDIC examinations. The FDIC should not be required to subsidize the operating costs of the Office of the Comptroller of the Currency (OCC) or the Office of Thrift Supervision.

Explanation

The FDIC currently does not charge for the examinations it performs on state non-member banks, the institutions for which it is the primary federal regulator. A number of recent Administration budgets submitted to Congress have included the imposition of FDIC exam fees for state-chartered institutions. ACB, the Conference of State Bank Supervisors, and other banking trade groups have successfully resisted these efforts.

Examination fees will not increase safety and soundness. State examiners already conduct thorough evaluations of institutions. These fees will, however, increase costs and encourage unnecessary or duplicative examinations. Further, the new fees will reduce funds available for lending to local communities and will tilt the dual state/federal system of bank regulation further toward federal domination by increasing the relative appeal of a national bank charter.

The House and Senate committees of jurisdiction have repeatedly rejected the exam fee proposal and substituted for it other sources of revenue. The Administration's 2004 budget did not include the proposal. However, ACB will remain vigilant.

The OCC has recommended that the FDIC be required to subsidize OCC's operating expenses. This would create an inequity between federal and state charters, because state chartering agencies would not receive a comparable subsidy. The proposal would also remove a valuable discipline that now helps to limit agency costs.

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Issue

Uniform Call Reports for banks and savings associations.

Position Statement

ACB supports the development of an online, streamlined Consolidated Report of Condition and Income (Call Report) for banks and savings associations. The required reporting items should be uniform for all insured depository institutions and should only include the items necessary for agency supervisory purposes and industry peer-group analysis.

Explanation

The federal banking agencies are developing a common core Call Report for banks and savings associations, as required by the American Home Ownership and Economic Opportunity Act of 2000. The agencies have issued a number of changes to the Call Report that will help in the adoption of a uniform form. ACB will urge the agencies to postpone considering new line items until the core report project is completed. ACB's committees will help ACB to determine the extent to which a proposed core report would actually reduce the regulatory burden.

ACB supports the development of a Call Report filing system that will be accessible in real time. Currently, the FDIC, the Federal Reserve, and the OCC are overhauling the procedures and data systems used to file Call Reports to create an online, real time central data repository that will enable banks and regulators to prepare, publish and exchange financial information more efficiently. Ultimately, Call Report data are expected to be released two weeks earlier, enabling bankers, regulators and investors to respond more quickly and more accurately to business environments and risks.

To involve the banking industry in the Call Report modernization project, the FDIC, Federal Reserve, and the OCC have formed an industry focus group and will conduct a pilot program this year. As a member of the focus group, ACB will work to ensure that any new Call Report filing mechanisms are not overly burdensome for community banks. The new Call Report system is scheduled to launch during the fourth quarter of 2004.

Currently, the OTS is not participating in the interagency working group. There should be parity in the reporting requirements and processing among the banking regulators, and ACB will encourage the OTS to join the current interagency project or modernize the Thrift Financial Report (TFR) independently.

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Issue

Resolution of the goodwill cases.

Position Statement

ACB supports a timely resolution to the pending goodwill cases.

Explanation

In 1996, in *United States v. Winstar*, the Supreme Court found that the government had entered into contracts with three acquirers of troubled savings associations and that the government had agreed that the goodwill arising from the transactions could count toward regulatory capital. The Supreme Court found that the contracts were breached in 1989, when FIRREA precluded the regulatory capital treatment of goodwill. The Court sent the acquirers back to the U.S. Court of Federal Claims to determine damages.

Since the Winstar decision, there has been little activity in most of the remaining Winstar-related cases. No other plaintiff in the related cases has collected any damages and several have settled. In mid-January 2002, the Supreme Court denied certiorari of the California Federal petition seeking a review of whether the court of appeals erred in affirming the trial court's denial of CalFed's claim for restitution and the trial court's calculation of CalFed's capital replacement costs.

There are over 100 related cases and the plaintiffs have formed a committee. ACB will work with interested members to identify an appropriate strategy to urge the Department of Justice to help the cases move forward, and urge Congress to ensure that money is appropriated and paid.

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Issue

Banking agency regulations no longer reflect market practice for collateral evaluations.

Position Statement

ACB supports amendment and clarification of the appraisal regulations of the federal banking agencies to reflect better the market practice for collateral evaluations for real estate-related financial transactions.

Explanation

The uniform federal banking regulations require all real property appraisals to be in writing and to conform to certain minimum requirements. These regulations were amended in 1994 to increase the exception for *de minimus* transactions to $250,000 for one-unit residential properties. That same year, the GSE conforming loan limit stood at $202,300 for these types of properties. Since then, the maximum conforming loan purchase amount for one-unit properties has increased more than $130,000 to $333,700 while the exemption threshold has remained unchanged. As a result, there is a significant difference between loans that may be purchased in the secondary market and loans that are exempted from the appraisal requirements.

ACB has submitted a request to each of the banking agencies that they amend the appraisal regulations to raise the threshold over which a licensed or certified appraiser must be used to be the same as the GSE conforming loan limit. An interagency group is looking at the issue. The agencies issued guidance that clarified that if the transaction involves a residential real estate transaction in which the appraisal conforms to the Freddie Mac or Fannie Mae appraisal standards applicable to that category of real estate, it is exempt from the appraisal regulation. For this type of transaction, the threshold would not apply. ACB will continue to work with the agencies.

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Issue

Strengthening the Deposit Insurance System.

Position Statement

Congress should focus on these high priority reforms:

- **Merging the Funds.** Merging the Bank Insurance Fund and the Savings Association Insurance Fund;
- **Authorizing a Free-Rider Fee.** Providing the FDIC with authority to impose a special fee on free riders that grow at rates that substantially exceed the norm and significantly dilute the reserve ratio;
- **Providing Flexibility to Manage the Fund.** Providing the FDIC flexibility to manage the fund within a range and eliminating the requirement that the FDIC impose a minimum premium; and
- **Providing for Rebates.** Providing for rebates when the fund reaches specific levels.

Debate on other reforms should not delay action on these issues. ACB takes the following positions on other reform issues:

- **Premiums.** Retain the current prohibition on imposing premiums on highly rated banks so long as the fund remains above the 1.25 percent level;
- **General Coverage.** Index the $100,000 general coverage level for inflation going forward;
- **Retirement Accounts.** Increase coverage for retirement accounts;
- **Municipal Deposits.** Do not include any special increase (above general coverage levels); and
- **Credits.** Provide a one-time assessment credit (based on the deposit base on December 31, 1996) and ongoing credits.

Explanation

Congress should promptly merge the funds, provide for an excessive-growth premium on free riders, and eliminate the mandatory premium now required if a fund is expected to remain below 1.25 percent of insured deposits for a year. These three reforms make up H.R. 1293, introduced by Representatives Bob Ney (R-OH) and Stephanie Tubbs-Jones (D-OH) in the 107th Congress. Continuing growth in BIF and SAIF balances makes it increasingly important for Congress to restore the FDIC's ability to provide rebates.

Both the House-passed reform bill (H.R. 3717) and a bill introduced by Sen. Tim Johnson (D-S.D.) (S. 1945) – each from the 107th Congress – would have merged the funds and eliminated the 23 basis-point minimum premium. However, neither bill gave the FDIC authority to impose special premiums on future free riders. House leaders eliminated free-rider language just before the House passed the bill.

Excessive deposit growth fueled by free riders undermines the federal deposit insurance system. Free riders can add an unlimited amount of insured deposits to the system at any time by shifting funds from uninsured accounts into banks that they control. This lowers the reserve ratio even if the absolute amount of money in the fund stays the same or even if it grows modestly through earnings. Therefore, ACB believes Congress should authorize the FDIC to assess growth-related premiums on rapidly growing institutions that materially dilute the reserve ratio. These premiums would avoid dilution of the fund and prevent the imposition of unnecessary premiums on other institutions.

It is not necessary to impose special growth premiums on smaller de novo institutions. First, they add little in absolute dollar terms to the insured deposit base, even if their growth is very rapid. Second, public policy should encourage the establishment of de novo institutions. Third, the FDIC already imposes a risk-based premium on these institutions, providing income to the fund.

A merged fund is the most actuarially sound approach to insuring deposits and the most effective way to protect taxpayers from future exposure. The merger will prevent the recurrence of a disruptive disparity between premiums charged by the BIF and the SAIF.

Current law requires the FDIC to impose a mandatory premium if a fund falls below 1.25 percent and is expected to remain there for a year or more. The premium would have to be sufficient to return the fund to 1.25 percent – up to 23 basis points. This would come at the worst possible time, when the industry is under financial pressure and the economy is weak. The FDIC should be able to manage the fund within a range and spread any recapitalization over a reasonable period.

Under current law, the FDIC may not charge premiums if the fund is above the 1.25 percent reserve ratio, except on "institutions that exhibit financial, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory, or are not well capitalized…." ACB believes that the vast majority of banks have already paid substantial premiums and the strongest – by definition – impose an extremely small risk to the fund. However, both H.R. 3717 and S. 1945 would allow the FDIC to impose a premium on all institutions. ACB opposes these provisions, though we recognize that the one-basis-point cap for the strongest institutions included in the House bill is preferable to the open-ended authority in S. 1945. It should be noted that far fewer institutions would benefit from the House bill's cap than are exempt from premiums under current law.

As the nation's economy emerges from its recession, the deposit insurance funds are likely to continue to grow. Current law does not provide for rebates, making it possible that the funds could reach excessive levels. ACB prefers the mandatory rebate system in H.R. 3717. This will more reliably ensure that resources not needed for reasonably foreseeable deposit insurance purposes will not remain in Washington. Banks and savings institutions will be able to deploy them in local communities for home lending, business development, and consumer needs.

The proposed increase in general coverage to $130,000 – included in H.R. 3717 and S. 1945 – has drawn considerable opposition among policy makers who fear it will unduly increase risk. ACB members are concerned that an immediate increase in general coverage levels will require substantial premiums while not providing a meaningful benefit to community banks. The controversy over an immediate general coverage increase contributed substantially to the Senate Banking Committee's inability to act on its bill. Indexing for future inflation does enjoy more support, though the Federal Reserve opposes any increase in coverage in the foreseeable future.

Substantially increasing retirement account coverage retains strong support as a way to further encourage and protect personal retirement savings. Policy makers realize that the shift in retirement funding from defined benefit plans to IRA and 401(k)-type savings has increased the burden on individuals to manage their own assets. Retirement assets often exceed the current $100,000 coverage limit by substantial amounts.

Both the House bill and Sen. Johnson's bill provided for substantial increases in municipal account coverage. Increasing coverage for these accounts would substantially increase the amount of insured deposits and require a costly increase in premiums. Because each state's municipal cash management system is different, increased coverage is not useful in many states. However, banks in all states would have to pay increased premiums to cover additional municipal deposits.

Both H.R. 3717 and S.1945 provided for a one-time assessment credit based on each institution's deposit base on December 31, 1996. This would provide institutions that paid substantial premiums in the early and mid 1990s some recognition for their past contribution. The FDIC would also have discretion to provide additional assessment credit in the future that would be based on previous premium payments. While each of these provisions are potentially beneficial, they only fractionally compensate institutions for the costs that could be imposed by future free riders. It will still be necessary to deal with this problem directly by allowing the FDIC to impose a premium on those institutions.

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Issue

Electronic communications with customers and other businesses.

Position Statement

ACB opposes any provisions in law or regulation concerning electronic communications for advertisement or other purposes that impede the ability of community banks to have appropriate contact with customers or other businesses. This would apply to all existing and future commercial telemarketing restrictions that unfairly limit telephone calls, facsimiles, and e-mails.

ACB specifically opposes the FCC unsolicited facsimile advertisement rules ("do not fax rules") that are scheduled to take effect on January 1, 2005 because they would significantly disrupt the manner in which financial institutions conduct their mortgage and other lending businesses by eliminating the established business relationship ("EBR") exception and imposing burdensome changes to the available methods by which financial institutions handle the processing of various loan information and loan document requests.

Explanation

Several new laws and regulations have been promulgated recently, which are intended to protect consumers from unwanted or fraudulent electronic advertising communications. These include:

- FCC and FTC regulations that govern the National Do-Not-Call Registry, which became effective on October 1, 2003;
- The unsolicited fax rules, which were part of the broader regulatory package of rules implementing the FCC's National Do-Not-Call Registry rules; and
- The Can-Spam Act of 2003.

In 2003, the FCC issued a final rule reversing a long-standing position on the treatment of fax solicitations under the Telephone Consumer Protection Act (TCPA). For many years the FCC interpreted the TCPA to provide that fax solicitations could be sent if there was an "established business relationship" with the recipient. In a final rule issued in 2003, the FCC eliminated the EBR exception and required that senders of fax solicitations have express, written consent from the recipients. Concern from the business community resulted in the FCC postponing the implementation of the new rule until January 2005.

Additionally, the unsolicited fax rules were part of a broader regulatory package of rules implementing the FCC's new National Do-Not-Call Registry. These rules redefined the FCC's definition of EBR to impose specific time limits on the duration of established business relationships. Previously, the definition of EBR was more lenient and allowed most interactions with customers via facsimile to constitute an EBR.

The changes to the EBR made by the FCC that apply to telephone solicitation should not apply to faxes. ACB will seek regulation or legislation to reinstate the "established business relationship" exception that existed prior to the recent FCC action. ACB will continue to urge the FCC to make clear that its unsolicited facsimile requirements supercede and preempt any inconsistent state and local rules.

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Issue

Reform of the U.S. Postal Service.

Position Statement

ACB supports Congressional efforts to reform the U.S. Postal Service. In particular, ACB supports proposals to allow the Postal Service to continue to use amounts saved from a reduction in retirement payments to reduce its debt to the Treasury and help keep postage rates down. ACB also supports proposals to relieve the Postal Service of the obligation to pay retirement benefits of postal employees that were earned through military service. ACB opposes any proposal that would allow or encourage the Postal Service to offer services in competition with private-sector financial services firms or to discriminate among customers on the basis of size, volume, or location.

Explanation

Despite advances in electronic delivery of financial services, the financial services industry remains a major customer of the Postal Service. Postal costs are a major expense for community banks and they depend on a healthy and reliable Postal Service to serve their customers.

The Postal Civil Service Retirement System Funding Reform Act (PL 108-18) allows the Postal Service to use savings it realized from the elimination of retirement overpayments to reduce financial pressures that could lead to increased rates. However, the Act requires the Service to hold these funds in an escrow account after 2005. Congress should repeal this escrow requirement. Congress should also address the fact that the Postal Service now must pay military service benefits earned by postal employees before they joined the Postal Service. These costs should be borne by the Treasury, not the Postal Service.

Congress is considering a number of other reforms to the operation of the Postal Service to increase its flexibility in the face of increase competitive pressure from other forms of communication. These reforms include enhanced pricing flexibility, a more businesslike corporate governance structure, outsourcing of functions that can be more efficiently provided by the private sector, and infrastructure improvements.

ACB will examine proposals in these areas to ensure that they do not permit or encourage the Postal Service to compete with private-sector financial services firms. ACB will also work to ensure that reform proposals do not allow or encourage the Postal Service to impose higher costs on small community banks, community banks that generate relatively light mail volume, or community banks located in relatively remote locations.

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ACCOUNTING

Issue

Loan Loss Reserves

Position Statement

Within the provisions of GAAP accounting and the asset classification standards of the federal bank regulatory agencies, depository institutions and their holding companies must be able to establish and maintain an adequate level of loss reserves that take into account not only a bank's historical experience but also current economic conditions.

Explanation

Adequate loss reserves are needed to protect the capital of insured depositories and the federal deposit insurance funds from undue exposure to charge offs that cannot be accommodated by a financial institution's general loan loss reserves. A proposed standard promulgated by the AICPA would negatively affect the ability of financial institutions to set aside sufficient loan loss reserves for "expected losses."

A task force of the Accounting Standards Executive Committee (AcSEC) of the AICPA issued a proposed Statement of Position (SOP) on June 19, 2003 that was intended to provide guidance under FASB Statements 5 and 114 on the reserve for loan losses. The proposed date of implementation for the Proposed SOP provisions of December 15, 2003, is expected to be delayed for an unspecified period of time.

Under the proposed SOP, the allowance for credit losses would include only those losses on loans that are impaired. The allowance would have only two components – one for individual loan impairments and one for impairments covering pools of loans. A key provision of the proposed SOP is that calculations of the allowance be supported by relevant "observable data" and that the allowance should be measured based on the present value of expected future cash flows. To replace a prior practice of determining losses over the life of the loan, the proposed SOP introduces the concept of a "loan confirmation period."

ACB submitted a letter strongly opposing the proposed SOP. In its letter, ACB stated that the establishment of an appropriate loan loss reserve is an "art" and not a "science." ACB argued that if the proposed SOP is implemented as currently written, the negative effects will include excess volatility in allocated reserves and earnings, incorrectly determined levels of reserves, and an inability of banks, especially smaller banks, to respond in a timely manner to economic cycles.

In addition to ACB's comment letter, the AICPA has received over 300 comment letters on the proposed SOP from other interested parties. Included in the comment letters was a joint letter from the federal banking regulatory agencies. In their letter to AICPA, the agencies called the proposal fundamentally flawed and unclear. They charged that, if implemented, the proposed SOP would cause financial institutions to regress from using modern credit risk management practices in determining the appropriate level of their loan loss allowances, cause financial institutions to maintain their allowance at inappropriate levels, overly constrain the use of expert credit judgment and "unallocated" amounts and imply an artificial degree of precision in the loan loss determination process, and that the proposal would introduce a new and unworkable concept of a "loan confirmation period."

Beginning in mid-December 2003, the AICPA began reviewing the comment letters. Because of the volume of comments, as well as the importance of this issue, the AICPA anticipates that the timetable for the implementation of the proposed SOP will be delayed considerably.

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Issue

Fair Value Accounting.

Position Statement

ACB opposes the adoption of any valuation method for customer loans or deposits which does not consider the full value of the customer relationship and fails to provide objective, reliable and comparable measurements. ACB also opposes any fair value measurement method which negatively affects regulatory capital levels and ratios. Any additional role for fair value measurements should be confined to footnote disclosures to the basic financial statements.

Explanation

At the August 27, 2003 Board meeting, the FASB decided to clarify certain aspects of the guidance for using present value to estimate fair value. FASB Concept 7 (CON 7) will be carried forward in a Fair Value Statement, for which an exposure document is scheduled to be issued in the second quarter of 2004. The Board decided to refer to the *expected cash flow approach* in CON 7 as an *expected present value approach*. Also, the Board decided to refer to the *traditional approach* in CON 7 as a *discount rate adjustment approach* (present value technique). This builds on the FASB's decision of June 2003 to add a separate fair value measurement project to its agenda.

Prior to that decision, on December 14, 1999, FASB had issued its "Preliminary Views" document on fair value (this document is the equivalent of an Advance Notice of Proposed Rulemaking by a regulatory agency). All financial instruments would be included in the scope of the new valuation standard described in this document. The FASB has stated that it is committed to resolving, in a timely manner, the conceptual and practical issues related to determining the fair values of financial instruments. It has already addressed fair value accounting, at least to some extent, in certain debt and equity securities, hedge related instruments, assets to be sold or otherwise disposed of, and certain impaired assets. The preliminary views document includes the two most important balance sheet accounts for financial institutions – loans and deposits.

Both loans and deposits include (1) elements of somewhat-predictable cash flows (realizing that the valuation of embedded options remains troublesome), as well as (2) intangible elements related to customer relationships. Both loans and deposits and their inherent relationships are fluid in a very complex relationship to global and local economic conditions. The complexity of the relationships between financial institutions and their customers may make it impossible to develop a simple, reliably reproducible methodology that can enhance the usefulness and comparability of financial statements.

In its testimony on the preliminary views, ACB expressed a concern that the intellectual and conceptual problems involved in measuring the fair value of customer relationships may result in loans and deposits being valued solely on the basis of the present value of estimated cash flows. ACB stated that such an approach would be incomplete, misleading and not indicative of the actual value of an institution's account bases. Later, ACB reiterated its position in a comment letter to FASB dated June 28, 2001, in response to the Joint Working Group of Standards Setters Special Report, which outlined Draft Standards.

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Issue

Accounting for Hedging and Derivatives and the Impact on Regulatory Capital (FASB Statements No. 133, "Accounting for Derivatives and Similar Financial Instruments and for Hedging Activities," and No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" and their interaction with evolving regulatory capital adequacy requirements).

Position Statement

ACB urges the federal banking regulators to permit – consistent with safety and soundness – the appropriate treatment for regulatory capital purposes to deal with adverse changes forced by revisions to GAAP for derivatives and hedging.

Explanation

FAS 133, as issued on June 6, 1998, was originally scheduled to take effect for entities whose fiscal years began after June 15, 1999 (January 1, 2000 for calendar year entities). The FASB then deferred the effective date by one year (i.e., January 1, 2000 for calendar year entities) by means of FAS 137, which amended FAS 133. FAS 138 became effective June 15, 2000, with a transition period ending June 15, 2001.

FAS 138 provides extensive guidance, clarifying the treatment of compound financial instruments with embedded derivatives. Additionally, FASB has provided continuing interpretive guidance on the myriad complexities arising from Statements 133 and 138. In April 2003, FASB issued Statement No. 149, once again amending and clarifying FAS 133.

The response of the federal bank regulators to this new GAAP approach remains under development, especially for the treatment of credit derivatives. Interim guidance issued by the four regulators in December 1998 has been updated in some respects but the regulators continue to rely on applying an off-balance sheet approach to calculations of risk-based capital. The existing regulatory approach creates an asymmetrical treatment of derivatives positions. Federal bank regulators should continue to work to make the regulatory capital treatment of derivatives reflective of GAAP accounting and not create incentives which discourage banks from using derivative financial instruments that serve to reduce the risk exposure of the financial institution.

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Issue

SFAS 141, "Business Combinations," requires business combinations to be accounted for as a purchase. At issue is the financial reporting and presentation of mutual institution combinations.

Position Statement

FASB has proposed the enterprise value method as the means of determining the "sales price" to be booked in a mutual institution business combination. ACB believes that the enterprise method has flaws and that the net asset value method would better represent consideration in business combinations. Nevertheless, should FASB use the enterprise method, ACB has offered to FASB a methodology that would reflect the economics of the transaction and the balance sheet structure of mutual institutions.

ACB had previously requested an interpretive ruling with respect to mutual institution combinations and urged the FASB to follow a specific set of accounting entries in cases in which negative goodwill results. Specifically, the fair value of assets would be determined consistent with SFAS 141, with the excess net asset value up to the pre-existing equity of the acquired entity treated as extraordinary income. Any remaining excess net assets would be booked as other comprehensive income and amortized over an appropriate period into net income. Existing "negative goodwill" should continue to be accreted over its remaining life, and mutual institutions should be provided with a transition period as least as flexible as that accorded other reporting institutions in adopting SFAS 141.

Explanation

SFAS 141 went into effect July 1, 2001, revising "merger accounting" standards for the accounting of business combinations between stock-owned entities. FAS 141 required that purchase accounting be applied to all business combinations, specifically eliminating pooling of interests accounting.

Left unresolved at that time was the treatment of mutual institution combinations. ACB's position was that the accounting of mutual institution combinations should reflect the economics and motivations behind such transactions. ACB's view was that a mutual combination, in reality, is not an acquisition or purchase because, among other reasons, no financial consideration is exchanged. ACB expressed this position on numerous occasions, most recently in comment letters to FASB dated November 26, 2001. FASB voted in December 2001 that mutual combinations would be subject to SFAS 141 and, in January 2002, voted that the identification of the acquired and acquiring accounting entities and identification of intangibles resulting from mutual combinations would be subject to the SFAS 141 approach.

ACB requested an interpretive ruling from FASB on the financial presentation of goodwill resulting from mutual combinations and recommended the establishment of accounting entries to reflect a mutual combination using purchase accounting through the November 2001 comment letter. First, estimates of the fair market value of assets acquired and liabilities assumed should be made consistent with FAS 141. An excess net asset amount will typically result from the calculation. However, no portion of excess net assets should be allocated as a pro rata reduction in asset values. Second, the excess net asset value should be recognized in part or in whole as extraordinary income to the amount less than or equal to the pre-existing book value of the equity of the acquired institution. To the extent that there are remaining net assets above the acquired institution's book value, that amount should be treated as other comprehensive income. This component of other comprehensive net income should be amortized into net income over an appropriate time period. In addition, obligations created by the combination that would not otherwise exist should be recognized as liabilities. ACB also recommended that FASB allow existing negative goodwill created by previous mutual combinations to be accreted into income over its remaining term.

At the end of 2001, FASB formally decided that mutual combinations can only be accounted for as a purchase, and that pooling of interests would no longer be an acceptable method. Left undecided was the process by which the purchase method would be applied.

In May 2002, the FASB board proposed using the enterprise method to determine the consideration or "sales price." The "enterprise method" is intended to represent the acquired mutual institution's "fair market value" and would be compared to the net asset value to determine the amount of goodwill created. In September of 2002, the Board recognized some outstanding issues with the enterprise method approach and instructed the staff to further research the measurement issues involved with the enterprise method as well as net asset calculation prior to publishing an exposure draft which is due out during the first quarter of 2004. At the beginning of this year, FASB instructed its staff to assemble an industry panel in order to come up with more specific directions on accounting for mutual combinations. ACB has been asked to participate in this panel.

ACB believes that net asset value reflects the acquired mutual institution valuation based on a well-established methodology that is readily measurable, transparent and reflects the assets acquired and liabilities assumed. By contrast, the case for the enterprise method is much weaker as it does not represent the price negotiated at the time of the transaction. Rather, it is a theoretical value placed on the acquisition after the fact. The net asset value is based on information available on similar assets and liabilities, and the enterprise value does not. There is a range of issues negotiated in a mutual combination, including the comfort that the two institutions have with each other, the maintenance of the franchise and the names of institutions that have often been in existence more than a century, and whether the level of service will remain in the community at least at the level that existed prior to the transaction. The objective of the transaction is to create an institution with the resources to compete in today's marketplace with a range of much larger competitors. Such combinations are intended to maintain the viability of the mutual institution and enable it to serve its community well. That objective, as distinct from stock transactions, is not for the target institution stockholders to get maximum value for the franchise sold.

Furthermore, unrestrained use of a mechanically applied enterprise method valuation is ripe for potential abuse. Institutions may arbitrarily influence an increase or decrease of the accounting value of the capital (or net worth) of the target institution resulting from the transaction that may not be based on facts and circumstances.

ACB has been working with FASB on the enterprise value measurement issue and expressed its concern with that approach in discussions with FASB staff during the past year. ACB has expressed to FASB staff its belief that the net asset value better reflects the economics of the transaction than the enterprise value method. Nevertheless, at FASB's request, ACB in November 2002, recommended an approach that would reflect the economics and risk management issues represented in the balance sheet structure of mutual institutions.

In applying FAS 141 and 142 to mutual institutions, FASB should provide them with a transition period that is at least as flexible as that of other reporting institutions covered by FAS 141 and 142.

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Issue

Whether accounting standards-setting in the U.S. should move from a rules-based to a principles-based system.

Position

ACB urges FASB to retain and improve the current rules-based system and recognize that a substantial transition period would be required should FASB move to a more "principles-based" standards-setting framework. Any standards-setting system should not eliminate the interpretations provided in the current system that, in general, has served the complexities of today's financial services industry well.

Explanation

There has been a good public discussion within the accounting industry and among policymakers about whether accounting standards should move from a rules-based standards setting approach to one that is principles-based, more similar to the approach of the International Accounting Standards Board. The debate was triggered by Enron's treatment of Special Purpose Entities, which should have been consolidated based on the intent on the accounting standards boards, though Enron argued to the contrary.

Under a principles-based system, the accounting standards setters establish the basic and broad principles underlying an accounting standard, but it is up to practitioners to determine the means of compliance. Under the rules-based system, the standard setter sets very specific rules and exceptions for the accounting practitioners to follow and implement.

FASB discussed a principles-based approach for US GAAP in its "Proposal for a Principles-Based Approach to U.S. Standard Setting." This proposal would provide less interpretive guidance and permit few if any exceptions to principles. In addition, the Sarbanes-Oxley Act requires a study examining the merits of moving to a principles-based system.

ACB commented on the FASB proposal on January 3, 2003. ACB said that while a principles-based accounting framework is attractive in concept, there are numerous practical issues that raise concerns and need to be addressed before adoption. Rather than immediately embracing a new principles-based framework, ACB urged FASB to retain and improve the current system and recognize that a substantial transition period would be required should FASB move to a more "principles-based" standards-setting framework. In that letter, ACB urged retaining substantial guidance and interpretation that helps users and preparers of financial statements. ACB is also concerned that minimal guidance will place smaller enterprises, including community banks with limited resources, at a disadvantage in applying standards in a principles-based regime.

The FASB Board meet to discuss comments on March 26, 2003 and decided to move forward in several areas. The Board directed the FASB staff to develop a plan for a limited-scope conceptual framework improvements project focusing on the selection of appropriate measurement attributes and related relevance/reliability issues. It also established a more near-term objective of using identical style and wording in the standards issued by the FASB and IASB on joint projects. Finally, the FASB Board decided to commence with other specific improvements relating to its ongoing efforts to improve process efficiency, improve its process for providing interpretive and implementation guidance, and improve accessibility and retrievability of the accounting literature.

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Issue

Whether accounting standards should be changed to require companies to expense employee stock options rather than continuing to only require footnote disclosure on the effect of issuing and having stock options exercised.

Position

ACB supports an approach for the accounting of stock options that provides for equitable accounting treatment across industries, ensures accurate measurement of the value of stock options, encourages compensation policies that align management's interest with the long-term interest of stockholders, and provides useful information to investors. ACB opposes a mandatory requirement to expense stock options as inconsistent with these objectives.

Explanation

Over the past few decades, there has been a trend toward awarding employee stock options to provide incentives for executive officers to "think like owners" and align their interests with shareholders. The accounting for employee stock options has received renewed attention during the past few years as a result of well publicized corporate accounting scandals in which the stock options led some executives to be more focused on short term stock price performance. Some have called for expensing of stock options.

Analysts have expressed a number of concerns about mandatory expensing of employee stock options. For example, they have raised questions about valuing and measuring stock options, and have emphasized that there are no cash flows associated with the granting and issuance of stock options. Such critics of expensing prefer disclosure rather than placing stock option related expenses on the income statement. However, several corporations have announced intentions to expense stock options. Expensing has become a treatment preferred by some policymakers and professional investors, contending that stock options should be treated as expenses, comparable to the treatment of other compensation and personnel expenses.

FASB had developed an approach to require stock option expensing during the 1990s. Under pressure, FASB decided to modify the proposal to indicate that expensing is the preferred method but did not require expensing under the relevant FAS, Statement 123. More recently, in late 2002, FASB undertook a limited scope project to reconsider the transition and disclosure policies under Statement 123. As a result, FASB published Statement 148, which amended Statement 123 and permits three alternative transition methods for those who intend to account for stock options as an expense and requires more prominent and frequent footnote disclosure.

In March 2003, the FASB Board officially started a project on equity-based compensation that will result in the issuance of an exposure draft during the first quarter of 2004 and the issuance of a final statement in the second half of 2004.

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Issue

Businesses are reshaping their operational plans in order to comply with FASB Statement No. 133, Accounting for Derivatives and Similar Financial Instruments and for Hedging Activities. This is resulting in a distortion of business economics that ultimately leads to uneconomical business models with adverse effects to both businesses and consumers.

Position Statement

ACB urges the Federal Accounting Standards Board (FASB) to further amend its Statement No. 133, Accounting for Derivatives and Similar Financial Instruments and for Hedging Activities, to diminish distortion of normal business practices. In particular, FASB should seek to diminish substantial uncertainties regarding application of FAS 133, and amend elements that either discourage hedging or discourage cash market activities that might create hedgable positions.

Explanation

FAS 133 was effective January 1, 2001 for most entities.

FAS 138 provides further guidance, clarifying the treatment of compound financial instruments with embedded derivatives and was effective June 15, 2000. Additionally, FASB has provided continuing interpretive guidance on the myriad complexities arising from Statements 133 and 138. In April 2003, FASB issued Statement No. 149, once again amending and clarifying FAS 133.

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Issue

Adoption of auditing standards by the Public Company Accounting Oversight Board (PCAOB).

Position

In adopting auditing standards pursuant to the requirements of the Sarbanes-Oxley Act of 2002, the PCAOB should keep in mind the limited resources of smaller public companies and take steps to reduce the burden and cost of compliance for these companies. Standards should also take into account the continuous and comprehensive regulation of the financial industry by both federal and state regulators.

Explanation

The Sarbanes-Oxley Act created the PCAOB to govern public auditors and the auditing process. The PCAOB is responsible for the registration, inspection and discipline of public auditing firms. The PCAOB also is responsible for establishing auditing, attestation, quality control and ethics standards for the public auditing profession. While the standards adopted by the PCAOB will technically apply only to public companies, it is likely that over time, the standards will be applied by state authorities and by banking regulators to public, private and mutual organizations.

In October, the PCAOB proposed standards to govern the auditor's attestation of and reporting on management's assessment of the effectiveness of internal control over financial reporting, which is now required of all public companies. The proposed standards would go far beyond what is currently required of large banks and savings institutions under the Federal Deposit Insurance Corporation Improvement Act and would be burdensome and costly, particularly for smaller institutions. In the proposed standards, the PCAOB did indicate that it was sensitive to the possible effects on small- and medium-size businesses, but gave only general guidance on how the attestation process could differ for these businesses to reduce burden. ACB asked in a comment letter that more specific guidance be given to auditors on how the auditor should address the issues particular to small- and medium-size businesses and how the attestation process for those companies could differ from that used for larger companies.

ACB will continue to monitor the actions of the PCAOB and provide input when necessary so that auditing standards are reasonable for all institutions. ACB will help ensure that standards adopted by the PCAOB are responsive to the needs of smaller financial institutions and that the burden and costs of auditing standards for these institutions are reduced whenever possible.

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Issue

The Financial Accounting Standards Board (FASB) is considering a project that would require that accounting for mortgage servicing rights (MSRs) be at fair value rather than at the lower of cost or market (LOCOM). Fair value accounting would eliminate the need for complex FAS 133 hedge accounting for institutions actively participating in hedging. Institutions who are not currently involved in hedging might be adversely affected if they are required to switch to fair value accounting for MSRs.

Position Statement

ACB urges the Financial Accounting Standards Board (FASB) to carefully consider the implications of requiring fair value accounting for MSRs if it decides to put this project on its agenda. ACB recommends that FASB allow MSRs to be recorded either at fair value or LOCOM and that FASB make this an elective option for financial service firms.

Explanation

A number of accounting firms have sent comment letters to FASB requesting the issuance of guidance requiring fair value accounting instead of the LOCOM for MSRs. Concerns have been raised about the burden and complexity of FAS 133 hedge accounting for MSRs. In response to these comment letters, FASB has indicated a willingness to consider a limited scope project to require fair value accounting for MSRs, but only if backed by strong industry support. According to industry reasoning, fair value accounting would eliminate the need for FAS 133 hedge accounting, eliminate impairment write-downs and provide greater transparency in financial statements. A requirement to utilize fair value accounting to value MSRs might also require some companies to start or increase hedging with derivatives.

There have been a number of negative critiques of FAS 133 recently. Large financial institutions generally believe that FAS 133 hedge accounting for MSRs poses a significant operational burden for most companies. There could be an adverse impact in requiring fair value accounting for MSRs on smaller institutions and on those not actively hedging. If the elective approach is adopted by FASB, it might potentially help institutions that are actively hedging and not harm the ones that are not hedging.

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TAX

Issue

Expansion of Individual Retirement Accounts (IRAs), Education Savings Accounts (ESAs), and Individual Development Accounts (IDAs).

Position Statement

ACB supports significant increases in the dollar amount for permissible annual contributions to IRAs and ESAs. The limits for IRAs and ESAs should be increased to the same amount as the new annual contributions to 401(k) plans allowed under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Congress should increase deposit insurance coverage for retirement accounts. ACB also supports making the EGTRRA increases in IRA account limits permanent, speeding up the timetable for increases in the IRA limits, and raising or eliminating the age requirements for beginning mandatory withdrawals from IRA accounts.

ACB also supports increased funding for the Assets for Independence Act and the revision and improvement of standards for Individual Development Accounts (IDAs) for low-income working families, including replacing the current lifetime limit on individual and household receipt of federal matching grants with an annual limit of up to $500 per individual.

Explanation

The Economic Growth and Tax Relief Reconciliation Act of 2001 substantially increased IRA and ESA contribution limits, an action long supported by ACB. IRA limits increased to $4,000 in 2004 and rise to $5,000 in 2006. ESA limits increased from $500 to $2,000. At the same time EGTRRA also substantially increased contribution limits for 401(k) plans ($13,000 in 2004, rising to $15,000 in 2006). While the EGTRRA provisions help to make IRA and ESA more attractive, IRA and ESA contributions limits should be raised to the same level as 401(k) contributions limits to make them competitive investment vehicles. IRA and ESA accounts allow individuals to establish and control their retirement plans and are important investment vehicles for individuals who do not have employer-sponsored pension plans.

President Bush and many members of Congress have proposed speeding up the increases in IRA accounts authorized by EGTRRA. They also have suggested making these increases permanent and raising or eliminating the mandatory age for beginning withdrawals from IRAs. These proposals would encourage saving and help people manage their accounts to make up for pension and stock losses incurred in the economic downturn.

As individuals increasingly rely on self-directed accounts for their retirement security, they have accumulated balances that exceed the $100,000 FDIC coverage limit. To help protect those retirement savings and help community banks fund local lending, it is becoming more important that Congress include a substantial increase in retirement account coverage. Congress is actively considering such an increase in connection with other deposit insurance reform proposals.

Individual Investment Accounts (IDAs) are matched savings accounts that may be used to buy a first home, pay for post-secondary education, or to start or expand a small business. Individual deposits would be matched dollar-for-dollar up to $500 through a tax credit. Revision of the structure and limits for IDAs will bring more financial institutions and low-income individuals into the program and will help a larger number of low-income persons establish savings habits.

Contact for further information: Beth Neese (202) 857-3152

Issue

Subchapter S.

Position Statement

ACB supports legislation to increase significantly, from 75 to 200, the number of shareholders who are eligible to form a Subchapter S corporation and to otherwise eliminate the shortcomings in the Subchapter S election for community banks.

Explanation

Subchapter S of the Internal Revenue Code was first enacted in 1958 to eliminate the double taxation on the profits of small corporations. In effect, small corporations became subject to a scheme of taxation similar to that imposed on partnerships. While shareholders are taxed on corporate profits regardless of whether those profits were actually distributed to them as dividends, the Subchapter S corporation is not itself subject to taxation. In contrast, a regular (or Subchapter C) corporation pays tax on its profits, and its shareholders also pay tax on part of the dividends paid to them.

Congress made Subchapter S status available to insured depositories for the first time in 1996, but many existing institutions, particularly savings institutions, have been unable to make the election because a corporation is not eligible to make the election if it has more than 75 shareholders.

A number of bills introduced in the 1st Session of the 108th Congress would improve and expand rules relating to Subchapter S status. Favorable provisions of the bills would: (1) increase the number of eligible shareholders from 75 to 150; (2) permit IRAs to be eligible shareholders; (3) clarify that interest on investments maintained by a bank to enhance safety and soundness is not disqualifying passive income; (4) clarify that stock required to be held by bank directors not be treated as a prohibited second class of stock; (5) permit bad debts to be charged off at the corporate level during the period that any pre-existing bad debt reserves – computed based on actual experience – are required to be recaptured into income; and (6) clarify that a current law reduction in the amount of deductions a regular corporation can claim will not apply to a bank after it has been a Subchapter S corporation for three years. Many of these provisions were included in "the American Jobs Creation Act of 2003" (H.R. 2896), approved by the Ways and Means Committee on October 28, 2003.

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Issue

Stock redemption.

Position Statement

The treatment of stock redemptions should be made consistent with the treatment of cash and stock dividends under the rules for recapturing the pre-1988 reserve.

Explanation

As a general matter, the possibility that the pre-1988 reserve accumulation of a savings association or savings bank will ever be subject to recapture is very remote, except in one situation. If an institution redeems stock, the proceeds will be deemed to come first out of any pre-1988 thrift reserve accumulation, even if the institution is a commercial bank that acquired the reserves as part of acquiring a thrift. The amount of the pre-1988 reserves subject to recapture equals the amount of the redemption distribution to the shareholders "grossed up" at the current tax rate (i.e., multiplied by the reciprocal of the current tax rate so that the amount of the recapture tax paid equals the amount of the redemption distribution).

Dividend distributions are treated completely differently from stock redemptions under the recapture rules. In the case of dividends, the distribution is deemed to come from the pre-1988 reserves only after all of the earnings and profits accumulated since 1952 are deemed to have been used up.

This treatment of stock redemptions, which represents virtually the sole circumstance where an institution will be required to recapture any of its pre-1988 reserves, can be avoided by operating through a holding company. Because recapture occurs only where the institution maintaining the reserves redeems shares, there will be no threat of such recapture where a holding company can be inserted between the depository institution and the public shareholders. While many thrift institutions may be willing to incur the cost of creating a holding company for the purpose of redeeming publicly held shares without incurring the recapture penalty, this solution may not be viable for some mutual holding companies. Fundamentally, as a matter of sound tax policy, a provision that can be avoided by certain taxpayers – those who are willing and able to undertake a transaction that may have no purpose other than tax planning – should be repealed simply to engender respect for the fairness of the tax laws.

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Issue

Over the years banks have faced an increasing and unfair burden for enforcement of tax laws through information reporting requirements imposed upon them. While ACB members are willing to do their part to assist the government in assuring compliance with tax laws, many of the recent information reporting laws and regulations are burdensome and costly for banks, which are simply the middleman in financial transactions. Many of these regulations should be simplified or repealed. Major issues of concern are outlined below.

Position Statement

(1) Payments to attorneys

ACB supports reporting third-party checks delivered to attorneys only where the amount of the check bears some relationship to the attorney's income.

Explanation

Section 6045(f), which was added to the Internal Revenue Code by the Taxpayer Relief Act of 1997, requires that an information return be filed with the IRS for "any payment made to an attorney in connection with legal services (whether or not such services are performed for the payor)" unless the payment is already required to be reported. The requirement applies to anyone, including a financial institution, who makes the payment in the course of a trade or business. Proposed regulations, which were published in the *Federal Register* on May 21, 1999, expand this requirement such that an information return on Form 1099-MISC is required to be filed where a check is merely delivered to an attorney who is not the payee.

ACB testified twice in 1999 in opposition to proposed regulations. Under the proposal, all payments delivered to attorneys after December 31, 1999, were to be reported. In response to the objections of ACB and others, the effective date of the delivery rule was initially delayed for a year, so that payments merely delivered to an attorney before January 1, 2000 would not have to be reported. A second delay in the effective date of the proposed rules was granted so that payments delivered to attorneys before January 1, 2001 did not have to be reported as outlined in the rules. On January 25, 2002, the IRS issued a Notice asking for comments on the proposed regulations on payments to attorneys and on the burden of and need for collections of this data. Comments were due by March 26, 2002. On May 17, 2002, the IRS issued a revised set of proposed regulations on reporting payments to attorneys. The revised regulations addressed many of the problems with the delivery rule and other provisions identified by ACB. ACB submitted comments on the revised proposed rules on August 15, 2002, complimenting IRS for dropping may of the onerous provisions contained in the earlier proposal and identifying continuing problems relating to joint and multiple payees that remain in the May 17th proposed regulations.

Position Statement

(2) Reporting of Interest Paid to Nonresident Aliens

ACB opposes IRS proposed regulations requiring reporting of deposit interest paid to nonresident aliens.

Explanation

On January 17, 2001, IRS issued proposed regulations providing guidance on reporting of deposit interest paid to nonresident aliens. The IRS also held a hearing on this issue on June 21, 2001. The IRS issued a revised set of proposed rules on August 2, 2002, modifying the list of countries covered by the information reporting requirements. ACB opposed the proposed rules when they were first issued and has continued to request that

Treasury/IRS withdraw the proposed information reporting because of their impact on banks, most recently in comments filed on November 20, 2002. Numerous members of Congress have also weighed in, urging that the proposed rules be withdrawn. As of the end of 2003, Treasury had not yet acted further on this issue.

Position Statement

(3) Other Information Reporting Requirements

ACB continues to believe that all information requirements should be simplified and streamlined to ease the burden placed on banks. The amount of information requirements should be reduced substantially. Actions should include allowing privacy statements to be mailed or sent with Form 1098 statements relating to mortgage interest. (Inserts may accompany Form 1099 but not Form 1098.) In view of the new privacy requirements, the prohibition on including inserts with the 1098 should be reviewed. In addition, proposed rules relating to reporting and withholding on nonqualified stock options should be withdrawn. IRS should examine procedures relating to all l099 statements to simplify reporting requirements.

Explanation

Congress and Treasury/IRS have continually expanded the role of banks in tax enforcement through broadened information reporting requirements in a number of areas. These actions are burdensome and costly to banks. A substantial amount of bank dollars and employees' time is devoted to interpreting complex rules and training employees. In addition, bank customers often do not understand that the bank is simply a "middleman" in these transactions. The information reporting rules often are not effective in achieving the goals set forth by Congress and Treasury/IRS. They also are not cost effective when the cost in dollars and employees' time is factored in.

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Issue

Capitalization of expenditures.

Position Statement

The Treasury Department and IRS issued final regulations on January 5, 2004, providing guidance on capitalization of costs in acquiring or creating intangible assets. The final rules require loan origination costs to be amortized unless these costs fall under the de minimis safe harbor of $5,000. The regulations also allow deduction of compensation costs if they meet the $5,000 de minimis threshold and provide extensive guidance on the tax treatment of costs to acquire intangibles. While ACB supports many parts of the regulation and recognizes that the rules will create certainty for taxpayers on how to treat costs, we continue to believe that all loan origination costs should be deductible as determined under the Third Circuit Court of Appeals decision in *PNC Bancorp vs. Commissioner*. *The Third Circuit* overturned a 1998 decision of the U.S. Tax Court requiring capitalization of these expenses, holding that loan origination costs are deductible as ordinary and necessary business expenses.

The Treasury Department also announced that it plans to issue guidance on the tax treatment of expenditures paid or incurred to repair, improve or rehabilitate tangible property and released Notice 2004-6, asking for comments on issues relating to tangible assets. ACB will work with the Treasury Department and IRS to address the issues raised in Notice 2004-6.

Explanation

Following the 1992 Supreme Court decision in *INDOPCO v Commissioner*, a case relating to the deductibility of expenditures versus capitalization, there has been much uncertainty about the application of section 263(a) of the Internal Revenue Code. This uncertainly has resulted in large costs to the government and to businesses as it has led to extensive litigation. In 2001, a coalition of businesses submitted a document containing a capitalization proposal to the Treasury Department and IRS. Concurrently, officials at the Treasury Department and IRS had begun a review of the court cases and litigation in this area and decided to take steps to begin to resolve outstanding issues. On January 24, 2002, the agencies published an Advance Notice of Proposed Rulemaking (ANPRM) in the *Federal Register* describing rules and standards they expected to propose in 2002 to provide a framework for addressing capitalization issues relating to expenditures incurred in acquiring, creating or enhancing intangible assets. On December 18, 2002, the Treasury Department and IRS issued proposed capitalization regulations (NPRM) that closely follow the ANPRM. The NPRM was followed by final regulations issued on January 5, 2004. The final regulations describe expenditures relating to intangible assets that require capitalization: Expenses not described in the rule are not required to be capitalized and may be deducted.

The final regulations also provide safe harbors and simplifying assumptions that permit the deduction of certain costs, including a 12 month rule allowing deduction of the cost of certain intangibles assets with a shorter useful life. The regulation also provides a de minimis rule that allows deduction of costs falling under a $5,000 threshold. A safe harbor amortization period of 15 years is created for intangible assets that do have a readily ascertainable useful life.

The Treasury and IRS specifically rejected the use of a "regular and recurring" cost rule in the NPRM contending that it would be too vague to be administrable. This rule was supported by ACB in comments submitted on the ANPRM and the NPRM..

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Issue

Interest on non-performing loans.

Position Statement

ACB supports implementing the regulations requiring that the tax treatment of capitalized loan costs be conformed to the institution's book treatment. ACB supports extending book/tax conformity to the treatment of non-accrual interest.

Explanation

Final regulations issued by the IRS permit depository institutions to elect to deduct on their tax returns write-offs on those loans that are classified as "loss assets" in conformity with the write-down policy of their regulators. Theoretically, those institutions whose loan classification procedures are approved by their regulators need not worry about IRS agents challenging the fact or the timing of bad debt deductions made pursuant to a conformity election, even where the loss classification is proved to be too pessimistic on the basis of subsequent events.

The IRS has not agreed to such treatment with respect to non-performing loans. Even though an institution must discontinue accruing interest income after a certain period of non-payment for GAAP accounting and regulatory purposes (generally 90 days), the IRS will usually require the institution to continue paying tax on the accrued interest not being paid, often until foreclosure.

In many cases, IRS agents are rendering the conformity election useless. Under the guise of checking the reliability of the institution's methodology for charging off loans, many agents are reviewing, with the benefit of hindsight, individual loan files and denying charge-offs taken in conformity with the institution's regulatory treatment.

In a 1996 decision, *Bank of Kirksville v. United States*, the District Court held in favor of an institution that ceased accruing interest on loans 90 days delinquent, where an extensive review of the financial condition of the borrower indicated that payment was unlikely. The IRS, however, has stated that it disagrees with this holding to the extent that it would permit a regulatory loan classification to stop interest accrual. Requests to adopt a method of tax accounting that ceases accrual where interest is 90 days past due in reliance on *Bank of Kirksville* will not be accepted.

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Issue

Mark-to-market rules of affiliate transfer of securities.

Position Statement

Financial institutions should be permitted to treat mortgages and other securities transferred from an affiliate, including a mortgage banking subsidiary, as eligible to be held for investment under the mark-to-market rules.

Explanation

Under the mark-to-market statute, Section 475 of the Internal Revenue Code, regular sales to, or purchases from, "customers" of securities will cause a taxpayer to become a "dealer" and, as such, be required to mark any "securities" he or she holds to market. (Under Section 475, the term "securities" includes mortgages.) A dealer is permitted to identify any securities that it holds as exempt from mark-to-market on the basis that they are held for investment (or not for sale). Transactions between members of the taxpayer's consolidated group may qualify as transactions with "customers" under Section 475. However, solely for purposes of determining whether a taxpayer is a securities dealer, sales and purchases with members of its consolidated return group can be ignored.

Most banks, however, are already securities dealers and intragroup transfers create a different problem. Many banks have created mortgage banking subsidiaries that originate loans in their own names and then sell them, often immediately, to meet pre-existing commitments. These subsidiaries provide operating and regulatory advantages and have been created for a variety of business reasons having nothing to do with tax minimization. For example, state-chartered savings institutions which are not permitted to branch interstate, may use mortgage banking subsidiaries to circumvent the inability of the institution itself to originate loans in other states. Typically, the mortgage banking subsidiaries sell the fixed-rate loans they originate into the secondary market, and they sell a large part of the variable-rate loan production to the depository institution, which joins with the subsidiary in filing a consolidated return, either as an affiliate or parent. The variable-rate mortgages acquired in intercompany transactions are typically held by the depository institution in portfolio, often commingled with the mortgage loans it has originated directly.

In another uncommon scenario, one depository institution will originate and sell mortgages, both into the secondary mortgage market and to another depository institution that is a member of the consolidated return group. The transferor institution also sells mortgages both outside and within the group, including sales back to the first institution. There can be a variety of sound business reasons for such transfers between affiliated depository institutions. In some cases, the transfers may have been part of a customer-initiated migration of deposits between BIF-insured savings banks and SAIF-insured savings associations. The loan assets would have to follow the deposit liabilities to maintain acceptable balance sheet ratios in both institutions. In other cases, one institution may have a better credit rating in a particular year than another institution within the consolidated return group. The higher-rated institution will be able to obtain liabilities in the market at better prices, and it makes sense to transfer loans within the group to where they can be funded at the lowest cost. In this second scenario, both the transferor and transferee institutions are likely to be deemed "securities dealers" under Section 475 based on transactions outside the consolidated return group.

The interaction of the consolidated return regulations and the section 475 regulations will prevent the portfolio lender, to which the mortgage banker sells the mortgage in an intragroup transfer, from treating the mortgage as held for investment. The group is treated as a single corporation, that is, a dealer and the purchasing member must continue to mark the security to market. It might be possible to avoid this problem by having the mortgage banker selectively identify the variable loans that it originates as held for investment. An issue remains, however, whether the sale to the intragroup customer can be ignored.

ACB has filed comments criticizing the proposed regulations and suggesting an alternative approach to coordinating the hedging and mark-to-market regulations. Final regulations have since been published, but they did not address the issue of securities transfers between affiliated companies. In subsequent meetings, IRS officials have said that legislation may be required to resolve the issue.

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Issue

Business Activity Tax

Position Statement

ACB supports legislation to enact a federal standard clarifying the physical presence standard as a nexus for imposition by states of a business activity tax (BAT) on businesses.

Explanation

State and local taxation of nonresident business is restricted by the Due Process Clause and the Commerce Clause of the United States Constitution. Businesses must have a nexus or connection with a state or locality before the state can impose a business activity tax. The concept of a nexus as a physical presence in the state has been upheld in judicial precedents.

As the focus of the economy has shifted to services and intangibles and as they have faced revenue shortfalls, states and localities have become more aggressive in attempts to apply an "economic" nexus standard in assessing business activity taxes on businesses with no physical presence in a state or locality. These actions have resulted in increased uncertainty and higher litigation costs for business.

In view of this situation, businesses are seeking federal legislation establishing a nexus standard that would prohibit state and local governments from imposing any business activity tax on a business unless that business has a physical presence in the state or locality that meets specified standards. Congressmen Robert Goodlatte (R-VA) and Rick Boucher (D-VA) have introduced the "Business Activity Tax Simplification Act of 2003" (H.R. 3220) would make the physical presence standard part of federal law. It also would modernize the application of Public Law 86-272 to include solicitation in connection with all sales, not just sales of tangible property. H.R. 3220 would expand Public Law 86-272 to cover all business activity taxes.

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Issue

Company purchase of life insurance on key employees to manage risk and fund employee benefits.

Position Statement

ACB opposes proposed legislation that would prevent the use of Bank Owned Life Insurance (BOLI) and Corporate Owned Life Insurance (COLI) to manage risk and fund employee benefits. ACB is willing to support legislation that would address abuses of BOLI/COLI if such legislation is narrowly constructed to address proven abuses.

Explanation

Life insurance policies are regulated by the states, but receive certain preferential tax treatment under the Internal Revenue Code. Banks and other corporations have purchased BOLI/COLI as an investment to protect the security of the company, to offset the cost of employee benefits, and to manage risk. Over the years, Congress and the IRS continually have examined the use of BOLI/COLI and modified tax rules to assure that these policies serve a real business purpose and are not just tax shelters. After a series of articles about "janitors insurance" appeared in the *Wall Street Journal*, a few members of Congress proposed new limitations on COLI. Several bills would require disclosure to employees when policies covering them are purchased, limit policies to key persons, and limit insuring employers after they leave employment. Although BOLI is structured differently from leveraged COLI policies and is closely examined by banking regulators, many of the proposals would affect BOLI as well.

Much of the action to date has centered in the Senate Finance Committee. On September 17, 2003, Senator Jeff Bingaman (D-NM), offered an amendment on COLI/BOLI during the Finance Committee markup of the *National Employee Savings and Trust Equity Guarantee Act*. The amendment would have affected all new policies and employees added to an existing policy after September 17, 2003. The Bingaman amendment would have required businesses to treat payments from COLI/BOLI policies as income if the insured was not an employee in the year preceding his or her death. The amendment included exemptions for "key persons" and for policies with proceeds going to families or beneficiaries. Proceeds used to buy back any equity interest owned at death by the insured also would have been exempt.

The Finance Committee adoption of the Bingaman amendment had an adverse effect on the market for COLI/BOLI policies. On October 1, 2003, the Committee voted to change the effective date of the Bingaman Amendment from September 17, 2003 to date of enactment. Committee Chairman, Charles Grassley (R-IA) also promised to hold a hearing on COLI to consider an alternative proposed by Senator Kent Conrad (D-ND). Conrad's amendment would allow COLI/BOLI to continue for "key persons" who meet the highly compensated test under pension rules, allowing insurance on "key persons" making $90,000 or more a year. Conrad's proposal would allow COLI policies on other salaried employees if the employees are given notice and give consent. The benefits from the policies covering these employees would have to be put in a "lock box" to assure that they are used for employee benefits. The amendment would not contain limitations on insuring employees after they leave employment of the insuring company. The Finance Committee held a hearing on COLI/BOLI on October 23.

On January 14, 2004, the staff of the Senate Finance Committee released a discussion draft on Corporate Owned Life Insurance. The staff indicated that Finance Committee Chairman Charles Grassley plans to address this issue early in 2004. The staff discussion draft, which reflects changes requested by ACB and other groups, would allow COLI/BOLI for key persons and set forth three definitions of key persons who would qualify. These would include highly compensated persons making $90,000 per year. A highly compensated person also could include: (A) One of the five highest paid officers: (B) A shareholder who owns more than 10 percent in value of the stock of the employer; or (C) An employee who is in the highest paid 35 percent of all employees. A director of the company also could be a key person. The staff discussion draft also would require notification and consent from the employee. Companies would have to keep records and report information about COLI/BOLI policies to IRS. The proposed changes would be effective after enactment.

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PAYMENT SYSTEMS AND TECHNOLOGY ISSUES

Issue

Establishment of laws, rules and regulations that maximize the role of community banks in the U.S. Payment Systems.

Position Statement

ACB believes that regulated depository institutions of all sizes must have equal access, on equitable terms, to the payments system and essential electronic banking services. No law, regulation or standard should be adopted that provides an unfair advantage to one group of competitors over another. Government programs/initiatives should to the fullest extent possible avoid competing with products and services offered by community banks.

ACB strongly supports the role of the Federal Reserve System as guarantor of the integrity of the nations payments system and believes that only insured depository institutions should have access to Federal Reserve and automated clearinghouse payment services.

Explanation

The dramatic growth in electronic banking services, delivery systems and payment options is transforming financial service relationships and product offerings. With many non-bank financial service firms and others developing products and services that compete directly with those traditionally offered by insured depository institutions. Banks need to preserve their unique role in the U.S. payment systems to ensure that consumers remain confident in the reliability and integrity of the nation's payments system.

New banking and payment systems are likely to be developed by large financial services firms, consortia of banks and non-banks, or large private corporations. While some new electronic banking services are relatively inexpensive, most require substantial investments in technology hardware and software. Consequently, many financial institutions, particularly smaller ones, are less able to leverage the advantages offered through technology. Therefore, it is imperative that insured depository institutions, regardless of size, have access to such systems on reasonable terms with other competitors in the marketplace. Such access will help ensure that all communities and customers will benefit from these new systems.

The private sector is best suited to develop and implement effective electronic banking systems. Some government entities such as the U.S. Post Office have considered offering products such as electronic bill payment that compete directly with services offered by community banks. Government programs/initiatives should only respond to explicit market failures. However, the federal government should assure that equitable access to the payments system is provided to all regulated depository institutions, including, if necessary, being a provider of last resort of essential payments system services.

ACB believes that the issuance of third-party payment instruments such as payroll cards, should be limited to regulated depository institutions, although banks and non-banks should be permitted to develop and provide ancillary services that support payment system activities. Moreover, the emerging laws and regulations governing electronic cash instruments must not unduly increase the risk to the U.S. payment systems or unfairly favor large financial services firms.

Contact for further information: Rob Drozdowski (202) 857-3148, Bob Seiwert (202) 857-3125

Issue

Security in electronic banking.

Position Statement

ACB believes it is critical that financial institutions have the flexibility to choose suitable security technologies, policies and procedures to manage their security risk. Any regulatory requirements, and/or guidelines on electronic banking security should take into account the potential detrimental effect regulatory and operational burdens can place on small community banking organizations.

ACB will work with government agencies to assure that electronic banking developments support the needs of law enforcement in such areas as detecting and preventing criminal activities and terrorism, including money laundering, tax evasion and other crimes.

Explanation

It is essential to the success of new electronic banking systems that they be developed and operated in a secure manner. This concern, while not new, is exacerbated with today's more extensive access to computer technology, along with the persistent risk of unauthorized access and network attacks. The safety of financial institutions, and the integrity of the nation's payments system, necessitate that special attention be given to the security of new electronic banking systems. Because of the increasingly dynamic world of computer, network, and software product offerings, financial institutions need to have the flexibility to adopt technologies and procedures that best fit their organization.

Community banks are active participants in electronic banking with an outstanding record of maintaining high levels of information security and protecting confidential customer information. The Gramm-Leach-Bliley Act required the regulatory agencies to "establish appropriate standards" and "physical safeguards" to "insure the security and confidentiality" of customer records and information. Other laws such as the USA PATRIOT Act mandate new regulations setting forth minimum requirements banks must follow to verify the identity of customers. These emerging requirements continue to place an increased management burden on community banks and higher costs for outsourcing technology services. ACB will continue to press the regulatory agencies to adopt requirements that are flexible, and appropriate to the size and complexity of each institution.

ACB will continue to work with the regulatory agencies and industry groups such as the Financial Services Roundtable's BITS (Bankers Information Technology Secretariat) to establish guidelines for information security that protect customer information and meet the needs of community banks.

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Issue

Electronic signatures, contracts and disclosures.

Position Statement

ACB will encourage and support legislative, regulatory, and private sector initiatives that strengthen community banks' ability to use electronic signatures, contracts and disclosures to enhance electronic-based financial services offerings. ACB also supports the development of industry best practices standards to assist community banks and other businesses in utilizing this new authority.

Explanation

On June 30, 2000, President Clinton signed into law the Electronic Signatures in Global and National Commerce Act ("E-Sign Act"), a key legislative priority for ACB in 2000. The new law establishes a uniform, national standard for the legal recognition of electronic signatures, contracts, and other records. It removed much of the legal uncertainty and confusion surrounding Internet-based transactions resulting from inconsistent state laws. Consumers have the option of authenticating a document electronically and receiving required disclosures electronically if they so consent and can "reasonably demonstrate" that they can access the material.

The application of electronic signatures, records and disclosures holds the potential for reducing costs, and providing information more efficiently to consumers. While the new law establishes only limited authority for federal financial regulators to interpret the E-Sign Act, the regulators are given the authority to specify performance standards to ensure accuracy, record integrity, and record accessibility. ACB will work to ensure that any regulatory guidance related to the E-Sign Act and electronic disclosure statements will not favor any particular technology or disadvantage community banks.

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Issue

Implementation of newly enacted check truncation legislation.

Position Statement

ACB supports the establishment of regulations and guidelines required to implement the Check Clearing for the 21st Century Act that minimize the potential compliance/operations burden, and education/outreach efforts for both consumers and banks on the check clearing process.

Explanation

President Bush signed into law the "Check Clearing for the 21st Century Act" ("Check 21" or the "Act") on Oct. 28, 2003. Check 21 establishes a new type of paper document, called a "substitute check," which can be created from an electronic check image and represents the legal equivalent of the original check. The Act is intended to make the check clearing process more efficient by reducing the dependency on physical transportation of paper items. While Check 21 does not require insured depository institutions to process electronic images, all depository institutions will be required to accept substitute checks presented for processing/payment and comply with new consumer protection provisions and disclosure requirements. The Act is effective on October 28, 2004.

The Federal Reserve is required to issue regulations to implement the major provisions of the Act including minimum requirements for substitute checks, consumer disclosure, and warranty/indemnification. ACB will work to make certain that CTA regulation and guidance does not disadvantage, or create undue burden for community banks that choose not to process electronic images.

ACB is also concerned that consumers may experience some confusion over the variety of ways checks are being cleared and the potential burden on call center/front-line bank staff to respond to such inquires. The rapid growth of ACH conversion by major bill processors and retail businesses combined with the newly enacted Check 21 Act is likely to exacerbate this concern. ACB will work with the regulators, other trade associations and others to develop consumer education/outreach materials to smooth the transition to the increased use of electronics in the check clearing process.

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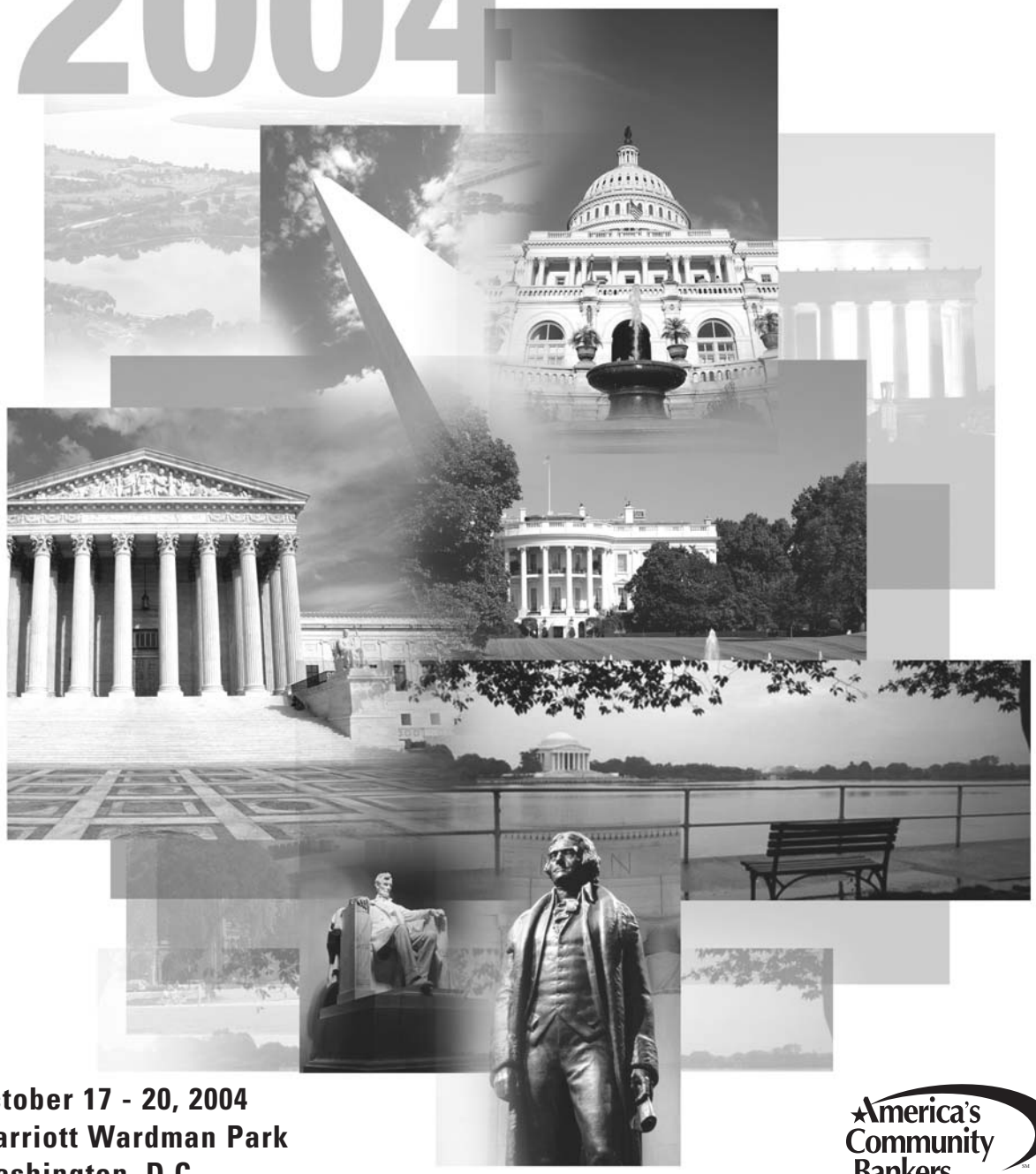

October 17 - 20, 2004
Marriott Wardman Park
Washington, D.C.

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