America's Community Bankers℠ Shaping Our Future

2006 POLICY POSITIONS

Public Policy and Advocacy

ACB banker members visit Washington each year.
Pictured on the front cover are Washington State members
with Rep. Cathy McMorris (R-Wash.).

America's Community Bankers℠ *Shaping Our Future*

America's Community Bankers®
900 Nineteenth St., N.W., Suite 400
Washington, D.C. 20006
Fax: (202) 296-8716
Toll free: (888) 872-0275
info@acbankers.org
www.AmericasCommunityBankers.com

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PREAMBLE

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 while reducing federal regulatory burdens.

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 2006:

- Regulatory Relief
- Credit Union Regulation and Taxation
- Fannie Mae and Freddie Mac
- Federal Home Loan Bank System
- Data Security
- Regulatory Capital Standards
- Flood Insurance
- Deposit Insurance Reform Implementation

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

2006 ACTION PRIORITIES

Regulatory Relief

The advancement of comprehensive regulatory relief is a priority for ACB during 2006, both through the regulatory and legislative processes. ACB seeks to reduce specific and cumulative regulatory burdens to make it more efficient for community banks to serve their communities in an intensely competitive environment, while operating in a safe and sound manner.

Credit Union Regulation & Taxation

Consistent with our fundamental support of charter choice, ACB supports legislative and regulatory changes to permit credit unions that want to convert to a mutual savings bank charter to do so without undue interference. In addition, bank-like credit unions that seek to expand beyond their traditional statutory 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 unjustified competitive advantages.

Mission and Regulation of Fannie Mae and Freddie Mac

ACB recommends policy makers strengthen safety and soundness regulation and 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 by establishing an independent regulator with powers and authorities modeled after those of the banking agencies;
- A clear distinction should be drawn between "primary" and "secondary" market activities, 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, and should be based in standard definitions of low and moderate income as defined for most other regulated companies active in the mortgage markets.

Regulation of the Federal Home Loan Bank System

FHLBanks should continue to be organized and operate as 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:

- Maintain the powers and authorities exercised by the Federal Housing Finance Board, but operated within a separate division of an independent regulator to be established for Fannie Mae, Freddie Mac and the FHLBanks;
- 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.

Data Security

Because of the risk to consumers posed by data breaches, and because of the growing patchwork of state laws, ACB supports Congress quickly considering data security legislation that:

- Creates a national standard;
- Exempts institutions subject to existing GLBA data security requirements
- Maintains functional regulation, and
- Provides full reimbursement of costs incurred to protect consumers by those responsible for security breaches.

Regulatory Capital Standards

Before Basel II is enacted, ACB believes that legislators, regulators and the industry should further examine and evaluate 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 should be weighed. 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. All U.S. banking institutions should remain subject to a leverage ratio requirement to support the safety and soundness of the banking system.

Flood Insurance

ACB supports efforts by FEMA, the Administration, and the Congress to implement reforms for the NFIP to help maintain availability of flood insurance, mitigate problems caused by severe repetitive loss properties, and to stabilize the program following the losses caused by Hurricane Katrina. However, any additional action by Congress must clarify that those properties that have experienced losses not expected to be recurrent will not be treated as repetitive loss properties. The program should be self-sustaining and maintain actuarial soundness overall. Additionally, mortgage lenders must be given advance notice of any actions that would impair the ability of the homeowner to repay the mortgage or recoup the value of the property.

Deposit Insurance Reform Implementation

ACB believes that the new risk-based premium assessment system required under the Deposit Insurance Reform Act of 2005 must:

- Be based on appropriate measures of risk to the FDIC;
- Not assess, directly or indirectly, a premium in connection with the use of Federal Home Loan Bank advances;
- Treat depository institutions fairly;
- Be transparent, using objective risk measurements to the greatest extent possible;
- Take into account large, rapid shifts of deposits from brokerage accounts into the deposit insurance system; and
- Minimize regulatory burden.

ACB believes that the FDIC must implement the required assessment, credit and rebate systems fairly and equitably.

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:

- Reducing excessive compliance costs imposed by the internal control requirements of the Sarbanes-Oxley Act (see *Auditing Standards* on page 85);
- Reducing compliance burdens under the Bank Secrecy Act and the USA PATRIOT Act (see *Anti-Money Laundering* on page 55);
- Eliminating small business lending limits and increasing commercial lending authority for savings associations (see *Commercial and Small Business Lending Limits* on page 39);
- Providing equitable treatment for institutions offering fiduciary services;
- Exempting financial institutions that do not share customer information from annual privacy notice requirements;
- Reduce impediments to residential development lending;
- Removing the limitation on investments in auto loans;
- Easing restrictions on interstate banking and branching;
- Clarifying examination authority for state-chartered banks operating on an interstate basis;
- Reducing regulatory costs for smaller institutions;
- 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;
- Removing outdated limitations on investments in financial institution service companies;
- Eliminating geographic limits on savings association service companies;
- Providing reimbursement for the production of records;
- Amending certain parts of the Home Owners' Loan Act and other banking laws; and
- Eliminating the prohibition on banks paying interest on business checking accounts and providing the Federal Reserve authority to pay interest on sterile reserves (see *Interest on Business Checking Option* on page 40).

Explanation

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

- Eliminating small business lending limits and increasing commercial lending authority for savings associations.

  Current law provides 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. Eliminating the restrictions on small business loans and providing a 20 percent "bucket" for other commercial loans would enable savings associations to make more loans to small- and medium-sized businesses, thereby enhancing their role as community-based lenders, without otherwise modifying the mission-direction underlying the qualified thrift lender test.

- 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.

- Exempting financial institutions that do not share customer information from annual privacy notice requirements.

  Banks that do not share their customers' personal financial information with third-parties (other than to complete transactions for their customers) should be allowed to provide an initial GLB privacy notice and provide subsequent notices, only if the banks change their policies and begin to share the information with third-parties. Annually providing copies of a policy that says a bank does not share information provides no benefit to consumers, and only increases regulatory costs of the bank.

- Eliminating Restrictions on Residential Development Lending.

  Savings associations regulated by the OTS can utilize 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.

- 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.

- 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).

- 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 it 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.

- 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).

- Eliminating the prohibition on banks paying interest on business checking accounts and providing the Federal Reserve authority to pay interest on sterile reserves.

  Prohibiting banks from paying interest on business checking accounts is long outdated, unnecessary and

anti-competitive. The repeal of the prohibition would benefit many community depository institutions that cannot currently afford to set up complex sweep operations for their – mostly small – business customers. Likewise, allowing the Federal Reserve to pay interest on so-called sterile reserves would give the Federal Reserve another tool in pursuit of its monetary policy and provide compensation to financial institutions required to maintain the reserves, without the inefficiencies caused by the current prohibition on interest payments to those institutions.

- 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.

- 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. ACB supports increasing the exemption limit to $500 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.

- Removing outdated limitations on investments in financial institution service companies.

  Present federal law stands as a barrier to a savings association customer of a Bank Service Company from becoming an investor in that BSC. A savings association cannot participate in the BSC on an equal footing with banks who are both customers and owners of the BSC. Likewise, present law blocks a bank customer of a savings association service corporation from investing in the savings association service corporation. ACB supports amending the Bank Service Company Act and Home Owners' Loan Act to provide parallel investment ability for banks and savings associations to participate in both BSCs and savings association service corporations.

- 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.

- 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 other banking laws 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 days 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 nonconforming activities under current law. This is inconsistent with the ten-year divestiture period for nonconforming 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.

- 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.

- Home office citizenship.

  ACB supports amending the HOLA to provide that for purposes of jurisdiction in federal courts, a federal savings association is deemed to be a citizen of the state in which it has its home office and its principal place of business (if the principal place of business is in a different state than the home office). Currently, if a federal savings association has interstate operations, a court may find that the federally chartered entity is not a citizen of any state, and therefore no diversity of citizenship can exist. The amendment would provide certainty in designating the state of their citizenship.

- Credit card savings association.

  ACB supports amending the HOLA to permit a savings and loan holding company to charter a credit card savings association and still maintain its exempt status as a unitary savings and loan holding company.

Under current law, a savings and loan holding company would have to charter a national or state-chartered credit card bank to maintain its exempt status. Under this proposal, a company could take advantage of the efficiencies of having its regulator be the same as the credit card institution's regulator.

- OTS participation in international bank supervision.

  ACB supports amending the International Lending Supervision Act of 1983 to assist the OTS' being recognized by international bodies as a consolidated supervisor and to add OTS to the multi-agency committee that represents the United States before the Basel Committee on Banking Supervision. Savings institutions and other housing lenders would benefit by having the OTS perspective represented in the committee's deliberations.

- Protection of information provided to bank regulators.

  ACB supports amending the Federal Deposit Insurance Act to provide that, when a depository institution submits information to a bank regulator as part of the supervisory process, the depository institution has not waived any privilege it may claim with respect to that information. Recent court decisions have created ambiguity about the privileged status of information provided to supervisors.

- Decriminalizing RESPA.

  ACB supports striking the imprisonment sanction for violations of the Real Estate Settlement Procedures Act. It is highly unusual for consumer protection statutes of this type to carry the possibility of imprisonment. Under the ACB's proposal, the possibility of a $10,000 fine would remain in the law, which would provide adequate deterrence.

Other Regulatory Relief Issues

ACB's efforts to address other important regulatory concerns are described under other policies. See: Auditing Standards on page 85 and Corporate Governance & Disclosure on page 53 for a discussion of the Sarbanes-Oxley Act; Anti-Money Laundering on page 55 for a discussion of the Bank Secrecy Act and the USA PATRIOT Act; and Credit Reporting/FCRA on page 63 for a discussion of the Fair and Accurate Credit Transaction Act.

Contact for further information: Ike Jones (202) 857-3132, Krista Shonk (202) 857-3187.

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 1990s, 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 Regulatory Paperwork Reduction Act (EGRPRA), the federal banking agencies must review all applicable regulations every ten years. John Reich, the FDIC Vice Chairman at the time, took the lead on this project, but all of the banking agencies are working together. The FDIC has hosted numerous banker outreach sessions to generate 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 institutions into 12 categories and are issuing one category every six months for a 90-day comment period. In December 2005, the agencies will request suggestions for updating capital requirements and CRA regulations. This will be the last set of regulations to be reviewed under the EGRPRA project. The regulators have already requested comments in the following areas:

- Applications & Reporting, International Operations, Powers & Activities
- Consumer Protection - Lending Related Laws
- Consumer Protection- Account/Deposit Relationships & Miscellaneous
- Money Laundering: Safety and Soundness; and Securities Rules
- Banking Operations; Directors, Officers, and Employees; Rules of Procedure

The agencies have begun to respond to feedback received during the comment periods and opinions voiced during the banker outreach meetings. In November 2004, the OTS issued an interim final rule that modifies application and notice requirements and harmonizes the timing requirements for various publication and public comment procedures.

In addition, the FDIC has established an EGRPRA website 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 EGRPRA website. 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 also 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 USA 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.

Contact for further information: Krista Shonk (202) 857-3187, Patricia Milon (202) 857-3121.

Issue

Charter choice for credit unions and elimination of the tax-exempt status and special regulatory treatment of bank-like credit unions.

Position Statement

All financial institutions, including credit unions, should have the ability to choose the type of charter and regulatory structure under which they operate. Credit unions that want to convert to a mutual savings bank charter should be able to do so without unnecessary regulatory interference. Accurate and complete information about a proposed conversion should be disclosed to credit union members without needless scrutiny from credit union regulators.

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 unjustified 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 seeking to build additional capital or expand their product offerings have sought to convert to mutual savings banks. However, the NCUA has imposed bureaucratic roadblocks to this process. The NCUA's conversion regulations mislead credit union members about conversion and present unnecessary hurdles for converting to a mutual savings bank. The requirements also conflict with the mutual to stock conversion rules established by the OTS.

In 2005, the NCUA went to extremes in an attempt to prevent two Texas credit unions from exercising their right to self-determination. The agency invalidated the two conversion attempts before the member votes were tabulated. The NCUA said the credit unions violated the agency's conversion regulations because required conversion disclosure documents mailed to all credit union members were not properly folded. Litigation ensued and the NCUA eventually agreed to settle the case and allow the credit unions to convert their charters. The NCUA should concentrate on adequately overseeing the credit unions it supervises and should not be preoccupied with trying to control who it regulates.

In light of the litigation surrounding credit union conversions, ACB worked with Congressmen Patrick McHenry (R-NC) and Ed Towns (D-NY) to introduce the Credit Union Charter Choice Act of 2005. This legislation would bring certainty and fairness to the conversion process, while protecting the rights of credit union members.

Credit unions are a $685 billion industry that earned over $5.8 billion in 2004, but paid nothing in taxes. Between 2005 and 2009, the credit union tax exemption will cost the federal government a cumulative 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. 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.

Congress chartered credit unions in 1934 to serve persons of modest means. In return, credit unions were exempted from taxation. However, credit unions are not required to demonstrate that they are fulfilling this statutory mandate. In fact, 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." Credit unions should be required to document their service to low-and moderate-income customers. Credit unions that do not derive the majority of their income from providing loans and deposit services to persons of modest means should lose their federal tax exemption.

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 large 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.

Credit union conglomerates often hide behind the small credit union image to preserve the federal income tax exemption. Many credit unions have formed subsidiaries known as credit union service organizations (CUSOs) that have contributed significantly to the dramatic growth of complex credit unions. CUSOs offer sophisticated products such as trust administration and investment services. CUSOs also provide non-traditional financial services such as real estate brokerage, pre-paid legal service plans and travel agency services. Income generated from bank-like products and non-traditional financial services should be reported to the IRS and subject to taxation.

During the November 2005 House Ways and Means Committee hearing on credit union taxation, Chairman Bill Thomas (R-CA) called for "transparency, accountability, and verifiability" from the credit union industry. ACB submitted draft legislation addressing the Chairman's concerns. The bill is in two parts. The first would require that credit unions file IRS form 990 and be subject to the unrelated business income tax (UBIT). The second would require that credit unions be subject to taxation on all income, but exempting all credit unions with less that $25 million in assets (about 65% of all credit unions) and any credit union that derives 75% of income from services to people of modest means (defined as those with less that 80% of the median income).

Contact for further information: Krista Shonk (202) 857-3187, Greg Mesack (202) 857-3134,
Ike Jones (202) 857-3132

Issue

Safety and soundness, mission, activities and oversight of Fannie Mae and Freddie Mac.

Position Statement

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;[1]
- Have full authority over program and mission to maintain secondary market focus;
- Have full authority to set capital levels;
- Not expand mission by increasing conforming loan limits to finance homes for higher income consumers that are well-served by the private market; and
- Establish appropriate housing goals for the enterprises.

ACB supports public policies that strengthen effective regulation and emphasize the secondary market nature of Fannie Mae and Freddie Mac's assigned role. ACB supports policies that explicitly prevent using the benefits of the Fannie Mae and Freddie Mac'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 and ancillary markets. ACB strongly recommends that Congress pass meaningful reform legislation that specifically outlines that Fannie Mae and Freddie Mac must stay in the secondary market, and it must permit the new regulator to strictly prevent them from entering the primary market. In addition, ACB strongly opposes any attempt to increase the conforming loan limits in high-cost areas for Fannie Mae and Freddie Mac. Through the legislation, the new regulator must also be given effective tools to direct Fannie Mae and Freddie Mac to adhere to their mission of targeting affordable housing.

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

Fannie Mae and Freddie Mac Activities

- There should be no change in the method of calculating the conforming loan limit to attempt to address regional variations in housing costs, or setting higher limits in states with high-cost metropolitan areas. (See *Conforming Loan Limits* on page 47)
- Fannie Mae and Freddie Mac must be prevented from expansion beyond the intended boundaries of their federal charters.
- Fannie Mae and Freddie Mac'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.
- The regulatory regime should establish transparency and fair competition for products and services provided by Fannie Mae and Freddie Mac. The regulator should ensure that the advantages conferred to the enterprises are not used in a manner that disadvantages community banks.
- There should be a clear distinction between "primary" and "secondary" market activities, and Fannie Mae and Freddie Mac should not be involved in activities of the primary market. (See definition of primary

1 Several financial regulators define systemic risk. For instance, the joint interagency statement issued by the FRB, OCC and SEC on April 8, 2003 states: Systemic risk includes the risk that the failure of one participant in a transfer system or financial market to meet its required obligations will cause other participants to be unable to meet their obligations when due, causing significant liquidity or credit problems or threatening the stability of financial markets.

market activities from which Fannie Mae and Freddie Mac should be prohibited under "Explanation.")
- Marketing to or otherwise doing business directly with consumers is inconsistent with Fannie Mae's and Freddie Mac's statutory mission and charter authority. (See *GSE Small Denomination Debt Instruments* on page 50). Fannie Mae and Freddie Mac should not purchase loans that are inconsistent with their federal charters or their conforming loan provisions. Only entities that meet high standards of financial strength and performance should be allowed to sell loans to or service loans for Fannie Mae and Freddie Mac.
- Technology developed by Fannie Mae and Freddie Mac should not be used to access the primary market. Fannie Mae and Freddie Mac 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 Fannie Mae and Freddie Mac to the exclusion of competitive market alternatives.
- Fannie Mae and Freddie Mac should be prohibited expressly from serving as "packagers" under any revised RESPA regulations.
- Fannie Mae and Freddie Mac's 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.

Fannie Mae and Freddie Mac 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 Fannie Mae's and Freddie Mac'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 Fannie Mae and Freddie Mac should reflect the specific financial risks facing each, including realistic treatment of counter party risk. Freddie Mac 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.
- Congress should not directly govern portfolio holdings of Fannie Mae and Freddie Mac. However, in order to manage safety and soundness and systemic risk concerns, the regulator should have authority to adjust Fannie Mae and Freddie Mac's portfolio holdings.
- ACB supports increased transparency and disclosure for Fannie Mae and Freddie Mac's debt, equity and mortgage-backed securities. Generally, disclosure should meet the standards applied by the SEC to private companies that issue securities. However, ACB opposes any attempt to eliminate Fannie Mae and Freddie Mac's exemption from having to register under the Securities Act of 1933.

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

Explanation

ACB recognizes the constructive role of the federally supported components of the housing finance system, including Fannie Mae and Freddie Mac. 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, Fannie Mae and Freddie Mac 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 Fannie Mae and Freddie Mac 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, Fannie Mae and Freddie Mac are not permitted to participate in the primary market for home mortgage loans.

This prohibition from primary market activities for Fannie Mae and Freddie Mac 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 Fannie Mae and Freddie Mac's charters:

- Identifying, soliciting, or contacting potential borrowers;
- Advising, pre-qualifying, 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 Fannie Mae and Freddie Mac internet sites and toll free numbers targeted at consumers;

- Intentionally or unintentionally discouraging competition in mortgage technological innovation and delivery;
- Fannie Mae and Freddie Mac 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 Fannie Mae and Freddie Mac or their charitable foundations, which appear to promote their corporate "brands."

In developing secondary market purchase programs and facilities, Fannie Mae and Freddie Mac 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 GSEs 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.

Contact for further information: Robert Davis (202) 857-5088, Janet Frank (202) 857-3129.

Issue

Reform of the regulatory structure for Fannie Mae, Freddie Mac, and the FHLBank System.

Position Statement

ACB strongly supports ongoing efforts to strengthen the regulation of the housing government sponsored enterprises: Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Any new regulator must have these key characteristics:

- Be independent of the political process;
- Have authority to determine its budget outside the Congressional appropriations process;
- Have supervision and enforcement powers equivalent to those of the federal banking regulators, including the ability to set capital levels; and
- Establish appropriate housing goals for the enterprises.

The agency that regulates Fannie Mae and Freddie Mac must possess authority over programs and mission, as well as safety and soundness.

Regulation of the FHLBank System can be provided by a consolidated GSE regulator, but only if adequate safeguards are provided to recognize and maintain the unique characteristics of the System and ensure the FHLBanks' access to the capital markets.

Status

In late October of 2005, H.R. 1461, the "Federal Housing Finance Reform Act of 2005" overwhelmingly passed the U.S. House of Representatives. Although the Senate Banking Committee passed S. 190, the "Federal Housing Enterprise Regulatory Reform Act of 2005," negotiations between Chairman Richard Shelby (R-AL) and Ranking Member Paul Sarbanes (D-MD) are ongoing. A negotiated deal must be agreed to before it will be brought to the Senate floor for a vote. The Administration has opposed H.R. 1461 because it does not include a provision regarding strict portfolio limits like the Senate's version.

Contact for further information: Robert Davis (202) 857-5088.

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;
- Be funded in a manner that provides that the System's assessments be allocated predominately to the regulation and supervision of the System;
- Possess similar supervision and enforcement powers to those of federal banking regulators to maintain safety and soundness and guard against systemic risk;
- Be organized with a strong emphasis on preserving the current statutory authorities and the cooperative structure of the System;
- 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. We believe that the Federal Housing Finance Board (Finance Board) must work with the Securities and Exchange Commission (SEC) to establish and administer 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.

Questions have arisen within the FHLBank System about how the SEC's Regulation Fair Disclosure (Regulation FD) is to be implemented by the FHLBanks. The FHLBanks should adopt policies that promote timely public disclosure of material information regarding the operations and financial condition of the FHLBanks. Moreover, each Bank's disclosure policy should specifically recognize the Regulation FD exemption that would permit an officer, employee or director of a Bank to discuss material nonpublic information with a person who agrees to maintain the confidentiality of the information. ACB believes that it is essential that FHLBank disclosure policies promote communication of the information needed by the cooperative owners of the FHLBanks to participate fully in their governance.

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, including the public interest directors. We recommend that the FHLBanks establish guidance on director qualifications, where appropriate.

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

ACB supports regular review of the FHLBanks' operations to ensure that individual FHLBanks are operating in a safe and sound manner. Regulation should also include analysis of the risk factors associated with concentration, collateral, and other significant matters related to the System.

Neither the Finance Board nor the FHLBanks' should act to diminish members' ownership rights to the Banks' retained earnings. We urge a thorough review of the current supervisory policy and its implementation by the Finance Board. We believe that the current guidance on retained earnings policies should be issued for public comment and that any changes to the guidance must also be issued for comment.

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 light of the multi-district operations of many members, 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 advance 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 of new independent regulators for Fannie Mae and Freddie Mac and the FHLBanks. In October 2005, the House adopted legislation that would create a structure that was generally acceptable to ACB. An independent regulator for Fannie Mae, Freddie Mac and the FHLBank System would be created. In July 2005, the Senate Banking Committee adopted legislation that was also generally acceptable to ACB. However, that legislation has not yet advanced, chiefly, because of a dispute about limits on the retained assets of Fannie Mae and Freddie Mac.

Any legislation should reflect the differences between the FHLBank System and Fannie Mae and Freddie Mac. 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 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 by its member institutions. FHLBank stock is not available to the public and is not tradable even within an FHLBank without the express permission of the FHLBank.

The FHLBanks' stock and debt instruments should be subject to full, accurate, transparent and enhanced disclosures that are appropriate for this unique GSE. In June 2004, the Finance Board issued a final rule requiring that each Federal Home Loan Bank register a class of securities with the SEC under the Securities Exchange Act of 1934. While we do not believe that the Federal Home Loan Bank Act provides authority to require such registration, the process of registering the Federal Home Loan Banks is well underway, and ACB supports the timely completion of that process. However, the SEC, Finance Board and the Federal Home Loan Banks must work together to harmonize the requirements of the securities laws with the cooperative nature of the System. In particular, the Federal Home Loan Banks should adopt policies on the disclosure of material operational and financial information that permits broad dissemination of information between the Banks and their members and within the Federal Home Loan Bank System.

The current corporate governance structure of the FHLBank System was established by statute. Over the years, certain governance functions have devolved from the regulator to the FHLBanks themselves. ACB members believe that the composition of the Boards of the each of the FHLBanks is a critical element in ensuring that the governance of the FHLBank is undertaken in an appropriate manner. As each of the FHLBanks, and the FHLBank System in general, has evolved into sophisticated financial institutions, we believe that financial, business and operating expertise must be demonstrated by the Board of each FHLBank. We strongly support careful consideration of changes to the statute, the regulation, and practices, which will ensure that each FHLBank has a Board that is composed of members with a stake in the System who understand the commitment and importance of serving on the FHLBank Board. As

the financial structure of the Banks becomes increasing complex, it is important to have strong financial qualifications for all directors so that they can effectively oversee the FHLBanks' operations.

The FHLBanks should have, within the risk-based capital structure, maximum flexibility in determining the most appropriate investment strategy for the FHLBanks, in order to meet the needs of their member institutions and 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 have been successful in many cases and have benefited the members of those FHLBanks. However, some FHLBanks' efforts to operate AMA programs were not successful and raised safety and soundness concerns about the operations of those programs among the members of the FHLB System and the Finance Board. The FHLBanks should continue to be innovative in ensuring that these programs and others meet the evolving needs of their members, and are conducted in a safe and sound manner. 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. Any policies developed must be accomplished in an environment of full industry participation and discussion that preserves the cooperative nature of the System and the vital functions performed by the FHLBank System and its district Banks.

The future of the acquired member assets programs and any resolution of the MDM 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 Procedure Act.

Contact for further information: Ike Jones (202) 857-3132.

Issue

Data Security: Safeguards, Customer Notification, and Credit Freezes.

Position Statement

ACB supports comprehensive data security legislation that:

1) Creates a national standard;
2) Exempts institutions subject to existing GLBA data security requirements
3) Maintains functional regulation, and
4) Provides full reimbursement of costs to protect consumers by those responsible for security breaches.

Background

While banks have had the mandate to safeguard sensitive customer information for years, the growth of the Internet and electronic commerce has made compiling and selling sensitive personal information easier for a multitude of companies. In 2005 a number of high profile breaches occurred that exposed millions of Americans' sensitive account and personal information to criminals. Since these breaches became public, states have been acting to require data safeguards, customer notification in case of a breach, and in some instances the option for consumers to freeze their credit files. Twenty-two states passed bills in 2005, and a number are poised to consider legislation within the next year. Each law has been different.

Explanation

Because of the risk to consumers posed by data breaches, and because of the growing patchwork of state laws, ACB supports Congress quickly considering data security legislation that will provide a uniform, nationwide mandate that unregulated entities, such as retailers and data brokers, be required to take steps to safeguard sensitive information that they hold on consumers. Banks have had such an obligation to protect their customer's sensitive financial information for years.

Currently, six Congressional committees are considering legislative options for improving the security of sensitive consumer information, and providing notices to consumers when there is a breach that places them at risk. Each bill takes a slightly different approach to addressing the problem, as mandated by each committee's jurisdiction. However, not all of the legislation would recognize the unique needs of banks.

In looking at the current legislative landscape, some of the legislation that is being considered includes: S. 1789, introduced by Senate Judiciary Chairman Arlen Specter, S. 1408, introduced by Senator Gordon Smith; H.R. 4127, introduced by Congressman Cliff Stearns; and H.R. 3997, introduced by Congressman Steve LaTourette. Of these bills, H.R. 3997 best meets the needs of ACB's members. First and foremost, having a national standard is critical for any legislation addressing data security and consumer notices. Adding another layer of regulation to a rapidly growing patchwork of state and local laws hurts consumers, hurts the economy, and will not provide effective customer protection.

Additionally, ACB believes that Congress should recognize that the Gramm-Leach-Bliley Act (GLBA) already requires financial services companies to have in place much of what is being considered in most data security legislation. Title V of GLBA requires financial services companies to implement data security safeguards, a customer response program, and a comprehensive privacy policy. This spring the banking regulators issued guidance extending Title V to require customer notices in case of a breach that puts consumers at risk. To layer a duplicative regulatory system on top of this robust framework would only increase costs for financial institutions, and ultimately their customers.
Likewise, financial institutions have an incredibly robust regulatory framework under which they operate. This is particularly true for depository institutions. Because of this existing framework, ACB believes that any legislation considered in Congress should embrace functional regulation as the most efficient and appropriate way to enforce and administer new data security and notification requirements. Both H.R. 3997 and S. 1408 utilize such a system.

Finally, ACB is concerned by efforts to include credit file freezes into comprehensive data security legislation. Credit freezes can do more harm than good for consumers because once a file freeze is in place the consumer is cut off from any new credit. Credit freezes could jeopardize the highly efficient credit granting system that is currently in place in the United States. Safeguards such as fraud alerts already exist thanks to the FACT Act, and they provide a high level of protection for consumers. They are very robust, but do not impair a consumer's ability to get credit.

Unfortunately, none of the legislation being considered currently addresses one of ACB's top priorities, reimbursement. One of the biggest costs associated with a breach is that of reissuing credit and debit cards, and closing accounts placed at risk. In instances where a community bank issued cards affected by a breach, these costs can mount quickly, and the community bank ends up bearing all of the costs itself. Community banks are doing this now because they are dedicated to protecting their customers. However, those responsible for breaches should bear their costs.

ACB urges that Congress pass legislation meeting the above requirements in order to eliminate the growing patchwork of state laws and provide consumers across the nation with strong protections while not adding an extra and unnecessary layer of regulation on banks.

Contact for further information: Greg Mesack (202) 857-3134, Steve Kenneally (202) 857-3148.

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. A simpler Basel I-A could also serve as an alternative standardized approach for Basel II, at least 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. All U.S. banking institutions should remain subject to a leverage ratio requirement to support the safety and soundness of the banking system.

Explanation

Overview

The regulatory agencies have been working for some time on the implementation of Basel II that will apply revised risk-based capital standards to approximately 25 of the largest banks in the United States. In response to ACB's concern that Basel II will provide a competitive advantage to the largest banks, the agencies issued an Advance Notice of Proposed Rulemaking (ANPR) in October 2005 that contemplates changes to Basel I for all other depository institutions. The ANPR essentially would lead to the creation of a Basel I-A. The ANPR was an initial step in the process, to be followed by a notice of proposed rulemaking to be issued around the same time that the agencies issue a notice of proposed rulemaking for Basel II.

Background

In June 2004, the Basel Committee on Banking Supervision finalized a new Capital Accord (Basel II) that would establish revised minimum regulatory capital standards on a global basis. Basel II will permit banking institutions for the first time to use internal risk ratings to determine capital requirements. Basel II has three mutually supporting pillars. Pillar 1 covers the minimum regulatory capital charge for credit, market and operational risk; pillar 2 covers supervisory review of capital adequacy; and pillar 3 requires public disclosure of risk profile and regulatory capital information.

The U.S. banking regulators issued an ANPR in June 2003 to begin the implementation process for Basel II in the United States. The proposal formally set forth the U.S. regulators' position that Basel II would apply only to the 10 or 12 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 would have the opportunity to opt-in to Basel II 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 raised concerns that implementation of Basel II would 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 Basel II.

ACB formed a working group to develop ACB's position on new capital requirements. ACB did not oppose implementation of Basel II in the United States, but in the comment letter for the Basel II ANPR and in Congressional testimony, we emphasized that more examination had to be given to the ability to implement the proposal adequately and the competitive impact of a bifurcated capital system. We also made the case that Basel II should not be implemented in the United States unless changes were made at the same time for community banks so that they, too, could better align capital requirements with balance sheet risk. We encouraged the U.S. regulators to revise Basel I to recognize the lower level of risk of retail loan products, to more accurately reflect the true risks in community bank portfolios, and to lessen the unintended competitive impact of Basel II. We provided specific examples of how Basel I could be made more risk sensitive.

The U.S. banking regulators responded to our concerns by issuing the ANPR in October 2005 to create a Basel I-A. This followed a meeting that the industry had with the regulators in July. The ANPR is an initial step in the process and provides only a general approach for the creation of a Basel I-A. With regard to mortgage lending, the ANPR proposes to add more risk baskets based on loan-to-value ratios and possibly other credit assessments, such as credit scores, that are relevant measures of credit quality. The ANPR also requests comments and suggestions for possible changes to the capital requirements for other retail consumer loans, commercial real estate loans, small business loans, and C&I loans.

The agencies have stated that despite implementation of Basel II for larger banks and any changes to Basel I for community banks, the leverage ratio will remain in place. We have strongly supported keeping the leverage ratio in place to mitigate the imprecision inherent in the internal ratings-based system contemplated by Basel II. However, we have also stated in comment letters and Congressional testimony that the precise level of the leverage requirement should be open for discussion. Institutions that comply with Basel II and a more risk-sensitive Basel I-A may not achieve the full benefits of more risk-sensitive capital requirements if they push up against the leverage ratio. Preliminary data compiled by the FDIC has shown that the leverage ratio will be a restraining factor for most of the Basel II U.S. banks. ACB submitted a comment letter on the Basel I-A ANPR on January 17, 2006.

The current timeline is for the agencies to issue notices of proposed rulemaking for both Basel I-A and Basel II sometime during the first six months of 2006. Basel II implementation is currently scheduled to begin in January 2009. There is no timeline yet established for Basel I-A implementation.

Contact for further information: Sharon Lachman (202) 857-3186, Jodie Goff (202) 857-3158.

Issue

National Flood Insurance Program (NFIP)

ACB's Position

ACB supports efforts by FEMA, the Administration, and the Congress to implement reforms for the NFIP to help maintain availability of flood insurance and to mitigate problems caused by severe repetitive loss properties. However, any additional action by Congress must clarify that those properties that have experienced losses not expected to be recurrent will not be treated as repetitive loss properties. The program should be self-sustaining and maintain actuarial soundness overall. Additionally, mortgage lenders must be given advance notice of any actions that would impair the ability of the homeowner to repay the mortgage or recoup the value of the property. Also, any bill to revise the NFIP should include a permanent NFIP reauthorization. Finally, any bill should clarify the expected scope of any changes under which FEMA might deny, cancel or otherwise change the availability of flood insurance.

Explanation

Repetitive Loss Properties
For many years, FEMA has endeavored to mitigate severe repetitive losses through various strategies, including the purchase, relocation, and elevation of properties that have experienced repetitive losses. The funds available for such mitigation efforts have been limited.

ACB supports increased flood insurance premiums as a way of making property owners take additional responsibility to prevent multiple claims in a short period of time. However, we think any legislation should take into account unusual circumstances that might unduly imperil the homeowner, the lender, or other affected parties.

Specifically, termination of flood insurance or large increases in premiums will have significant consequences for both homeowners and the lenders that have financed the homes. The mortgage lender who extended credit based upon the borrower's ability to pay and the property's market value should be notified formally of any large 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. More importantly, any premium increase should be done in a gradual manner, or in some form of a step process, and not in one immediate spike.

There are also situations where a lender's collateral would be put at great risk by a mitigation buy-out offer that could involve the demolition of the secured property. Lenders deserve some assurances that the proceeds of any buyout would be applied to pay off or reduce the balance of the loan secured by the property. As a result of this concern, we recommend that any possible legislation continue to provide for a formal notice to the mortgage lender or servicer of a buyout offer made under the mitigation program.

Any reform legislation should avoid causing the potential denial of coverage across large geographic regions. For instance, if a region recently experienced an unusually large number of hurricanes, it would not be practicable for FEMA to respond to such circumstances by seeking extensive mitigation or relocation for the entire coastline. Such actions would be neither practicable nor warranted. We believe it is essential that Congress clarify the expected scope of circumstances under which FEMA might deny, cancel or otherwise change the availability of flood insurance to avoid such unintended applications of any statutory change. ACB also opposes imposition of insurance requirements in the 500 year flood plain until sufficient information is available to evaluate the impact of such a change.

Prevent Lapse in NFIP Statutory Authority
ACB supports a permanent extension of authorization of the NFIP. Under the NFIP, financial institutions are prohibited from originating or refinancing loans secured by property in Special Flood Hazard Areas unless covered by flood insurance. A lapse in authorization of the NFIP, as has occurred in the past, causes significant disruption to mortgage markets and to consumers who are trying to finance their homes. To avoid such problems in the future, ACB advocates a permanent extension of NFIP authority.

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

Issue

Implementation of the Federal Deposit Insurance Reform Act of 2005 (Reform Act).

Position Statement

ACB believes that the new risk-based premium assessment system required under the Reform Act must:

- Be based on appropriate measures of risk to the FDIC;
- Not assess a premium in connection with the use of Federal Home Loan Bank advances, or not otherwise treat the use of Federal Home Loan Bank advances as a risky activity;
- Treat depository institutions fairly;
- Be transparent, using objective risk measurements to the greatest extent possible;
- Take into account large, rapid shifts of deposits from brokerage accounts into the deposit insurance system; and
- Minimize regulatory burden.

ACB believes that the FDIC must implement the required assessment, credit and rebate systems fairly and equitably.

Explanation

The Federal Deposit Insurance Reform Act of 2005 gives the FDIC authority to establish a new risk-based system for the assessment of deposit insurance system; provides assessment credits for those depository institutions that capitalized the FDIC funds in the 1990s; and requires rebates to depository institutions whenever the FDIC fund reaches specified levels. The Reform Act requires the FDIC to establish the new risk-based assessment system and the method for providing assessment credits and rebates through the rulemaking process.

The new risk-based assessment system must use appropriate measures of risk to the FDIC fund: quality of management, quality of internal controls, capital, asset quality and similar factors. The FDIC must not assess premiums based on an institution's use of Federal Home Loan Bank advances. The use of Federal Home Loan Bank advances reduces risk to depository institutions by providing a stable source of funding. The new system must be fair -- treating depository institutions with similar risk profiles the same.

The methods for assessing risk must be transparent and should employ objective measures of risk to the greatest extent possible. The FDIC should minimize any additional regulatory burden associated with the new system.

Free riders remain a potential source of instability to the deposit insurance system. Rapidly-growing institutions that materially dilute the deposit insurance reserves should be assessed for this risk.

Contact for further information: Patricia Milon (202) 857-3121, Ike Jones (202) 857-3132.

FUNDAMENTAL POLICY PRINCIPLES

LEGISLATION/REGULATION **CHARTER CHOICE, DUAL BANKING AND BUSINESS FLEXIBILITY**

Issue

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

Position Statement

ACB believes that depository institutions of all types should have the ability to choose the charter that best suits the needs of their customers and business model. This ability has given the United States one of the most robust financial systems in the world, and provided access to basic financial services for a vast majority of Americans. A fundamental part of the U.S. financial system is the ability of a depository institution to change charters when it determines that such a change is necessary to continue serving its customers and communities. Regulators must not be allowed to stand in the way of conversions for self-interested reasons.

Eliminating choices for depository institutions is not the best way to address a lack of coordination among regulatory agencies. Efforts to improve regulation should focus on greater cooperation and coordination, not reducing the number of charters or the flexibility of some 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 on page 100.) Congress should reject proposals that would restrict regulatory flexibility. ACB opposes efforts that effectively minimize the benefits of operating under a national charter and broad regulatory reorganization proposals that reduce the ability of institutions to choose their form of organization or charter, or limit institutions' business flexibility.

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. Distinct charters demand distinct supervisory expertise to bring value. The regulators have developed rules based on statutory authority and the specific needs of the institutions they supervise. 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.

Unfortunately, some in Congress continue 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 holding companies would increase competition and benefit consumers. Blocking this regulatory action is anti-competitive and would set a bad precedent for future enhancements of the powers under the GLBA.

While ACB supports the existence and viability of the industrial loan company charter as a choice, consistent with the limitations that are currently placed on the affiliations granted to unitary savings associations organized after May 4, 1999, ACB does not support expansion of powers and authorities for ILC charters owned by commercial companies, either by acquisition or de novo charter.

Some policymakers 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 institution's 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.

Contact for further information: Patricia Milon (202) 857-3121, Greg Mesack (202) 857-3134.

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 at either the 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 recent years, ACB has been involved in activities that we believe help to preserve and enhance the mutual institution charter. 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 in Oswego, New York, 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.

As a follow up, ACB testified before the Bank Committee of the Connecticut Legislature in opposition to a bill that would impose restrictions on the ability of a savings bank to convert to stock form. 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 has not been enacted, however a similar bill has been introduced each session, and there is a possibility that a similar bill will be discussed again in 2006. ACB will actively oppose such legislation. In Connecticut, the legislature enacted changes to the conversion requirements that were much less onerous than those proposed.

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. Additional changes to the conversion regulations are expected from the OTS in 2006.

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.

Contact for further information: Patricia Milon (202) 857-3121.

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:

- 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, (see *Identity Theft* on page 62).
- Interested affected parties should work cooperatively to improve basic financial education at every level in the education process, especially among youth.
- Interested affected parties should support the U.S. Department of Treasury's Office of Financial Education, which is solely responsible for the U.S. government's plan on financial literacy.

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 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.

Contact for further information: Priya Dayananda (202) 857-3130.

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 the coordination of regulation by banking agencies through established channels, and in particular through 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.

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. Former Comptroller of the Currency John D. Hawke, Jr. 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.

Contact for further information: Sharon Lachman (202) 857-3186.

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 form 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. This includes state laws that require additional or different disclosures for the same products.

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 supported the successful efforts of OTS to become recognized by the European Commission as a consolidated coordinating financial regulator and we continue to support the designation for as many companies as seek the designation. 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.

Contact for further information: Sharon Lachman (202) 857-3186

Issue

Supporting minority and multi-cultural owned financial institutions.

Position Statement

ACB promotes the vitality of minority and multi-cultural owned financial institutions.

Explanation

In December 2001, ACB formed the MBank Council to represent African-American, Hispanic- and Asian-American owned financial institutions, as well as other multi-cultural owned 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 multi-cultural banks, such as customer service, management training, and continuing education for executives and boards of directors; to work with other ACB committees and ACB Business Partners to develop products and services specialized to meet the unique needs of minority and multi-cultural institutions; to partner with federal banking agencies on minority depository institutions' concerns; to work with the U.S. House of Representatives' Congressional Black Caucus, Congressional Asian and Pacific American Caucus, Congressional Hispanic Conference and Congressional Hispanic Caucus; and to serve as a clearinghouse on issues related to minority and multi-cultural financial institutions.

Contact for further information: Priya Dayananda (202) 857-3130.

Issue

Federal tax incentives for homeownership.

Position Statement

ACB opposes proposals to eliminate or restrict the current federal income tax deductions for mortgage interest and real estate taxes. Homeownership provides substantial benefits both to individual homeowners and their communities. Homeownership is a great source of wealth for American families. Homeowners have an average of $121,000 in net equity, which represents half of their net worth. Owning a home is still the American dream. By age 55, more than four-in-five households are owner occupants, and the owners' equity provides considerable financial security as they near retirement.

Tax incentives remain a critical economic support for homeownership as well as a fundamental indicator of federal support of homeownership. ACB supports maintaining the deductibility of all interest paid on loans secured by real assets, including second-deed-of-trust and home equity loans, as well as purchase money and refinanced mortgages, at least at current levels. ACB also supports maintaining the deduction for real estate taxes, at least at current levels. Reducing or eliminating the benefits of these two deductions would constitute the abandonment of the housing aspirations of millions, and greatly diminish the net wealth of the middle-class families.

ACB supports providing federal tax incentives for homeownership to taxpayers who are not able to take advantage of the current tax incentives for homeownership.

Explanation

Currently, taxpayers are allowed to deduct interest paid on up to $1 million of mortgage debt secured by a taxpayer's first or second home. In addition, homeowners may deduct interest on home equity loans of up to $100,000. Other provisions allow taxpayers to deduct state and local property taxes. These deductions are already subject to substantial limits for upper income taxpayers.

In January 2005, the President created the President's Advisory Panel on Federal Tax Reform. On November 1, 2005, the Panel released its final report. The Secretary of the Treasury will use the report in crafting his tax reform recommendations to the President. The Panel devised two tax reform plans. Although both alternatives would eliminate the Alternative Minimum Tax, both would significantly reduce the value of the homeownership tax incentives for millions of American middle-class families. The Panel would replace the mortgage interest deduction with a Home Credit. The Home Credit would be equal to 15% of mortgage interest paid by the taxpayer on his or her principal residence and used to acquire, construct or substantially improve that residence. The size of the mortgage debt available for the credit would be capped at the regional average area home price (currently between $227,000 and $412,000). The Home Credit would be available to taxpayers who do not itemize deductions and those who do. The Panel recommends eliminating the deduction of interest on second homes and home equity loans. Also, under both reform models, the Panel recommended the elimination of the deduction of state and local property taxes.

ACB opposes replacing the current mortgage interest deduction with the Home Credit and eliminating the deduction for property taxes. However, ACB supports providing non-itemizers with homeownership tax incentives that provide a substantially similar economic benefit as the mortgage interest deduction and the deduction of property taxes.

Contact for further information: Ike Jones (202) 857-3132.

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 Relief* on page 6 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 2004, for example, nearly $41 billion, or 3.1 percent of total thrift assets, were in commercial loans, half of which were made to small businesses. This represents an increase of approximately 4 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 November 16, 2005, the House Financial Services Committee passed H.R. 3505, the "Financial Services Regulatory Relief Act of 2005" by an overwhelming bipartisan vote of 67 to 0. This measure would eliminate the small business lending limit restriction on federal savings associations and increase from 10 to 20 percent of total assets the lending limit restriction for other commercial loans. It is anticipated that the full House will adopt the legislation in early 2006, and that the Senate Banking Committee will take up similar legislation in February 2006.

Contact for further information: Ike Jones (202) 857-3132, Robert Seiwert (202) 857-3125.

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 anticompetitive. 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.

On May 24, 2005, the House of Representatives adopted the Business Checking Freedom Act of 2005 (H.R. 1224), which would give banks the option of offering interest on business checking accounts two years after the legislation's adoption. In the meantime, the legislation would increase the number of transfers allowed between interest-bearing accounts and transactions accounts from 6 to 24 per month.

Under H.R. 1224, the House of Representatives authorizes existing industrial loan companies (ILCs) with financial parents the ability to offer business NOW accounts, but denies the expanded authority to newly formed ILCs with commercial parents. ACB supports the legislation, including this limitation on ILC powers.

Contact for further information: Ike Jones (202) 857-3132.

Issue

Savings associations' authority to offer 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. We also will work to ensure that savings associations will have the ability to offer the same trust or brokerage activities on the same terms as other charter types.

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 has developed a revised proposal to implement the GLBA exemptions with input from the banking industry and the regulators. If this proposal were finalized in its current form, the trust and fiduciary business of many banks would be disrupted. Compliance with the proposal would be very expensive and difficult. Many customer relationships would have to be significantly changed or terminated. Further, the proposal does not extend to savings associations all of the exemptions available to banks. The banking industry and the regulators submitted strong letters in opposition to many of the provisions of the proposal. The SEC is reworking the proposal implementing the exemptions. As a result, the SEC has exempted banks, savings associations, and savings banks from the definition of "broker" until September 30, 2006. The extension of the exemption is intended to prevent financial institutions from incurring unnecessary compliance costs while the SEC considers input received during the comment process.

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. The SEC issued a proposal in May 2004 that was unacceptable to ACB. Rather than granting full parity for savings associations engaging in the same activities as those of banks, the SEC proposed limiting the exemption to a narrow portion of the trust business conducted by savings associations. ACB submitted a very strong letter in opposition to the proposal.

Contact for further information: Krista Shonk (202) 857-3187, Ike Jones (202) 857-3132.

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

Supporting the 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 customers 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: Robert Seiwert (202) 857-3125.

Issue

Small Business Access to Capital

Position Statement

ACB supports legislative and regulatory policies that allow community banks to offer their small business customers cost-effective access to government guaranteed intermediate and long-term funding sources. ACB also supports the agency's role in providing timely, cost effective and targeted loan programs for small business disaster relief. Rules, regulations and laws that limit the ability of the U.S. Small Business Administration (SBA) to provide community banks with ongoing, cost effective and easily accessible, government guaranteed loan programs for small businesses will be opposed.

Explanation

Many small business owners indicate that one major obstacle to entry or expansion of their small business is the availability of sufficient intermediate and long-term capital to support their working capital and fixed assets requirements. Because of the inherent risk, banks need help in sharing the risk posed by making intermediate or long-term capital loans to small businesses.

In the past, the SBA has been an important partner in providing the loan guarantee programs needed by community banks to provide the appropriate intermediate and long term capital to their small business customers. The two SBA loan guarantee programs most used by community banks today are their 7(a) and their 504 loan programs.

Over the years, the SBA's 7(a) program has successfully served as the premier small business government loan program for many start-up and growing small businesses that lack sufficient access to capital. Loan proceeds can be used for a number of business purposes including working capital, machinery and equipment, furniture and fixtures, land and building, leasehold improvements, and debt refinancing.

The SBA's Certified Development Company (CDC) 504 Loan Program complements the 7(a) program by providing small businesses with the necessary long-term, fixed-rate financing needed by them to acquire real estate or equipment for expansion or modernization. Typically a 504 project includes a loan secured from a private-sector lender with a senior lien, a loan secured from a CDC (funded by a 100 percent SBA-guaranteed debenture) with a junior lien covering up to 40 percent of the total cost, and a contribution of at least 10 percent equity from the borrower.

Community banks continue to experience a strong demand for intermediate and long-term loans from their small business customers and prospects. The SBA's 7(a) and 504 loan programs are important ingredients in helping community banks provide this funding to their small business customers and prospects. Without these loan guarantee programs many small businesses would not be able to obtain the necessary capital to establish or grow their businesses. The availability of cost effective and timely loan guarantee programs to aid small businesses in recovering from natural or manmade disasters is also of critical importance to community bankers.

ACB will work both independently and jointly with other trade associations to assist federal banking organizations and other rule making bodies in assuring the ongoing availability, efficiency and viability of the SBA's loan guarantee programs.

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

RETIREMENT SAVINGS

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

In the past, 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. 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.

It is anticipated that Congress will once again take up pension reform legislation in the 109th Congress. ACB will continue to oppose legislation that would create rigid rules severely limiting or restricting employee investments in company stock.

Contact for further information: Ike Jones (202) 857-3132.

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 supports the proposal to allow younger workers to direct at least a portion of their Social Security taxes into personal accounts. Community banks and the investment products they offer, including insured deposits, should be a part of any such proposal. Because community bankers understand the creation of wealth and their customers, they are in an excellent position to help consumers choose appropriate investments for these personal accounts. Insured deposit accounts will be the most appropriate investment for many consumers. Therefore, insured deposit accounts should be an option for workers choosing personal 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 for 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 the number of 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 personal 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. However, in November 2004, President Bush set Social Security reform as a major domestic priority for his second term.

Most reform 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.

In 2005, Members of Congress introduced several bills promoting Social Security reform through personal retirement accounts, including S. 587 by Senator Sununu, H.R. 530 by Representative Sam Johnson and H.R. 1776 by Representative Paul Ryan.

Contact for further information: Ike Jones (202) 857-3132.

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, from time to time, legislative proposals are initiated that would raise conforming loan limits in states with high-cost metropolitan areas. 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 Federal Housing Finance Board's (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 legislation or a 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 nonmortgage 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: 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

FHA programs were created solely to help increase homeownership for low to moderate income individuals who could not afford a mortgage. If the existing FHA loan limits for "high cost areas" were implemented nationwide, many individuals who could reasonably afford a mortgage could take advantage of a mortgage program not intended for their use.

The expansion of FHA programs in this manner unnecessarily extends a full faith and credit government program to an area well served by the private sector.

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 Government Sponsored Enterprises (the GSEs), including Fannie Mae, Freddie Mac and Farmer Mac, 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

There has been an increase in the percentage of long-term funding made up of these small denomination debt instruments. If the GSEs continue to 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 may represent 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 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.

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

Issue

Refocusing the mission of the Farm Credit System on agricultural loans to family farmers.

Position

ACB opposes expanding the powers of Farm Credit System (FCS) institutions to compete unfairly against tax-paying community banks. Such powers include a variety of regulatory and industry proposals aimed at transforming FCS lenders into full-service retail lenders by providing a wide array of consumer loans and commercial loans to non-farm borrowers. The mission of the FCS should be refocused on its historical purpose – providing agricultural loans to family farmers with limited resources. The FCS should primarily be required to work with community banks, particularly as a funding source and through loan participations.

Explanation

Congress created the FCS to serve the needs of family farmers and ranchers for agricultural loans. However, FCS institutions have increasingly focused their lending on large agricultural interests, rather than bona fide ranchers and farmers. Moreover, the Farm Credit Administration (FCA) has granted FCS institutions powers beyond their traditional agricultural lending role. The cumulative impact of such changes represents a dramatic departure from the mission of the FCS and its limited-purpose charter.

Recently, the full-time professional managers of the FCS have launched a campaign to convince the FCA and Congress to grant the system even more powers that would transform the FCS into a full-service finance company that is focused on business and consumer lending. Given the system's tax and GSE funding advantage, an expansion of the system's powers increases its government-created competitive advantage against rural community banks.

ACB believes the FCS needs to be opened up as a funding source for community banks serving agriculture. In addition, Congress should ensure that the FCS faces comparable regulatory safeguards and controls as are being developed for the housing GSEs. The FCA should focus on regulatory actions that increase safety and soundness of FCS institutions in lieu of issuing proposals to expand FCS powers. Since FCS lenders are unique among GSEs as retail lenders, they should be subject to the same disclosures and transparency requirements as community banks. ACB will urge the FCA and Congress to restrict the FCS to its historical mission of serving family farmers.

Contact for further information: Ike Jones (202) 857-3132.

SAFETY AND SOUNDNESS

Issue

Natural Disaster Insurance Program.

Position Statement

ACB supports development by the federal government of a mechanism for spreading the risk of major natural disasters (including earthquakes, hurricanes, tornadoes, fire and volcanic eruptions) over a risk pool including all holders of improved commercial and residential 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 recently occurred across the country, demonstrate that natural disasters can overwhelm the capacity of private industry and local and state 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 and participant pools are necessary. In particular, all types of improved residential and commercial properties—whether mortgaged or unmortgaged—should be included in the Natural Disaster Insurance Program to spread the risk.

Contact for further information: Priya Dayananda (202) 857-3130, Greg Mesack (202) 857-3134.

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 supports legislative, regulatory and private initiatives to promote "best practices" in corporate governance, but believes that it is essential to reduce the existing excessive compliance burdens 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 for widely held companies.
- 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; and
- 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.

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."

Recently, more attention has been placed on studying the impact of Sarbanes-Oxley and the SEC regulations, particularly with regard to small companies and access to the capital markets generally. The SEC established an advisory committee to examine the impact of Sarbanes-Oxley and other federal securities laws on smaller public companies. That group met several times throughout this year and is expected to submit a final report with recommendations to the SEC by April 2006. It is anticipated that the recommendations will call for relief from the Sarbanes-Oxley section 404 internal control requirements for smaller public companies (see also *Auditing Standards* on page 85, for ACB's position on reducing the burden with regard to internal control reporting and attestation.) ACB believes it essential to reduce the significant and costly burdens that Sarbanes-Oxley imposes on smaller and mid-size community banks.

Contact for further information: Sharon Lachman (202) 857-3186.

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. In today's vigorous regulatory environment, FinCEN and the federal banking regulators should clarify their anti-money laundering ("AML") expectations as new compliance questions arise and financial criminals develop new methods to launder illicit funds. Although anti-money laundering prevention is an important national security objective, the federal banking agencies should consider a community bank's limited resources when evaluating 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. Today, financial institutions are required to establish detailed procedures for scanning their customer databases for names of possible terrorists, gathering and maintaining information about their customers' identities, and closely monitoring accounts for signs of suspicious activity. ACB strongly believes that anti-money laundering detection efforts should be based on an institution's exposure to money laundering risk. Furthermore, all anti-money laundering reporting requirements should provide demonstrable value to law enforcement and enhance our nation's security.

On June 30, 2005, FinCEN and the federal banking regulators jointly issued the BSA/AML Examination Manual. The manual includes examination procedures and extensive BSA background material that is designed to ensure examination consistency across the agencies and within each agency. The regulators will update the manual in summer of 2006. ACB has specifically requested the regulators to provide community banks with additional guidance for conducting a BSA risk assessment and developing and documenting internal anti-money laundering controls. ACB will monitor the experience of community bankers examined under the new procedures and will continue to forward suggestions to the regulators for improving the manual.

Recent anti-money laundering exams have placed renewed emphasis on suspicious activity reporting ("SAR") and currency transaction reporting ("CTR"). However, community banks are often uncertain whether a particular set of facts warrants a SAR filing. ACB urges FinCEN to provide additional information about what constitutes suspicious activity and how to monitor for it. Without additional guidance regarding what events trigger a SAR and what events do not, institutions will continue to file "defensive" SARs to protect themselves from the vigorous regulatory environment.

Our nation's anti-money laundering efforts can be improved by ensuring that only relevant information is reported to the authorities. The utility of currency transaction reports (CTRs) has been questioned in recent years. Because the CTR exemption process is burdensome, many community banks file CTRs on all cash transactions over $10,000. To address this issue, the House Financial Services Committee adopted legislative language that would allow institutions to exempt certain customers from CTR reporting based on the institution's knowledge of the customer's routine transactions. Institutions would be required to file a one-time notice with FinCEN.

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

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. Banks have always worked collaboratively with law enforcement but 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.

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.

In the 109th Congress, there were attempts in the Senate to include an amendment to the Commerce, Justice, State and the Judiciary appropriations bill, which would have addressed the regulation of Internet gambling and its enforcement.

ACB expects to see the House and Senate address the issue of Internet gambling again in 2006.

Contact for further information: Priya Dayananda (202) 857-3130.

Issue

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

Position Statement

ACB supports retaining the standard that an independent contractor can 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 "knowing 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 threshold for legal liability 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 contributes 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: Ike Jones (202) 857-3132.

Issue

The use of alternative home loan mortgage products, including Interest Only ARMs, Option ARMs, Limited or No-Documentation Loans, and High Loan-to-Value Ratio Loans.

Position Statement

ACB supports the ability of banks to use mortgage products to serve the needs of a broad array of consumers without undue restrictions from regulators. When appropriate underwriting practices are used, ACB believes that banks can use these mortgage products beneficially. ACB does not believe that any of these alternative mortgage features, either singly or in combination, are unduly risky. ACB supports adequate disclosure to potential borrowers about the terms of these mortgage products. ACB believes that lenders can protect themselves against market downturns through careful management and sensible underwriting practices. ACB believes that restrictive standards on the use of these mortgage products are unnecessary for regulated financial institutions.

Explanation

During the past year, bank regulatory agencies have expressed concern about risks associated with the growth of alternative home mortgage products, including Interest Only ARMs, Option ARMs, Limited or No-Documentation Loans, and High Loan-to-Value Ratio Loans. Some regulators have labeled these "exotic" or "non-traditional" mortgages. Their concerns focus on the health of financial institutions, as well as on the impact on borrowers, of alternative mortgages when there is a downturn in the housing market or when the required monthly payments rise.

On December 20, 2005, the federal financial institutions regulatory agencies jointly issued for public comment a proposed guidance on "non-traditional" mortgages. ACB will submit comments that express ACB's views that the proposed guidance may be too restrictive and prescriptive regarding underwriting and risk management standards. Additionally, ACB believes that the consumer protection guidelines are unworkable and impose de facto changes to Reg Z regarding Adjustable Rate Mortgage (ARM) disclosure requirements because these changes would not apply to non-regulated lenders.

For many ACB members, these loans are not considered "exotic" or "non-traditional" because they have been originating these mortgage products for decades. Negatively amortizing home loans have been in wide use in some markets since the 1980s with no increased incidence of non-performance or default.

These products confer major benefits for both the financial institutions and homebuyers. Interest Only ARMs, Hybrid ARMs and Option ARMs allow banks to share interest rate risk with the borrower in exchange for offering the borrower more flexibility in payments. These products create unacceptable risks only when not underwritten properly. Non-bank lenders and brokers that are not subject to bank-like examination and supervision have used these products in some cases to get borrowers into homes they could not otherwise afford. Restrictions on regulated financial institutions would do nothing to control the practices of these lenders.

ACB believes that regulated financial institutions do not need further regulatory restrictions on mortgage products. Members already take various underwriting precautions, including underwriting the loan to the fully indexed payment and requiring higher down payments for loans with less documentation. ACB believes lenders can originate alternative mortgage products in a safe and sound manner with the management systems they currently employ.

Finally, members can choose to protect themselves from market downturns by selling these alternative loans into the capital markets, transferring the risk to investors.

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

Issue

Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

Position Statement

ACB strongly supported the Bankruptcy Prevention and Consumer Protection Act of 2005 (Act). The Act contains important reforms of the nations bankruptcy laws, including the following:

- Needs-based bankruptcy (means testing for Chapter 7 relief);
- A limitation on repeat filings;
- The elimination of cramdowns;
- Consumer education; and
- Elimination of unnecessary creditor representation requirements.

The Judicial Conference of the United States has issued interim rules to implement the Act. In 2006, The Conference will begin a rulemaking process to provide permanent rules and forms in the Federal Rules of Bankruptcy Practice to implement the Act. Additionally, the Federal Reserve is undertaking rulemaking to implement changes to the Truth-In-Lending Act that were included in the Act. ACB supports permanent rules that strictly implement the Act in order to prevent the abuses of the bankruptcy system, as Congress intended.

Explanation

On April 20, 2005, the President signed into law the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005" (P.L. 109-8). The means test and consumer protections provisions became operative on October 17, 2005.

There are some portions of the new bankruptcy reform law that require the Federal Reserve to promulgate several new consumer disclosure rules. Although the Federal Reserve issued an Advance Notice of Proposed Rulemaking on the subject in December 2004, it reopened the process in order to address changes in the Truth in Lending Act made by the new bankruptcy law.

In addition, the Judicial Conference of the United States has authority over the implementation of the new law. The Judicial Conference's Advisory Committee on Rules of Bankruptcy Procedure of the Judicial Conference ("Committee") is specifically tasked with this process.

On August 22, 2005, the Judicial Conference issued interim rules to implement the Act, and announced its intentions to publish proposed permanent rules in August 2006, with final adoption and an effective date no later than December 1, 2008. ACB will actively monitor and participate in the rulemaking process to advocate permanent rules that reflect congressional intent to end abuses of the national bankruptcy system.

Among the important reforms achieved in the Act are:

Means Testing – A Chapter 7 case may now be dismissed as an "abuse" of Chapter 7 if the debtor's net income is too high for the state where the debtor resides. The "means test" formula is used to identify those Chapter 7 cases. The formula should reflect the intent of the law that individuals who can repay their debts must seek relief under Chapter 13.

Repeat Filings – The new law only permits a debtor to file under Chapter 7 every 8 years, and a debtor cannot receive a discharge in a Chapter 13 case, if the debtor received (a) a Chapter 7, 11, or 12 discharge in a case filed within 4 years of commencement of the Chapter 13 case, or (b) a Chapter 13 discharge in a case filed within 2 years of the commencement of the Chapter 13 case.

Cramdowns – Under the old law, Chapter 13 debtors tried to strip liens off of collateral where the collateral was worth less than the secured claim(s) it secured. To compound the problem, the courts were not consistent as to whether a debtor was permitted to strip off liens in Chapter 13. Under the new law, the secured creditor's lien is preserved in order to secure his right to payment for the unsecured portion of his claim.

Consumer Education – The new law establishes that an individual debtor may not file a bankruptcy petition unless he completes a course with an approved nonprofit budget and credit counseling agency. Also, individuals will not receive a discharge in Chapter 7 or 13 unless, during their bankruptcy case, they complete an instructional course concerning personal financial management approved by the United States Trustee.

Creditor Representation – The new law establishes that a creditor holding a consumer debt of the creditor's representative may appear and participate in the meeting of creditors without being represented by an attorney.

Contact for further information: Patricia Milon (202) 857-3121, Priya Dayananda (202) 857-3130.

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 and local governments from further restricting information sharing activities.

Explanation

The recently enacted Fair and Accurate Credit Transactions (FACT) Act creates measures, in addition to those in the 1999 financial privacy law, intended to preserve the privacy and security of customer information. The FACT Act includes new requirements governing the disposal of consumer data, new guidelines on potentially fraudulent activities for which banks should look, substantial new procedures to combat identity theft, and other measures. ACB will work with its member institutions and regulatory authorities to ensure continued compliance with customer information privacy requirements and to implement the FACT Act.

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. It also requires financial institutions to establish comprehensive information security programs for safeguarding customer records (the "501(b) standards"). ACB is committed to working with regulators to ensure that these provisions are effective, but do not pose a large financial or regulatory burden for financial institutions. ACB is particularly concerned about the cost of sending yearly privacy notices to customers. From the community bank perspective those institutions that do not make changes to their privacy policies should be exempted from the need to send annual privacy notices.

GLBA also includes a potentially explosive provision, which allows 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 FACT Act reauthorized the preemption of state laws allowing the sharing of credit information between companies and their affiliates, but the risk of other onerous financial privacy laws remains.

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, the Right to Financial Privacy Act and the FACT Act.

Contact for further information: Greg Mesack (202) 857-3134, Steve Kenneally (202) 857-3148.

Issue

Combating identity theft.

Position Statement

ACB supports efforts to implement recently passed laws to combat the growing epidemic of identity theft, and to continue working to identify and address emerging threats to consumers. ACB believes that financial regulators must work with financial institutions to identify new techniques used by criminals to defraud consumers in the rapidly evolving world of identity theft. In addition, ACB supports passing comprehensive federal legislation to protect sensitive consumer information that could be used to commit identity theft. However, any legislative solution considered should allow financial institutions the flexibility to select appropriate security technologies to manage this ever-changing risk instead of designating a static solution.

Explanation

Congress enacted the Fair and Accurate Credit Transactions (FACT) Act in 2003, creating 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.

In 2004, Congress followed up on the landmark FACT Act by passing legislation to increase the penalties for committing identity theft, and passing the CAN SPAM Act to fight spam, which is increasingly used to carry out identity theft. Techniques such as "phishing" and "spoofing" are being used more and more to dupe unsuspecting consumers into giving their personal financial information to fraudsters. Financial regulators are working to provide information to consumers on the threats posed by identity theft scams. In 2004, the national bank, thrift, and credit union regulators jointly released a brochure highlighting the threats posed by phishing.

Identity thieves are constantly creating new tools to defraud consumers. 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 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.

Recently, data breaches by a number of companies have made sensitive consumer information, such as Social Security numbers, available to criminals. Such information can be used to commit identity theft, and federal legislation should be passed to better protect sensitive personal information. (For additional information see the *Data Security* policy position on page 24.)

Contact for further information: Greg Mesack (202) 857-3134, Steve Kenneally (202) 857-3148.

Issue

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

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 Transaction Act of 2003 (FACT Act). The FACT Act:

- Permanently reauthorizes the uniform, national standards of the FCRA that govern the use of 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;
- Establishes a comprehensive framework for preventing and combating identity theft;
- 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.

In 2006, the Federal Reserve and the Federal Trade Commission are expected to release studies related to Use and Effects of Credit and Insurance Scores, Affiliate-Sharing, Prompt Investigation of Disputed Customer Information, and Accuracy and Completeness. The final rulemaking on Affiliate Marketing is expected in mid 2006.

ACB will focus its efforts on ensuring that regulatory action implementing the FACT Act provides financial institutions the necessary flexibility to conduct their current and future information sharing activities without undue interference, while also providing real protections for consumers.

Contact for further information: Steve Kenneally (202) 857-3148, Greg Mesack (202) 857-3134, Janet Frank (202) 857-3129.

Issue

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

Position Statement

Congress should pursue national, anti-predatory lending standards to create uniformity and ensure consistency among state-based mortgage lending initiatives. A uniform national standard would have significant benefits for consumers, including:

- Curbing abusive and deceptive practices by mortgage 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 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 bipartisan federal legislative response 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.

ACB believes that there are several policies that are critical to achieving these policy goals. First, it is important that any new predatory lending law does not alter the current regulatory structure by making federally chartered institutions subject to state regulation. Any new predatory lending standard should create a level playing field for institutions to compete, without placing new restrictions on federally chartered institutions.

Second, ACB believes that the rate and fee triggers for any uniform predatory lending law must not be set too low. It is important that a predatory lending law be tailored to focus on the areas of the market where abuse is likely to take place, while not being written overly broadly so as to limit the availability of credit for those in need.

ACB also advocates limiting assignee liability for loans subject to predatory lending laws. The secondary market is now the principal source of capital for mortgage lending. Because of the evolution of mortgage finance, if investors are unwilling to purchase pooled mortgages, consumers will not be able to get loans. The current system of unlimited assignee liability for high-cost loans acts as a usury cap for higher risk borrowers because it scares capital away from loans subject to assignee liability. Without liquidity, the market for high-cost mortgages will dry up, depriving borrowers of needed credit.

In addition to lenders, there are other important actors, such as mortgage brokers and appraisers, who influence whether borrowers receive loans that are right for them. The laws regulating brokers and appraisers lack uniformity; in fact, some states do not license mortgage brokers. There needs to be strong, uniform regulation of mortgage brokers and appraisers. This is important to protecting both borrowers and lenders.

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 stated: “Abusive mortgage loans are not generally a problem among financial institutions that are subject to regular examination by federal and state banking agencies.”

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 harming consumers. These laws often act as usury limits that prevent access to credit.

Policy makers should distinguish between "subprime lending" programs and "predatory lending" practices. These terms are often mistakenly used interchangeably. Responsible subprime lending provides needed mortgage 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. Policy makers should not impose new laws and regulations that inaccurately label subprime loans as "predatory" or that stigmatize legitimate loan terms.

In the House of Representatives several bills have been introduced to address the problem of predatory lending. Among these are H.R. 1295, introduced by Representatives Ney and Kanjorski, and H.R. 1182, introduced by Representatives Miller (NC) and Watt. While both of these bills are well intentioned, ACB's members have concerns about their potential impact on the lending activities of financial institutions. ACB looks forward to working on developing these bills further to create a workable uniform national standard for subprime lending.

Additionally, ACB is concerned about county ordinances, such as that in Montgomery County, MD, which links certain lending practices with discrimination. These laws threaten to dry up credit for communities and make lenders susceptible to charges of discrimination with few due process protections or opportunities for redress.

Contact for further information: Greg Mesack (202) 857-3134, Janet Frank (202) 857-3129, Priya Dayananda (202) 857-3130.

Issue

Reforming the mortgage settlement process.

Position Statement

ACB supports enhancement of a consumer's ability to shop for, obtain and understand the terms of a mortgage loan. The current Good Faith Estimate works and settlement services "packages" are evolving without new regulations or the Section 8 safe harbor.

ACB believes that any comprehensive reform of the Real Estate Settlement Procedures Act (RESPA) should:

- Be accomplished through the rulemaking process.
- Include a reasonable transition period.
- Be structured to improve the settlement process for consumers, without disrupting the smooth operation of mortgage markets or significantly increasing the regulatory burden for lenders.
- Require the disclosure of Yield Spread Premiums (YSPs) that are paid to brokers who are not employees of lenders.
- ACB generally does not oppose packaging of settlement services, however new regulations are not necessarily required to make packaging viable and available. ACB supports allowing lenders to use third-party service providers to provide all or part of a settlement package.
- HUD should not simultaneously amend its regulations to revise the GFE at the same time it changes the regulation to allow packaging. The packaging proposal should be implemented and tested by the market before changes are made to the GFE.
- The GFE should remain an estimate that a lender makes in good faith, subject to changing loan provisions and conditions, and not be converted to a binding document.
- There are a number of state and federal requirements that are duplicative of or conflict with the original RESPA proposal. ACB believes that HUD should attempt to work these issues out with other jurisdictions, and if this were not possible, to assert preemption. It is also important that HUD work with federal banking agencies to ensure that any accounting, examination or supervision concerns are addressed.
- ACB supports inclusion of an opportunity to cure and/or provide remedies for errors or violations of packaging or GFE requirements

Explanation

Over the past several years, there have been a number of initiatives intended to address possible reform of the mortgage settlement process. During this time, ACB worked with other industry groups, consumers groups, HUD and the Federal Reserve to develop a proposal to amend the applicable regulation in order to update and reform the process.

In July 2002, HUD published a proposed rule entitled "Simplifying and Improving the Process of Obtaining Mortgages to Reduce Settlement Costs to Consumers." The proposal consisted of three major areas of reform: (1) disclosure of mortgage broker fees to borrowers; (2) significant changes to the good faith estimate (GFE); and (3) establishment of a safe harbor from Section 8 of RESPA to allow entities to offer guaranteed packages of settlement costs to borrowers, as an alternative to the GFEs.

In October 2002, ACB submitted comments to HUD on the proposal. ACB generally supported HUD's goals, but expressed serious concerns about various parts of the proposed rule. In particular, ACB objected to converting the current Good Faith Estimate (GFE) into a binding document, instead of an estimate that a lender makes in good faith, subject to changing loan provisions and conditions.

In March 2004, in response to industry and Congressional pressures, HUD withdrew the RESPA proposal for further review and analysis. At that time, HUD Secretary Alphonso Jackson reaffirmed his commitment to RESPA reform and promised to consult with all affected industry groups issuing an amended proposal or a final rule. In the summer of 2005, ACB members and staff articulated the association's position in various roundtable discussions that HUD held on RESPA throughout the country with affected industry groups.

It is unclear when HUD will take the next action in the RESPA rulemaking process. However, HUD has indicated that it will move ahead to establish a new framework for borrower disclosures under RESPA, which would:

- Address the issue of mortgage broker compensation (specifically the problem of lender payments to mortgage brokers) by fundamentally changing the way in which such lender payments in brokered mortgage transactions are recorded and reported to borrowers;
- Significantly improve the GFE and amend HUD's related RESPA regulations, to make the information provided in the GFE more useful to consumers, to facilitate shopping for mortgages and to avoid unexpected charges to borrowers at settlement; and
- Remove regulatory barriers allowing lenders, and possibly others, to offer guaranteed packages of settlement services to consumers to further reduce settlement costs.

ACB will continue to monitor closely HUD's activities regarding RESPA reform and to work with HUD to support a rule that will improve the real estate settlement process for borrowers in a manner that does not disrupt the mortgage origination business.

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

Issue

Implementation of Community Reinvestment Act.

Position Statement

ACB members are committed to making credit available to the communities in which they operate. ACB will continue to work with Congress and regulators to ensure that the intent of the Community Reinvestment Act (CRA) is not lost in its implementation, and will continue to urge regulators to review CRA rules for their effectiveness in placing performance over process, promoting consistency in evaluations, providing flexibility in the examination process, and eliminating unnecessary burdens.

ACB will resist actively any attempts to lower the current OTS definition of "small" savings institutions (less than $1 billion in assets) or to change the existing OTS rule for CRA to correspond with other federal financials institutions regulatory agencies.

ACB also requests the following areas of emphasis as part of that review process:

- 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 optional 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. On August 2, 2005, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Reserve Board of Governors issued final amendments to the rule that implements the CRA. The final rule was effective on September 1, 2005.

The final rule reduced the CRA regulatory burden by raising the asset size threshold for small banks to less than $1 billion and by adding a new category, "intermediate small bank," with an asset size threshold between $20 million and less than $1 billion in assets. An intermediate small bank will be evaluated for CRA purposes under two tests: the current streamlined small institution examination lending test, and a community development test that includes review of the number and amount of community development loans and qualified investments as well as a review of the bank's provisions of community development services. For all banks, the rule expanded the definition of "community development" to include activities that revitalize or stabilize distressed or undeserved rural areas including low income as well as moderate-income tracts and middle income non-metropolitan tracts. The rule provides that evidence of discrimination will adversely affect a bank's CRA performance. The regulators have issued examination procedures for small institution banks that describe the scope of the examinations, the changes to the performance context and lending criteria.

The Office of Thrift Supervision finalized its regulation that implements CRA earlier in 2005. The definition of small savings association was amended to be a savings association with less than $1 billion in assets. The OTS regulation does not include an intermediate savings association category as was adopted for banks. In addition, OTS did not add a community development test to be used in examining intermediate small savings associations.

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

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

Issue

Retention of the ability to provide a variety of overdraft protections to customers who write checks on accounts with insufficient funds.

Position Statement

ACB supports the ability of community banks to provide both credit-based and discretionary overdraft protection services for customers within a rational regulatory scheme that uses an optimal practices approach, and which incorporates efforts to fully inform and educate consumers regarding appropriate use of such services. ACB opposes efforts to bring discretionary, non-credit services under the coverage of the Truth in Lending Act (TILA) and Regulation Z.

Explanation

Many community banks offer discretionary overdraft protection services for their demand deposit accountholders. These services may or may not be offered as part of a menu that also includes overdraft lines of credit or linked account features. Reflecting the discretionary nature of the service, 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. Customers benefit because they do not have to pay a fee to the merchant and the bank's NSF fee, and they are not embarrassed by having the check returned.

In addition to these traditional approaches to handling overdrafts in the absence of a line of credit, there are several vendors that have developed more formal programs for community banks to implement an automated approach.

ACB believes the following factors to be among the important factors for community banks to consider when offering overdraft protection programs:

- 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 ATM receipts must clearly indicate actual amounts on deposit, whenever possible.
- 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.

In 2005, the Federal Reserve amended Regulation DD (Truth in Savings Act) in response to concerns about the marketing and expansion of overdraft protection programs. Under the new regulation, institutions that advertise overdraft protection programs must disclose on a customer's periodic statement the total amount of fees or charges imposed for paying overdrafts and the total amount of fees charged for returning items unpaid. In addition, the new rule requires institutions to specify in their TISA account-opening disclosures the categories of transactions for which an overdraft fee may be imposed. The account-opening disclosure requirements apply to all institutions, regardless of whether the institution actively promotes or advertises the service. The rule also includes examples of advertisements that would be considered misleading. The Federal Reserve declined to extend the coverage of TILA, but stated that its adoption of the final rule under Regulation DD does not preclude a future determination that TILA disclosures would also benefit consumers.

The Federal Reserve's regulation follows interagency guidance issued in March 2005 (with the OTS issuing its own version) that includes best practices to employ when offering overdraft protection services. ACB believes the best practices should not be mandatory. Rather, institutions should be permitted to tailor their policies and procedures to their specific business model and customer base. Taken together, the new guidance and requirements are intended to avoid consumer confusion regarding when and how overdrafts are paid, as well as the fees associated with this deposit account service.

Separate from regulatory developments, the issue of overdraft protection and TILA coverage is working its way through the courts. Late in 2004, ACB filed a friend-of-court brief in a case on appeal to the U.S. Ninth Circuit Court of Appeals, which is being asked to overturn a lower court ruling that discretionary overdraft protection programs are not subject to TILA. ACB argued that the appeals court should uphold the lower court and defer to the view of the Board, which is charged with implementing TILA, and, as noted above, has declined to expand TILA's coverage for now, but has indicated that it will continue to study these types of services and programs for possible future changes. ACB also pointed out the consumer benefits to these programs, the high levels of satisfaction, and the operational difficulties of attempting to apply a credit disclosure statute and regulation in a non-credit context. The case will be argued in February 2006.

ACB will continue to provide feedback to the federal banking regulators on this issue and to oppose expanding the scope of TILA to include discretionary services.

Contact for further information: Krista Shonk (202) 857-3187, Steve Kenneally (202) 857-3148.

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. We oppose efforts by states and other jurisdictions to impose different or additional disclosure requirements on those institutions operating in multiple states with a federal or national charter.

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 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 affect 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. To the extent that a federal standard of disclosure has been developed, ACB will work to ensure that additional or different requirements will not be required on a state by state basis for the same activity, product or service.

Contact for further information: Sharon Lachman (202) 857-3186, Greg Mesack (202) 857-3134.

Issue

Regulation of stored value cards.

ACB Position

ACB supports extending regulatory protections to those stored value cards that mimic traditional deposit accounts. The funds underlying a stored value card should be treated like cash unless a clear and unmistakable account can be identified with a particular consumer.

Explanation

Certain variations of stored value products are designed to be treated like cash, while others have deposit account characteristics. Under certain payroll card arrangements, issuing banks maintain account ledgers that are related to the institution's deposit taking function as well as records of the funds of each accountholder. The cards may be reloadable, the cardholder's name may be printed on the face of the card, the card may have a PIN or signature based security feature, the cardholder may be able to make additional deposits to the card, use the card at an ATM, or use the card to pay for goods at merchants that accept traditional credit and debit cards. Occasionally, a financial institution will brand the payroll cards that it issues.

By contrast, other kinds of stored value cards can only be used for a particular merchant's products or for products at a finite number of merchant locations. These cards are designed to act as a cash substitute. They are not designed to function like a traditional deposit account that accepts multiple credits and debits and identifies a specific individual with a specific account number and account balance.

Many community banks have been reluctant to enter the stored value market. While the federal banking agencies have taken initial steps to address the regulation of stored value products, uncertainties persist regarding the application of various banking laws to these products. In August 2005, the FDIC issued a proposed rule regarding the deposit insurance coverage of funds underlying stored value cards. Furthermore, in December 2005, the Federal Reserve issued an interim final rule providing that payroll card accounts are covered by Regulation E.

As community banks begin to explore the payroll card market, we are concerned that imposing different regulations on depository institutions and less regulated providers of stored value products, may discourage innovation and could conceivably eliminate insured institutions as major participants in the development of payroll card products. We urge federal regulators to ensure that all providers of payroll card services are subject to the same regulatory requirements.

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

Issue

FDIC examination fees for state non-member banks.

Position Statement

State banks should not have to pay the cost of their FDIC examinations.

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 2005 budget did not include the proposal. ACB will continue to monitor this issue.

Contact for further information: Priya Dayananda (202) 857-3130.

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 than under existing procedures, 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 was initially scheduled to launch during the fourth quarter of 2004. However, the Agencies have delayed the implementation until sometime in the second half of 2005.

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

Contact for further information: Jodie Goff (202) 857-3158.

Issue

Resolution of the goodwill cases.

Position Statement

ACB supports a long overdue 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.

In the almost 10 years since the Winstar decision, there has been slow activity in most of the remaining Winstar related cases. 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.

In 2004, there were two decisions of note. The first was the upholding of the Glendale Federal decision by the U.S. Court of Appeals for the Federal Circuit. The court upheld damages of $384.1 million. The Justice Department had not announced whether it will appeal the decision as of January 2005. In September, the U.S. Court of Federal Claims found for the former American Federal Bank, concluding that there had been a breach of contract. This case can be distinguished from many of the other Winstar cases because American Federal Bank did not sign any assistance agreements when it acquired insolvent institutions. However, in documents filed with its regulator the calculation of the goodwill and the plan to write it down over 40 years was explicit. This decision provides hope for the other plaintiffs that did not sign assistance agreements.

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.

Contact for further information: Ike Jones (202) 857-3134.

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 more than doubled and is now $417,000, 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.

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

Issue

Electronic communications with customers and other businesses.

Position Statement

ACB opposes any provisions in law or regulation that would restrict legitimate electronic communications – whether by email, facsimile or telephone - between community banks and their customers or other businesses.

Explanation

President Bush signed the Junk Fax Prevention Act of 2005 (the "Act") on July 9, 2005. The Act creates an "established business relationship" (EBR) exemption that would allow commercial entities to send faxes to current and past customers. The Act defines EBR, codifies an exemption for EBR faxes, requires the sender of an unsolicited fax to provide certain information on the transmission, and allows recipients to opt out of receiving faxes. The FCC issued a Notice of Proposed Rulemaking (NPRM) to implement the Act in December 2005. The Act requires that the governing regulations be finalized by April 5, 2006.

Notwithstanding passage of the remedial legislation, ACB also will continue to urge the FCC to make clear that its unsolicited facsimile requirements supersede and preempt any inconsistent state and local rules.

In May 2005, the Federal Trade Commission issued an NPRM seeking comment on proposed rules to implement the CAN-SPAM Act of 2003. ACB submitted comments in support of the definition of "valid physical postal address" and urged the FTC not to reduce the opt-out response period from ten days to three days. ACB also advocated that the FTC should confirm that the opt-out requests expire after five years and requested clarification on the use of third parties used to disseminate email messages.

In the area of unsolicited email, the FTC, in December 2004, issued a final rule implementing key definitions of the CAN-SPAM Act. Specifically, the FTC's final rule establishes the requirements of "primary purpose" under the Act, in order to determine when an email message has a primary commercial purpose and is subject to additional restrictions versus relationship or transactional messages. The rule also addresses messages that contain both types of content. In such mixed-message instances, ACB urged the FTC to consider good faith compliance efforts when reviewing primary purpose determinations. ACB will continue to work with the FTC to help minimize the compliance burdens and restrictions associated with the CAN-SPAM Act.

Contact for further information: Steve Kenneally (202) 857-3148, Sharon Lachman (202) 857-3186

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 increased 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.

In the 109th Congress, Representatives John McHugh (R-NY) and Henry Waxman (D-CA) introduced H.R. 22, the Postal Accountability and Enhancement Act, which passed the full House by a vote of 410-20 on July 26, 2005. In the Senate, Senators Susan Collins (R-ME) and Tom Carper (D-DE) introduced the companion postal reform bill S.662, which the Senate approved on February 9, 2006. The bill will be in conference to resolve House and Senate differences before it goes to the President to be signed into law.

ACB has supported language that gives the Treasury Department responsibility for the military service cost of certain postal retirees, which has been the standard historically.

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.

Contact for further information: Priya Dayananda (202) 857-3130.

Issue

Increasing participation in the electoral process.

Position Statement

ACB supports identifying and eliminating unnecessary restrictions on participation in the electoral process and increasing opportunities for individuals to make campaign contributions.

Explanation

The federal election laws have changed significantly over the past several years, adding new restrictions on the use of individual and corporate donations. At the same time, the Federal Election Commission's regulations include some outdated rules regarding the means of making voluntary contributions.

In recognition of the greater challenge to political fundraising, ACB in 2003 filed a petition with the FEC, asking the Commission to amend its regulations to permit the use of the payroll deduction mechanism as a means for individual employees of member companies to contribute to a trade association's political action committee or separate segregated fund.

In its petition, ACB argued that there was no legal justification for the prohibition on the use of payroll deduction. Moreover, ACB pointed out the significant evolution of the payments system that has rendered the restriction particularly obsolete.

Finally, after nearly two years of review and procedural issues, the FEC voted in June 2005 to amend its regulations and allow corporate members of an association to use a payroll deduction system to forward employee contributions to the association's political action committee. This was a great victory for ACB and for trade associations.

ACB will continue to review the FEC's regulations for possible other changes that may be appropriate or necessary.

Contact for further information: Matthew Smyth (202) 857-5578.

ACCOUNTING

Issue

Within the provisions of GAAP accounting and the asset classification standards of the federal bank regulatory agencies, depository institutions and their holding companies must establish and maintain an adequate level of loan loss reserves.

Position Statement

The process of establishing an appropriate loan loss reserve involves a significant amount of discretion and expert credit "judgment," and must take into account not only a bank's historical experience but also current economic conditions. ACB supports the process of applying enhanced disclosures, regulatory guidance, and justification to loan loss reserves. ACB opposes any effort to move toward a rules-based accounting approach that restricts bank managements' ability to utilize their expertise when determining loan loss reserve levels.

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. In early 2004, the AICPA's Accounting Standards Executive Committee (AcSEC) rescinded their proposed standard that would have negatively affected the ability of financial institutions to set aside sufficient loan loss reserves for "expected losses" based on their historical losses.

Earlier, after several years of deliberations, AcSEC issued a Statement of Position (SOP) on June 19, 2003, that was intended to provide guidance under FASB Statements 5 and 114 on reserving for loan losses. 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.

Since AcSEC's decision to rescind the 2003 SOP, which was supported by FASB, the group has continued to work on a new SOP that will focus strictly on enhancing disclosures on loan loss reserves. AcSEC circulated a preliminary draft of the disclosure only SOP in November 2005. They are currently seeking to gain clearance from FASB to release the guidance for public comment. . Additionally, the federal banking agencies are currently working on several initiatives related to the allowance for loan losses. They are revising the 1993 Policy Statement on the Allowance for Loan and Lease Losses, establishing a uniform examiner training template for all agencies to use and are putting together a Q&A document.

Contact for further information: Jodie Goff (202) 857-3158.

Issue

Fair value accounting.

Position Statement

ACB opposes the adoption of any valuation method for customer loans or deposits that 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

In June 2004, FASB issued an Exposure Draft of a proposed financial statement "Fair Value Measurement." This proposed standard is intended to codify the guidance on "how" to measure the fair value of financial instruments as required in existing literature. This ED represents the first phase of FASB's much broader project on providing a comprehensive standard that will require full fair value accounting in the primary financial statements. FASB continued to deliberate the FV measurement ED during 2005, and posted a working draft of the revised ED to its website which reflects all of the decisions reached by FASB through October 2005.

Since the mid-1990's, FASB has remained 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 fair value guidance that currently exists has evolved "piecemeal" over many years through several different standards. ACB and others in the banking industry have continued to caution FASB on advancing a comprehensive fair value standard without resolving the conceptual problems with trying to measure the fair value of 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. The lack of active markets for many of these instruments on the liability side, such as core deposits, furthers the argument that a full fair value reporting requirement could result in less useful information being presented in the financial statements than what is issued under the current, mixed attribute standards.

In previous testimony and comment letters, ACB has 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.

FASB is expected to discuss the working draft of the revised ED at a Board meeting in January 2006, and a final FV Measurement Statement is expected to be released in the first quarter of 2006. At that time, FASB intends to move forward on the more comprehensive fair value standard.

Contact for further information: Jodie Goff (202) 857-3158.

Issue

FAS 141, "Business Combinations," issued in July 2001, requires business combinations to be accounted for using the purchase method of accounting. Since the issuance of FAS 141, the Finanacial Accounting Standards Board ("FASB") has been discussing ways in which to apply the purchase method of accounting to combinations between mutual enterprises. FASB issued its long-awaited Exposure Draft ("ED") of an amended FAS 141 on June 30, 2005. At issue is how the elimination of the pooling-of-interests method of accounting will impact the financial reporting and presentation of mutual institution combinations.

Position Statement

In its deliberations for the development of a revised business combinations standard, FASB has stated that the enterprise value method would be the appropriate method to use in 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 move forward requiring the use of the enterprise method, ACB has offered to FASB a methodology we believe would better reflect the economics of the transaction and the balance sheet structure of mutual institutions.

Explanation

FAS 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. Combinations of mutual enterprises were not subject to the initial provisions of FAS 141, and such transactions continued to be accounted for in a manner similar to the pooling of interest method. After careful consideration, FASB decided in September 2002 that mutual combinations would be subject to an amended FAS 141 standard that was scheduled to be released in 2004. ACB maintained the position 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 to FASB through numerous comment letters and has maintained verbal communications over the past few years.

Among other things, the recently issued ED will require use of purchase method (or acquisition) accounting, rather than the pooling of interest method, when mutual savings banks merge. The mutual combination provision is included in this much broader proposal to replace FAS No. 141 with expanded requirements for the accounting of business combinations, which was put into place in 2001. ACB participated in FASB's roundtable on October 28, 2005, and submitted a comment letter relaying the longstanding concerns of the impact on mutual combinations.

ACB believes that net asset value would better reflect 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. FASB has continued its deliberations on the FAS 141 amendment project, which included conducting field visits with mutual enterprises to evaluate the impact of using purchase accounting for mutual combinations.

FASB expects that the field visits and deliberations will result in the issuance of a proposed Statement in the first quarter of 2005 that supersedes FAS 141, so that all of the requirements needed to apply the purchase method would be contained in a single document.

Contact for further information: Jodie Goff (202) 857-3158.

Issue

Businesses continue to reshape their operational plans in order to comply with Statement of Financial Accounting Standard 133, Accounting for Derivatives and Similar Financial Instruments and for Hedging Activities. At issue is the continued frustration of banks over the problems and confusion caused by FAS 133. Rather than attempting to comply with the complex standard, many institutions choose not to utilize derivative financial instruments that could more economically help reduce the institution's risk exposure.

Position Statement

ACB urges the Financial Accounting Standards Board (FASB) to further amend FAS 133 to diminish distortion of normal business practices. In particular, FASB should seek to diminish substantial uncertainties regarding the application of FAS 133, and amend elements that either discourage hedging or discourage cash market activities that might create hedgable positions. Additionally, ACB urges the federal banking regulators to carefully evaluate the constraints that this standard has placed on financial institutions and to resolve the inconsistency in the regulatory capital treatment of derivatives.

Explanation

FAS 133 was effective January 1, 2001, for most entities. Since that time, many organizations have continually struggled with complying with the controversial standard. FASB's Derivatives Implementation Group (DIG), since its formation concurrent with FAS 133 in 1998, has released a myriad of implementation guidance in the form of DIG Issues. FAS 138 provides further guidance, clarifying the treatment of compound financial instruments with embedded derivatives and was effective June 15, 2000.

Despite FASB's efforts to offer implementation guidance, community banks continue to be frustrated by the hurdles created with FAS 133. Many community banks could benefit substantially from certain derivative hedging activities, but the difficulties and risks associated with understanding and complying with FAS 133 are simply too great a disincentive for entering such transactions. The inability to utilize derivative hedging furthers the competitive disadvantages of community banks, and diminishes the vital role they play in the financial services industry.

Contact for further information: Jodie Goff (202) 857-3158.

Issue

Audit and attestation standards issued by the Public Company Accounting Oversight Board (PCAOB) for public companies, and by the FDIC for insured depository institutions with $1 billion or more in assets.

Position

The PCAOB and the FDIC should keep in mind the limited resources of smaller companies and take steps to reduce the burden and cost of compliance for these companies when adopting and enforcing audit and attestation standards. Notwithstanding efforts by both agencies to provide relief to community banks, ACB continues to emphasize that the agencies need to recognize the continuous and comprehensive regulation to which banks are subjected by both federal and state regulators and provide further relief to the industry when appropriate.

Explanation

The Sarbanes-Oxley Act created the PCAOB to govern external auditors of public companies. 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. In June 2004, the SEC approved PCAOB Auditing Standard 2, "An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements." This standard provides the professional standards for independent auditors to attest to, and report on, management's assessment of the effectiveness of internal control over financial reporting under section 404 of Sarbanes Oxley. While the standards adopted by the PCAOB technically apply only to public companies, Auditing Standard 2 was proving to have an impact on the audit and attestation work of auditors of private banks that are subject to similar requirements under FDICIA.

ACB sent written correspondence to both the PCAOB and FDIC in 2004 and 2005 with regards to the audit and attestation standards. The PCAOB letter highlighted ACB members' concerns over the amount of resources and funds being allocated in preparation for Sarbanes-Oxley Section 404 compliance and application of the PCAOB auditing standard. ACB urged the PCAOB especially to evaluate these significant audit costs and provide appropriate relief to community banks that are already subject to heavy regulation and routine bank examinations.
ACB also participated and/or submitted written statements for several roundtables held by the SEC's Advisory Committee on Smaller Public Companies in 2005. These roundtables culminated with the Advisory committee recommending that the SEC:

- Exempt microcap companies from Section 404 and the requirement that they disclose material weaknesses in internal controls known to management;
- Exempt smaller public companies from the Section 404 external audit requirement (this would maintain the management report on internal controls).

ACB separately asked the FDIC to clarify the audit and attestations guidance for privately held banks subject FIDICA requirements. The FDIC promptly responded and issued final amendments to their regulations that raised the FDICIA threshold from $500 million to possibly $1 billion for the internal control reporting and related audit requirements.

ACB will continue to work closely with the PCAOB, SEC and the banking agencies to ensure that they continue their efforts to provide appropriate relief from undue auditing standards for the already heavily regulated public, private and mutual banks.

Contact for further information: Jodie Goff (202) 857-3158.

Issue

The Financial Accounting Standards Board (FASB) issued an Exposure Draft of a FAS 140 Amendment, "Accounting for Servicing of Financial Assets" which will permit entities to choose either fair value or the lower-of-carrying-amount-or-market (LOCOM) as the subsequent measurement attribute for each class of separately recognized mortgage servicing rights (MSRs).

Position Statement

ACB commends FASB's decision to allow for this elective option when accounting for MSRs and urges the FASB to maintain this option and to carefully consider the implications of requiring burdensome disclosures in community bank financial statements on MSRs.

Explanation

A number of accounting firms had previously 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 is currently deliberating on guidance that could 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. FASB has tentatively agreed that entities should be permitted to choose either fair value or LOCOM as the subsequent measurement attribute for all servicing rights that are separately accounted for under GAAP. Subsequent changes in the fair value of all servicing rights for those entities that elect fair value measurement will be recognized in earnings. 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.

FASB is expected to maintain optional FV reporting of MSRs in the final FAS 140 Amendment that is expected to be issued in the first quarter of 2006.

Contact for further information: Jodie Goff (202) 857-3158.

Issue

In early 2004, FASB's Emerging Issues Task Force (EITF) reached a final conclusion on Issue EITF 03-1 "The Meaning of Other-Than-Temporary Impairment," that was to provide new requirements on evaluating whether interest rate impairments on available-for-sale securities accounted for under FAS 115 were other-than-temporary. The effective date for the guidance was originally scheduled for September 30, 2004, financial statements. FASB delayed the effective date in late 2004, and eventually nullified much of the troublesome guidance in EITF 03-1 once ACB and others in the industry objected to potentially severe unintended consequences.

Position Statement

ACB strongly opposed the guidance in EITF 03-1, as its implementation would likely have resulted in unrealized losses associated with interest rate impairments to improperly be charged to the income statement. ACB appreciates FASB's actions in nullifying the guidance, and we generally support the guidance issued on November 3, 2005, in FSP FAS 115-1.

Explanation

As the effective date of EITF 03-1 approached, ACB had received a significant amount of input from members regarding concerns with the potential ramifications associated with implementing the guidance. ACB and others in the industry sent letters to FASB asking the board to postpone the September 30, 2004 effective date which would provide FASB more time to reevaluate how it would impact current practice and provide better assurance that the appropriate financial statement results are achieved. More specifically, the EITF needed to reconsider aspects of the guidance regarding what constitutes a "pattern" of selling below market value securities and when such a pattern would "taint" the remainder of the securities in that portfolio.

Financial institutions of all sizes hold debt and equity investment securities to attain various financial objectives, including hedging their interest rate risk. FAS 115 states, "investments not classified as trading securities (nor as held-to-maturity securities) shall be classified as available-for-sale ("AFS") securities." The mere title of the AFS category implies that these securities are "available" to be sold by institutions as part of their asset/liability management ("ALM") strategies.

In August 2004, FASB agreed to delay EITF's effective date and provided a FASB staff position (FSP) that it thought would resolve much of the confusion and concerns on implementing the guidance. FASB received in excess of 220 comment letters on the FSP, where many of the commenters, including ACB, asked FASB to rescind the guidance as it could not be reasonably applied.

After shelving the issue for almost 10 months, FASB voted in June 2005 to nullify the troublesome guidance in EITF Issue 03-1. ACB and others in the banking industry had objected strongly to the potential impact this guidance would have had on the ability of banks to sell below market value (underwater) securities in the available for sale ("AFS") category, without "tainting the entire AFS portfolio.

FASB issued FSP FAS 115-1 on November 30, which is effective for reporting periods beginning after December 15, 2005. The final FSP on OTTI emphasizes that institutions should carefully consider the severity and duration as the key factors when determining whether impairment is OTTI. The guidance also reminds holders of securities to refer to SEC's Staff Accounting Bulletin 59 for further guidance. ACB is hopeful that the FSP will resolve the concerns surrounding "tainting" for banks and auditors when evaluating OTTI for available for sale securities.

Contact for further information: Jodie Goff (202) 857-3158.

Issue

FASB's project on amending FAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." FASB issued an Exposure Draft of a FAS 140 amendment in June 2005, which proposes new requirements for loan participations to gain favorable sale accounting treatment.

Position Statement

ACB believes that the language in Appendix A of the proposed standard on obtaining a true sale opinion for all loan participations is ambiguous and, if maintained, will result in increased costs and unnecessary complexities for community banks.

Explanation

FASB's initial Exposure Draft of a FAS 140 Amendment, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," issued in June 2003, required the use of a qualifying special purpose entity ("QSPE") in order for loan participations to meet the legal isolation requirements set forth in FAS 140, and gain favorable sale accounting treatment. Since then, there has been a significant amount of dialogue between FASB, bank regulators, trade groups and attorneys in trying to reach a workable solution.

FASB's project on QSPEs and the isolation of transferred assets emerged in light of the fall-out from the highly publicized off-balance-sheet scandals epitomized by the Enron Corporation scandal. ACB believes the current dilemma on how to properly structure loan participation agreements in order for banks to maintain favorable sale accounting treatment and derecognition has become an unfortunate and unintended consequence of FASB's FAS 140 amendment project and a focal point of its deliberations. ACB and other observers in the banking industry, including the federal banking regulators, have consistently maintained that there were no abuses when banks engaged in loan participation transactions, nor were there any instances of financial institutions misusing the structures for financial statement misrepresentations. Loan participations are well-understood and widely used in the banking industry, and ACB believes that they should have been scoped out of the FAS 140 amendment altogether.

In current practice, banks take extensive precautions to ensure that proper due diligence is performed to ensure that both parties' interests, future payments and credit risks are shared on a pro-rata basis. If FASB moves forward with the implementation guidance in Appendix A with regard to isolation and true sale legal opinions, ACB is concerned that many smaller banks will lose a vital risk management tool, and face further competitive disadvantages upon losing the ability to diversify credit risk and accommodate larger customer borrowing needs.

ACB submitted a comment letter to FASB in October 2005, and continues to monitor FASB's deliberations on this project. A final FAS 140 amendment is expected in the first or second quarter of 2006.

Contact for further information: Jodie Goff (202) 857-3158.

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 supports providing additional tax incentives for support of non-profit organizations with missions to promote homeownership by low and middle-income families. 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 from community banks that may be caused by the new lower tax rates for dividends, enacted as part of the Jobs and Growth Tax Relief Reconciliation Act of 2003.

ACB supports providing additional tax incentives for support of non-profit organizations with missions to promote homeownership by low and middle-income families. One such proposal is the Community Development and Home Ownership Tax Credit, which 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 the 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.

Contact for further information: Ike Jones (202) 857-3132.

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 2005 and rise to $5,000 in 2008. ESA limits increased from $500 to $2,000. At the same time EGTRRA also substantially increased contribution limits for 401(k) plans ($14,000 in 2005, 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 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. ESA accounts provide consumers an important tool for financing education.

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.

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: Ike Jones (202) 857-3132.

Issue

Subchapter S.

Position Statement

Legislative changes in 2004 and 2005 made significant improvements to Subchapter S, enhancing the viability of the Subchapter S option for community banks. ACB supports further improvements that will eliminate other barriers to 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 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, had been unable to make the election because a corporation is not eligible to make the election if it has more than 75 shareholders.

The American Jobs Creation Act of 2004 ("AJCA"), enacted in October 2004, (as amended by the Gulf Opportunity Zone Act of 2005) enhanced the viability of the Subchapter S option for community banks through provisions that: (1) increase the number of eligible shareholders from 75 to 100; (2) permit family members to be treated as one shareholder; (3) permit certain IRAs to be eligible shareholders for bank, thrift and holding company S Corporations; and (4) clarify that interest earned by banks, thrifts and holding companies and dividends earned on assets required to be held by a bank or thrift (such as Federal Reserve Bank shares and Federal Home Loan Bank shares) are not disqualifying passive income under the passive income test applicable to S Corporations.

ACB supports further improvements that will: (1) clarify that stock required to be held by bank directors not be treated as a prohibited second class of stock; (2) 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 (3) 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.

Contact for further information: Ike Jones (202) 857-3132.

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.

Contact for further information: Ike Jones (202) 857-3132.

Issue

IRS regulations on treatment of interest accrual on non-performing loans.

Position Statement

ACB supports implementing the regulations on the tax treatment of interest on non-performing loans that are consistent with the regulatory loan classifications.

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 be concerned 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.

While the IRS has provided this clarification for loans classified as "loss," they have 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 regulatory purposes (generally 90 days), the IRS will usually require the institution to continue accruing and paying taxes on the interest for these loans, often until foreclosure. The lack of an explicit IRS regulation on the treatment of interest accrual on non-performing loans provides the IRS agents a significant amount of subjectivity and hindsight in reviewing loan files and subsequently denying charge-offs taken in conformity with the regulatory treatment.

Despite the unwillingness of the IRS in recent years to consider amending regulations to cease accrual of interest for tax purposes that is 90-days past due, ACB and others in the industry continue to provide evidence to the IRS that such a regulation would provide much needed clarification and consistency for the treatment of the accrual of interest on non-performing loans for tax purposes.

Contact for further information: Jodie Goff (202) 857-3158

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. Furthermore, community banks should be exempt from the requirements of section 475 of the Internal Revenue Code, unless they affirmatively elect the mark-to-market method of tax accounting.

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. There are a few scenarios involving transfers where institutions are likely to be deemed "securities dealers" under section 475 based on transactions outside the consolidated return group.

Many banks create 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.

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. ACB will continue to urge the IRS to exempt community banks from the requirements of section 475 where institutions have not elected mark-to-market tax accounting.

Contact for further information: Ike Jones (202) 857-3132, Jodie Goff (202) 857-3158.

Issue

Business activity tax.

Position Statement

ACB supports legislation to enact a federal standard clarifying the physical presence standard as the 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 and Commerce clauses 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. In the 109th Congress, Congressmen Robert Goodlatte (R-VA) and Rick Boucher (D-VA) introduced the "Business Activity Tax Simplification Act of 2005" (H.R. 1956), which would make the physical presence standard part of federal law.

The federal Interstate Income Tax Law (P.L. 86-272) prevents a state from imposing an income tax on income derived within the state from interstate commerce if the only business activity within the state is the solicitation of orders for tangible personal property, provided that the orders are approved and filled outside the state. H.R. 1956 would modernize the application of P.L. 86-272 to include solicitation in connection with all sales, not just sales of tangible property. H.R. 1956 would also expand P.L. 86-272 to cover all business activity taxes. ACB supports the adoption of the Goodlatte-Boucher legislation.

Contact for further information: Ike Jones (202) 857-3132.

Issue

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

Position Statement

Bank Owned Life Insurance (BOLI) and Corporate Owned Life Insurance (COLI) policies are useful tools for banks and other corporations to manage risk and fund the overall costs of employee benefits. ACB supports compromise legislation (adopted by the Senate Finance Committee on February 2, 2004, and included in legislation in the 109th Congress) that addresses abuses of Bank BOLI and COLI, while continuing to permit BOLI/COLI for key persons.

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 employees 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.

In the 108th Congress, during consideration of pension reform legislation in February 2004, the Senate Finance Committee adopted a compromise proposal on this issue that would allow COLI/BOLI for key persons and set forth three definitions of key persons who would qualify. ACB worked to insure that the definition of "key person" in the compromise proposal was adequate to cover the officers, key members of the management and directors of community banks. These definitions 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 provision also would require notification and consent from the employee. Companies would have to keep records and report information about COLI/BOLI policies to the IRS. The proposed changes would be effective after enactment. However, the Senate did not act on the pension bill in the 108th Congress. In the 109th Congress, the compromise COLI/BOLI provision is included in the Pension Security and Transparency Act of 2005, which was adopted by the Senate on November 16, 2005. H.R. 2251, introduced in May 2005, also includes the compromise provision. ACB supports both bills.

Contact for further information: Ike Jones (202) 857-3132.

Issue

Modifications to real estate mortgage investment conduit (REMIC) rules.

Position Statement

ACB supports the Real Estate Mortgage Investment Conduit Modernization Act, which would allow certain modifications of residential and commercial mortgages held in REMICs, while preserving the tax treatment of REMICs.

Explanation

The REMIC vehicle was created by Congress in 1986 to facilitate the issuance of multiple classes of securities backed by pools of mortgage loans. The REMIC vehicle stimulates economic growth by providing lenders with access to the capital markets and reducing the cost of financing to borrowers. A REMIC is not subject to corporate tax at the pool level and thus is not permitted to engage in business by reinvesting its assets. The ban on a REMIC's engaging in business is intended to prevent it from originating new loans or the financing of loans acquired after an initial issuance period. Current law prevents the prudent modification of REMIC collateral as a disqualifying substitution or new investment.

Experience with mortgage securitization over the last 10 years has shown that the REMIC rules pose an impediment to the use of this vehicle. Mortgage loan servicers are often called upon to administer loans in a manner that accommodates the ongoing business of the borrower in leasing, managing, maintaining and improving the real property collateral; changes in the performance of the collateral; and sales of collateral or sales of ownership interests in the borrower, as well as changing circumstances for consumer borrowers, including job interruptions or other personal hardships. However, as a consequence of a Supreme Court ruling in a tax case in 1991, which concluded for unrelated reasons that modifications are analogous to substitutions, many borrower requests for loan modifications that would not be detrimental to investors may be treated as deemed exchanges under section 1001, thus disqualifying the REMIC. Prudent loan administration often requires flexibility in accommodating changes that were not foreseen when the loan was entered into and the ability to modify loans to ensure eventual repayment before default on the loan is foreseeable.

The REMIC Modernization Act would modernize REMIC rules in the U.S. Tax Code to allow certain modifications of residential and commercial mortgages held in REMICs. H.R. 1010, introduced by Reps. Foley (R-FL), Pomeroy (D-ND) and others, and S. 580, by Sens. Smith (R-OR), Conrad (D-ND) and others, reintroduced the Real Estate Mortgage Investment Conduit (REMIC) Modernization Act in the 109th Congress.

Contact for further information: Ike Jones (202) 857-3132.

PAYMENT SYSTEMS AND TECHNOLOGY ISSUES

Issue

Establishment of laws, rules and regulations that maximize the role and protect the interests of community banks in the U.S. payments system, including the credit/debit card networks and the Automated Clearing House Network (ACH).

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. As a significant participant in the credit/debit card marketplace, community banks should have the opportunity to help shape the operating rules of the major credit/debit card networks (e.g., Visa, MasterCard, etc.).

ACB strongly supports the role of the Federal Reserve System as guarantor of the integrity of the nation's payments system and believes that only insured depository institutions should have access to Federal Reserve and automated clearinghouse payment services. Government programs/initiatives should to the fullest extent possible avoid competing with products and services offered by community banks.

Explanation

The dramatic growth in electronic payments is transforming financial service relationships and product offerings to the point where electronic payments now exceed paper-based transactions in the U.S. payments system. Many non-bank financial service firms and others are developing products and services that compete directly with those traditionally offered by insured depository institutions. Banks need to preserve their unique role 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, 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.

ACB believes that community banks should have more of an opportunity to help shape the operating rules governing credit/debit-based transactions that are becoming the lifeblood of the banking industry. Moreover, the issuance of third-party payment instruments such as payroll cards that are transacted through these networks should be limited to regulated depository institutions. ACB will work to ensure community banks serve a more proactive role in the formation of the operating rules governing credit/debit networks.

ACB believes it should take an active role in the development of new rules and the amendment of existing rules governing the ACH Network. ACB will work within the rulemaking structure to protect the interests and promote the role of its membership in the ACH Network.

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.

Contact for further information: Steve Kenneally (202) 857-3148, Greg Mesack (202) 857-3134.

Issue

Security in electronic banking.

Position Statement

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. However,
ACB believes it is critical that financial institutions have the flexibility to choose suitable security technologies, policies and procedures to manage their electronic 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.

Explanation

It is essential to the success of 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, network attacks, and emerging threats such as Phishing and Spyware scams. The safety of financial institutions, and the integrity of the nation's payments system, necessitate that special attention be given to the security of electronic banking systems.

Community banks are active participants in electronic banking with an outstanding record of maintaining high levels of information security and protecting confidential customer information. In October 2005, the Federal Financial Institutions Examination Council (FFIEC) issued guidance, "Authentication in an Internet Banking Environment" affirming the importance of verifying that parties accessing banking information via the Internet are the real account holders. The guidance suggests that the industry standard of User ID and Password is not a strong enough mechanism to safeguard this information. The guidance requires banks conduct a risk assessment of their operations and implement additional measures if required. The guidance does not mandate a specific technological solution, but notes that shared secrets, tokens, and biometrics can be considered as well as software based techniques that analyze the user's physical location and their historical record of online banking activity. Further, encryption of data and the truncating of sensitive information revealed on an accessed account screen can also be considered as risk mitigators.

Prior to the FFIEC guidance, 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 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 also will continue to work with the regulatory agencies, including the FFIEC, and other industry groups, to establish guidelines for information security that protect customer information, ensure that only authenticated customers have online banking access, and meet the needs of community banks.

Contact for further information: Steve Kenneally (202) 857-3148.

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 business in utilizing this authority.

Explanation

The Electronic Signatures in Global and National Commerce Act ("E-Sign Act") established 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 reduces costs, and provides information more efficiently to consumers. While the E-Sign Act establishes only limited authority for federal financial regulators to interpret the provisions of the law, the regulators are given the authority to specify performance standards to ensure record accuracy, integrity, and record accessibility. ACB will work to ensure that any regulatory guidance related to the E-Sign Act and electronic disclosure programs will not favor any particular technology or disadvantage community banks.

Contact for further information: Steve Kenneally (202) 857-3148.

Issue

Implementation of the Check Clearing for the 21st Century Act (Check21).

Position Statement

ACB supports Check21 implementation that strengthens the efficiency and reliability of the check clearing system, while promoting consumer understanding and preserving consumer rights.

Explanation

Check21 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. Check21 also allows, but does not require, banks to accept electronic images of checks drawn on that bank, and thus eliminating paper entirely from the payment settlement process.

The Federal Reserve issued regulations to implement the major provisions of Check21, including minimum requirements for substitute checks, consumer disclosure, and warranty/indemnification.

ACB is 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 Check21 Act has exacerbated this concern. ACB will continue to work with the regulators and other trade associations to develop consumer education and outreach materials to smooth the transition to the increased use of electronics in the check clearing process.

Contact for further information: Steve Kenneally (202) 857-3148.

Issue

Interchange

Position Statement

ACB believes that interchange rates and governance should be set by the private sector. ACB opposes any efforts by state or federal governments to regulate interchange rates, which are set by the private market through contracts.

Explanation

In recent years there has been a concerted effort by the retail industry to utilize the government to force lower interchange fees. Last year retailers and their trade associations, alleging that interchange fees are set illegally, filed 41 class action suits in federal court. In the aftermath of Hurricane Katrina, retail lobbyists argued to lawmakers that interchange fees contributed to price gouging on gasoline. This culminated in attaching an FTC study on interchange's role in gasoline price gouging to a petroleum refinery improvement bill passed by the House of Representatives.

The ultimate goal of the retail industry is to force lower interchange rates through government intervention, be it in court or through Congress. This strategy ignores the fact that the use of credit and debit cards benefits retailers, because electronic payments are safer than handling cash, the risk of bounced checks is eliminated, good funds are credited to merchant accounts faster, consumers spend more when using credit or debit cards, and the growth of electronic payments has made the overall economy stronger. In addition, consumers have benefited from the interchange system because they enjoy secure transactions with very limited liability at no direct cost. A consumer, who pays one's credit card off every month can have a card with no annual fee and benefit from short-term interest free loans each month. It is at the merchants' discretion whether to pass any perceived cost increases to customers.

Interchange is a fee for a service that is provided to consumers and merchants alike. Maintaining the networks needed for speedy credit and debit card authorizations is costly. Furthermore, by law consumers and merchants have limited liability for fraudulent transactions, but those costs are born by the banks that must charge a fee to mitigate that risk. This limited liability protects both merchants and consumers from fraudulent use of cards. These costs cannot be avoided, and if interchange is capped then the fees will be made up elsewhere. There is concrete proof of this in Australia, where retailers successfully lobbied for the government to interfere in the private market and cap interchange fees. This did not result in lower prices for consumers as retailers had promised, it merely resulted in a higher cost of credit as banks charged new and higher fees on credit and debit cards in order to make up for the revenues lost on interchange. The cap on interchange fees ultimately resulted in a shifting of credit from retailers to consumers. ACB opposes such an event happening in the United States. It is bad public policy and bad for the economy.

Contact for further information: Greg Mesack (202) 857-3134, Steve Kenneally (202) 857-3148.

Chairman

F. Weller Meyer
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Acacia Federal Savings Bank
Falls Church, VA

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Independence Community Bank Corp.
1535 Richmond Avenue
Staten Island, NY

President

Diane Casey-Landry
President & CEO
America's Community Bankers
Washington, DC

Government Relations

Robert R. Davis
Executive Vice President
and Managing Director
(202) 857-5088
rdavis@acbankers.org

Patricia Milon
Chief Legal Officer and Senior Vice President
Regulatory Affairs
(202) 857-3121
pmilon@acbankers.org

Priya Dayananda
Director, Government Relations
(202) 857-3130
pdayananda@acbankers.org

Janet Frank
Director, Mortgage Finance
(202) 857-3129
jfrank@acbankers.org

Jodie G. Goff
Manager, Accounting and Financial
Management Policy
(202) 857-3158
jgoff@acbankers.org

Ike Jones
Vice President and Legislative Counsel
(202) 857-3144
ijones@acbankers.org

Steve Kenneally
Director, Payment and Technology Policy
(202) 857-3148
skenneally@acbankers.org

Sharon Lachman
Regulatory Counsel
(202) 857-3186
slachman@acbankers.org

Greg Mesack
Director, Government Relations
(202) 857-3134
gmesack@acbankers.org

Krista Shonk
Regulatory Counsel
(202) 857-3187
kshonk@acbankers.org

Corporate Communications

Bob Schmermund
Executive Vice President
(202) 857-3104
bschmermund@acbankers.org

Membership

Ron Haynie
Senior Vice President
(202) 857-3135
rhaynie@acbankers.org

All staff can be reached toll-free at (888) 872-0275;
their extensions are the last four digits of their direct line.

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America's Community Bankers®
900 Nineteenth St., N.W., Suite 400
Washington, D.C. 20006
Fax: (202) 296-8716
Toll free: (888) 872-0275
info@acbankers.org
www.AmericasCommunityBankers.com