STATEMENT OF
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ON
S. 1405
THE FINANCIAL REGULATORY RELIEF
AND ECONOMIC EFFICIENCY ACT
FOR THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
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Mr. Chairman and members of the Committee, I appreciate the opportunity to present the views of the Federal Deposit Insurance Corporation on S. 1405, the Financial Regulatory Relief and Economic Efficiency Act. I commend you, Mr. Chairman, and members of the Committee for your continuing commitment to relieving regulatory burden on financial institutions. S. 1405 contains many necessary and beneficial provisions that the FDIC supports.

RELIEVING REGULATORY BURDEN

As this Committee is well aware, over the past 25 years, Congress has enacted many laws and the banking agencies have adopted many regulations that have protected consumers, strengthened financial institution safety and soundness and improved crime detection. While, individually, few of these laws impose a significant burden on financial institutions, cumulatively, they have created a complex regulatory framework that raises costs for banks and savings institutions. The FDIC shares your commitment to relieving this regulatory burden while maintaining the benefits and protections established for consumers and financial institutions.

Over the past several years, Congress and the federal regulatory community have become more sensitive to regulatory costs, especially those incurred by small businesses. Several recently enacted statutes underscore this concern. For example, the Contract with America Advancement Act of 1996 strengthened requirements that federal agencies consider the effect of regulations on small entities. Section 303(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 (CDRI) required the FDIC and the other bank and thrift regulatory agencies to review systematically their regulations and written policies to improve efficiency, reduce unnecessary costs, and eliminate inconsistencies and outmoded and duplicative requirements. Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 requires each appropriate federal banking agency and the

Federal Financial Institutions Examination Council (FFIEC) to review all regulations every 10 years to identify outdated and unnecessary requirements imposed on insured depository institutions.

The FDIC has taken its responsibilities under CDRI seriously. FDIC Director Joseph H. Neely directed a senior level task force that reviewed each FDIC regulation and written policy to determine whether it was necessary to ensure a safe and sound banking system or to protect consumers. While CDRI was not specifically designed to aid small banks or thrifts, the FDIC paid particular attention to their needs. In 1996, the FDIC examined all 120 of its regulations and written statements of policy, 60 of these in conjunction with other banking agencies. FDIC staff recommended rescinding or revising 90 of the 120 regulations and policy statements to improve efficiency, reduce unnecessary costs, and remove inconsistencies and outmoded and duplicative requirements. The staff determined that these deletions and revisions could be made without harming financial institution safety and soundness or consumer protection.

As of March 1, 1998, the FDIC's Board of Directors had acted on all but nine of the 90 recommendations for change. All but one of the remaining nine recommendations are being coordinated on an interagency basis, and the agencies recently reached agreement on implementing three of the recommendations. With regard to the rest, all the agencies are committed to reaching agreement as soon as possible.

One of the FDIC's most important regulatory relief proposals would simplify our application procedures. This proposal would consolidate the FDIC's application procedures previously found in various parts of our regulations into a single rule. The proposal also would revise three related statements of policy and delete two others. The revised procedures would expedite processing of over 90 percent of applications filed with the FDIC. For applications filed by well-managed, well-capitalized institutions, the procedures would fix or shorten the time frame for receiving comments and for the FDIC to act on the application, and would treat some applications, such as branch applications, as approved if not acted on by a certain date.

The FDIC also has proposed combining regulations governing activities and investments of insured state banks and savings associations into a single regulation. This proposal also would update the FDIC's regulations governing the safety and soundness of securities activities of subsidiaries and affiliates of state nonmember banks. The proposal would allow institutions to engage in certain activities and make certain investments by filing a notice rather than an application with the FDIC. This proposal should relieve regulatory burden significantly without affecting safety and soundness, because the FDIC retains the ability to place restrictions on an activity or deny a particular institution the right to engage in the activity.

Additional regulatory relief actions taken by the FDIC include:

* Streamlining the FDIC's securities registration and disclosure regulation by cross-referencing the Securities and Exchange Commission regulations; * Increasing the

flexibility of the FDIC's audit regulations and policies and streamlining external auditing program procedures; * Revising disclosure regulations to make information more accessible to the public; * Simplifying reporting requirements for suspected criminal activity; * Proposing simplified deposit insurance rules; and * Proposing consolidation of regulations regarding international and foreign activities.

The FDIC and the other federal banking regulators that participate in the FFIEC have simplified reporting requirements. Effective March 31, 1997, the FFIEC adopted generally accepted accounting principles for most Consolidated Reports of Condition and Income (Call Report) schedules. The FDIC now has in place an electronic system for filing Call Reports for all banks. The FDIC also published guidelines to assist smaller institutions in preparing error-free Call Reports.

The FDIC is continuing its efforts to eliminate unnecessary burden without compromising safety and soundness or consumer protection. For example, we continue to balance our need for new information against the burden that new information requirements impose on financial institutions' computer systems. We will delay our requests for new information until after the Year 2000 whenever possible to relieve pressure on bank systems and management and allow them to better focus attention on ensuring their institutions' Year 2000 readiness.

The remainder of my testimony today will discuss several provisions of the Financial Regulatory Relief and Economic Efficiency Act and the reasons that these provisions are necessary and important. I will then discuss our concerns regarding other provisions of the bill. Finally, my testimony includes a few technical drafting suggestions attached as an appendix.

S. 1405

Let me turn to some specific provisions of S. 1405 that the FDIC supports.

Deposit Brokers

Brokered deposits present risks. To attract brokered deposits, depository institutions ordinarily must pay premium interest rates. To pay these rates, institutions may be tempted to make higher yield, riskier loans. Unchecked use of brokered deposits may result in overly rapid growth. To address the risk of brokered deposits, Section 29 of the Federal Deposit Insurance Act (FDIA) prohibits undercapitalized insured depository institutions from accepting deposits from deposit brokers. It also prohibits adequately capitalized insured depository institutions from accepting deposits from deposit brokers unless the institution has obtained a waiver from the FDIC.

The FDIC is well aware of the risks of brokered deposits and monitors depository institutions' use of these deposits through on-site examinations and off-site surveillance. During safety and soundness examinations, the FDIC thoroughly reviews liquidity and funding sources, including brokered deposits, for every institution it supervises. In addition, banks must report brokered deposits on Call Reports submitted to the regulatory agencies. The FDIC also closely monitors deposit growth. The FDIC and the other bank regulatory agencies can curtail the use of brokered deposits effectively when necessary, through formal and informal enforcement actions against financial institutions, including informal agreements, prompt corrective action and cease-and-desist orders.

S. 1405 repeals Section 29A of the FDIA, which prohibits a deposit broker from soliciting or placing deposits with insured depository institutions unless the deposit broker has notified the FDIC in writing that it is a deposit broker. The FDIC supports repeal of this provision. It serves little useful supervisory purpose, since the FDIC can and does obtain sufficient information on brokered deposits through existing means to monitor and control brokered deposit activity. The provision also may confuse consumers regarding the meaning of the notice that brokers must give the FDIC.

Although a deposit broker must notify the FDIC that it is in the business of deposit brokerage, the FDIC cannot reject a notice and has no explicit enforcement powers over deposit brokers generally. Nevertheless, deposit brokers frequently state that they are "registered" with the FDIC. These statements could easily deceive consumers, who tend to associate the FDIC with the safety of their funds. While Congress may wish to require deposit brokers to register with a government agency, that agency should be an agency other than the FDIC to avoid consumer confusion over the safety of their funds.

Interest on Claims in Receiverships

After paying the principal amount of all claims against the receivership estate of a failed insured depository institution, other than the claims of equity holders, a receiver may have funds remaining to pay interest on the claims. Neither the FDIA, the National Bank Act, nor the statutes of most states address the interest rate for interest that accrues after a receiver's appointment. These statutes do not generally address the priority in which the receiver should pay this interest. State statutes that do address post-insolvency interest vary greatly, resulting in disparate treatment of receivership creditors in different states. In some cases, the receiver may have difficulty determining how to distribute post-insolvency interest to creditors.

S. 1405 clarifies the FDIC's authority to promulgate a regulation establishing the interest rate and priority of this post-insolvency interest. In the past few years, an increasing number of FDIC-administered receiverships have had sufficient assets to make some post-insolvency interest distributions. This trend may continue because prompt corrective action requirements of the FDIA can result in institutions being placed in receivership before their capital is depleted. Institutions closed because they are liquidity insolvent -- rather than balance-sheet insolvent -- may also have sufficient assets to pay post-insolvency interest.

By establishing a uniform interest rate and distribution priority for all receiverships, the federal rule envisioned by S. 1405 would benefit the receiver, receivership creditors, and equity holders. A federal rule will treat similarly situated creditors in bank failures equally by eliminating existing discrepancies in distributions based on the type of institution or its location.

Consistent Coverage under Health Plans Administered by the Federal Banking Agencies

In the early 1980s, the FDIC and the other federal banking agencies established health plans separate from the Federal Employees Health Benefits plans (FEHB plans). Doing so allowed the FDIC to offer health insurance to the many limited-term employees we hired to help with the bank and savings and loan crises. These limited-term employees were not eligible for FEHB coverage because of their limited appointments. The FDIC and other agencies also were able to offer enhanced benefits at significantly lower cost because of the demographics of their workforces.

Over the past few years, as the banking industry has recovered, the FDIC has been downsizing significantly and no longer has limited term employees who are ineligible for FEHB insurance. Workforce reductions also mean that a significantly smaller group is sharing risk and claim expenses.

The FDIC terminated its separate health plan for most active employees at the end of 1997. Most FDIC employees were able to enroll in an FEHB plan during the 1997 open season. However, under 5 U.S.C. . 8905(b), employees generally must be enrolled in an FEHB plan for at least five continuous years immediately prior to retirement to be eligible for FEHB plan coverage during retirement.

As a result, the FDIC had to maintain a non-FEHB plan for approximately 2,000 retired employees and active employees within five years of retirement. The cost of the employer premiums for that plan for 1998 alone is nearly triple -- approximately $12 million more than -- the amount that other government agencies are paying for FEHB coverage. The plan is particularly costly because of the demographics of the participants and the small size of the group. Maintaining this separate plan also imposes additional administrative costs.

S. 1405 greatly reduces costs by making these employees and retirees eligible for FEHB plan coverage. The FDIC will reimburse the Employees Health Benefits Fund for the cost of providing benefits to FDIC employees and retirees who transfer into an FEHB plan. S. 1405 parallels legislation passed by Congress on behalf of the Office of the Comptroller of the Currency and the Office of Thrift Supervision in 1994. I understand that this provision of S. 1405 also was included in Section 4 of H.R. 1836 that passed the House and is pending in the Senate.

Thrift Service Companies

S. 1405 extends to the Office of Thrift Supervision authority to examine and regulate service companies and service providers comparable to the authority of the FDIC and other bank regulatory agencies over bank service companies and service providers.

The FDIC strongly supports parity of authority among the federal financial institution regulators with respect to examination and regulation of entities that provide services to financial institutions, especially as the regulators evaluate the Year 2000 readiness of financial institutions. The Year 2000 problem potentially affects all financial institutions regardless of charter. The federal financial institution regulators are working together closely to help banks, thrifts, credit unions, data service providers and software vendors anticipate and remediate Year 2000 problems. To succeed in these efforts, each federal financial institution regulator, including the OTS, must have adequate examination and regulatory authority.

Alternative Compliance Method for Annual Percentage Rate Disclosure

In 1996, Congress amended Section 128(a) of the Truth in Lending Act to allow a creditor to provide a simplified disclosure when it makes a variable-rate closed-end consumer loan secured by the borrower's principal dwelling. As an alternative to a 15-year historical example, a creditor may notify the consumer that periodic payments may increase or decrease substantially during the term of the loan. The creditor must also provide an example of the highest payment that could be charged on a $10,000 loan. Last November, the Federal Reserve Board revised Regulation Z to implement the amendment.

S. 1405 will allow a creditor to provide a similar simplified alternative disclosure when making a variable-rate open-end consumer loan secured by the borrower's principal dwelling. The bill thus provides regulatory relief to creditors who make open-end home equity loans by harmonizing disclosure requirements for variable-rate open-end and closed-end home equity loans. To take advantage of simplified disclosure requirements for variable-rate closed-end home equity loans, creditors who currently offer both open-end and closed-end home equity loans must make different disclosures even when their loans are similar. S. 1405 allows these creditors to make similar disclosures on similar loans without substantially reducing consumer information.

Although, the FDIC supports most of the provisions of S. 1405, we have concerns about the following two provisions in the bill.

Affiliations Between Depository Institutions and Government-Sponsored Enterprises

Section 2614 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended Section 18 of the FDIA to prohibit a depository institution from being an affiliate of, being sponsored by, or accepting financial support from a government-sponsored enterprise (GSE). S. 1405 would amend Section 18 of the FDIA to remove the prohibition on affiliation between a depository institution and a GSE. It would leave in place the prohibition on sponsorship by, or acceptance of financial support from, a GSE.

The proposed amendment would render Section 18 of the FDIA ambiguous. The FDIA defines an "affiliate" to mean any company that controls, is controlled by, or is under common control with another company. The FDIA does not define the terms "sponsor" or "to accept financial support." It is unclear whether the prohibition on accepting financial support would apply to capital, loans, dividends or other funds. Because it is difficult to imagine an institution controlling or being controlled by another without funds flowing between them, it is also unclear whether S. 1405 intends to allow GSEs to control or to be controlled by a bank or thrift. However it is interpreted, the S. 1405 amendment to Section 18 raises serious problems. If Section 18's prohibition against a bank accepting financial support from a GSE would prohibit a subsidiary bank or thrift from accepting additional funds or capital from a parent GSE, the prohibition would present serious safety and soundness problems for banks and thrifts in financial difficulty. If the prohibition would prevent a subsidiary GSE from paying dividends to its parent bank or thrift, a bank or thrift's investment in a GSE could be unsuitable for safety and soundness reasons.

On the other hand, if Section 18 is interpreted to allow banks and thrifts to receive capital, dividends and funding from a GSE, it presents different but equally troublesome problems. GSEs have lower borrowing costs, which allows some GSEs to dominate their markets. By capitalizing or funding a subsidiary bank or thrift, a parent GSE may pass the benefit of its lower borrowing costs to its subsidiary, giving the subsidiary a competitive advantage over other banks and thrifts and possibly allowing the GSE to exercise market power through vertical integration. A GSE subsidiary of a parent bank or thrift, or a GSE affiliate of a sister bank or thrift, may also be able to pass along the benefits of its lower borrowing costs, again giving its parent or affiliate a competitive advantage over other banks and thrifts.

Allowing a GSE to affiliate with a bank or thrift raises serious issues that merit further analysis. The FDIC believes that additional study is warranted on the effects - intended and unintended -- of allowing GSEs and depository institutions to affiliate.

Mutual Holding Companies

Existing OTS and FDIC mutual-to-stock conversion regulations safeguard members of a mutual institution by providing priority stock subscription rights in the event of a conversion from mutual to stock form, regardless of whether a mutual holding company is organized in the conversion. As currently drafted, S. 1405 would remove certain important safeguards for thrift mutual-to-stock conversions that involve a parent mutual holding company owning more than 50 percent of the common stock of a newly formed subsidiary stock holding company and the subsidiary stock holding company owning all the stock of the thrift. S. 1405 would permit the subsidiary stock holding company to issue two classes of common stock. One class could pay dividends to public shareholders, which could include insider investors, while the other could withhold dividends from the mutual holding company. Over time, much of the net worth of the converted thrift could be transferred from the mutual holding company and the thrift's members to public shareholders and insider investors.

While the changes proposed by S. 1405 amend the Home Owners Loan Act and, therefore, affect thrifts, not banks, they are inconsistent with the FDIC's regulatory approach to mutual-to-stock conversions involving banks. The FDIC ensures by order that the mutual holding company receives the same dividends as those paid to public shareholders. The FDIC imposes conditions on converting institutions to ensure that the trustees of the mutual holding company properly exercise the fiduciary duty they owe the mutual's members, to prevent unjust enrichment of the public shareholders and to ensure that when the mutual holding company converts to stock ownership the mutual members will have the opportunity to receive a fair portion of the net worth of the converted bank. S. 1405 would achieve none of these results.

S. 1405 would also make priority stock subscription rights in thrift mutual-to-stock conversions effectively dependent on whether state law grants depositors voting rights. Many states do not explicitly grant mutual bank and savings association depositors corporate governance voting rights. In those states that do not explicitly grant depositors voting rights, S. 1405 could deny depositors priority stock subscription rights in mutual-to-stock thrift conversions. Moreover in all states, S. 1405 appears to allow priority stock subscription rights to the thrift mutual depositors only at the initial conversion offering and not for any subsequent stock offerings.

These proposed changes in S. 1405 also are inconsistent with the FDIC's approach to bank mutual-to-stock conversions. For banks, the FDIC grants eligible depositors in mutual-to-stock conversions priority stock subscription rights. These rights offer the only economic opportunity for depositors to benefit from the conversion of the institution. S. 1405 would deny depositors this opportunity.

CONCLUSION

The FDIC supports the Committee's continued efforts to reduce unnecessary burden on insured institutions without compromising safety and soundness or consumer protection. S. 1405 contains many beneficial provisions that will help relieve regulatory burden on financial institutions. Although there are a few provisions that cause us concern, in general, the FDIC supports S. 1405.

TECHNICAL APPENDIX

Section 105

As currently drafted, section 105(c)(1) of S. 1405 would amend section 8(b)(9) of the FDIA (12 U.S.C. . 1818(b)(9)) by striking "to any service corporation of a savings association and to any subsidiary of such service corporation." It appears that substitute conforming language was inadvertently omitted.

Section 302

Section 37(a)(3)(D) of the FDIA required the federal banking agencies to develop jointly, before December 19, 1992, a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of their assets and liabilities in financial statements and other required reports, "to the extent feasible and practicable." S. 1405 repeals this requirement.

Since this requirement was enacted, the agencies have increased the amount of fair market value information that they collect. As required under generally accepted accounting principles (GAAP), public institutions, institutions with assets greater than $100 million or institutions that have derivatives during the reporting period must disclose the fair market value of all on-and-off-balance-sheet financial instruments (including loans and deposits). The regulators require that institutions with over $500 million in total assets disclose these fair market values in reports submitted by institutions subject to section 36 of the FDIA. While these disclosure requirements do not apply to the majority of banks, they do apply to banks holding the vast majority of assets.

In response to a 1993 request for comment, the federal banking agencies advised the FFIEC that it would not be feasible or practicable to require fair market value disclosures for all assets, liabilities, and off-balance-sheet instruments through bank Call Reports. Given that finding, no further action should be required under Section 37(a)(3)(D) of the FDIA. Nonetheless, repeal of the requirement would make it clear that the agencies need no longer pursue further development of a supplemental disclosure method.

Section 502

As currently drafted, section 502 of S. 1405 would apply to a health benefits plan administered by the FDIC before January 3, 1998. Because of the passage of time since that provision was first drafted and the FDIC's need to provide an interim health plan for its retirees and near-retirees until legislation is adopted, the date references in section 502 would need to be updated as described below:

(1) By striking "January 3, 1998" and inserting "or before January 2, 1999" each place it appears; and

(2) In subsection (b)(5), by striking "January 4, 1998" and inserting "January 3, 1999, or such earlier date as established by the Office of Personnel Management after consultation with the Federal Deposit Insurance Corporation or the Board of Governors of the Federal Reserve System, as appropriate".

Section 601

Section 2707 of the Deposit Insurance Funds Act of 1996 (DIFA, also known as Subtitle G of the Economic Growth and Regulatory Paperwork Reduction Act of 1996) contains what appears to be a technical error. Section 2707 amends section 7(b)(2) of the FDIA to provide that assessment rates for Savings Association Insurance Fund members may not be less than assessment rates for Bank Insurance Fund members. Section 2707 begins as follows: "Section 7(b)(2)(C) of the FDIA (12 U.S.C. 1817(b)(2)(E), as redesignated by section 2704(d)(6) of this subtitle) is amended -". The proper reference is to section 7(b)(2)(E), because the redesignations made by section 2704 of the DIFA do not take effect until January 1, 1999, and then only if no insured depository institution is a savings association on that date.

Section 602

Section 602 would make a conforming amendment to section 8(o) of the FDIA (12 U.S.C. 1818(o)). Currently, section 8(o) contains what appears to be a technical error that dates back to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Section 8(o) provides for termination of deposit insurance when a member bank ceases to be a member of the Federal Reserve System, subject to an exception for certain mergers or consolidations.

Prior to FIRREA, section 4(c) and (d) of the FDIA, which relate to federal-to-state and state-to-federal conversions and mergers respectively, were both contained in section 4(b). In FIRREA, Congress divided former section 4(b) into subsections (c) and (d), but neglected to change the cross-reference in section 8(o) of the FDIA. Later, in a technical amendment to correct this oversight, Congress amended section 8(o) to include an exception for section 4(d) mergers, but no exception for section 4(c) conversions. Providing a technical, conforming amendment to section 8(o) to include a cross-reference to section 4(c) would remedy that omission and restore the original intent.

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