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Financial Services Regulatory Relief: Implementation and Reintroduced Provisions in the 110th Congress

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Summary

Federal financial services regulatory agencies are implementing the Financial Services Regulatory Relief Act of 2006, P.L. 109-351 (120 Stat. 1966), as the 110th Congress considers new financial services regulatory relief bills. Most of the provisions under consideration were debated and excluded from the final legislative process that enacted P.L. 109-351. The simultaneity of these developments shows Congress's continued concern with reducing the regulatory burden of financial services providers. This report gives a brief summary of the provisions of P.L. 109-351 followed by the specific provisions that federal regulatory agencies are implementing. It then examines the regulatory relief provisions currently being introduced in the 110th Congress. The report concludes with a discussion of the financial services regulatory relief legislative process and whether these provisions could reverse the increasing concentration of the financial services industry.

This report will be updated as developments warrant.

Introduction

The intended purpose of regulatory relief for financial services providers is to lower the cost of regulation on institutions offering financial services. However, regulatory relief provisions could have a significant impact on the growing concentration in the U.S. banking industry. For example, regulatory relief that reduces regulations limiting banks' ability to merge could lead to more large and fewer small banks. On the other hand, it is important to bear in mind that financial institution regulations exist for many important purposes: to encourage the safety and soundness of individual institutions, ensure systemic stability, deter concentration and encourage competition, and provide consumer protection. Regulatory tools vary as well. In addition to the laws and regulations specifying both the kinds of activities in which institutions may engage and their structural arrangements, regulatory tools include licensing provisions; periodic examinations; reporting and disclosure requirements; and supervision by regulators, particularly of problem institutions. In providing regulatory relief, Members of Congress, regulators, and industry analysts necessarily face the issue of whether existing laws and regulations restrain efficiency and/or competitiveness in the financial services marketplace.

The Financial Services Regulatory Relief Act of 2006, P.L. 109-351 (120 Stat. 1966), was enacted on October 13, 2006, after protracted debates in both houses of Congress on the underlying bills — H.R. 3505 and S. 2856. While federal financial services regulators are implementing P.L. 109-351, regulatory relief provisions excluded from the law are now being reintroduced in the 110th Congress. This report gives a brief summary of the provisions of P.L. 109-351 by title followed by the provisions that federal regulatory agencies are implementing. The report then briefly examines the financial services regulatory relief provisions that currently being reintroduced in the 110th Congress. It concludes with a discussion of financial services regulatory relief legislative process and the banking industry's increased concentration.

The Financial Services Regulatory Relief Act of 2006, P.L. 109-351 (120 Stat. 1966)

The Major Provisions by Titles

- **Title I. Broker Relief.** Requires the Securities and Exchange Commission to consult and seek concurrence with the federal banking agencies in implementing the broker-dealers section of the Gramm-Leach-Bliley Act.
- **Title II. Monetary Policy Provisions.** Authorizes the Federal Reserve Board to pay interest on balances it holds for depository institutions at Federal Reserve Banks. This title would also give the Federal Reserve Board greater flexibility to set reserve requirements on transaction accounts maintained at its banks.
- **Title III. National Bank Provisions.** To date, not all the provisions of P.L. 109-351 have been implemented. It may take years and new legislation to complete the implementation as demonstrated by the provisions of the Gramm-Leach-Bliley Act of 1999, which is being implemented by P.L. 109-351 in 2007. At the same time, provisions that were considered in the legislative process but were excluded from P.L. 109-351 are now being reintroduced in the 110th Congress. One title would permit a national bank greater flexibility in designing its articles of association, including how its directors are elected. A national bank could also choose not to use cumulative voting, which is now mandated by current law. This title also has provisions to simplify dividend calculations and repeal obsolete regulations, including regulations that limit the authority of the Comptroller of the Currency. These provisions, like the national bank provisions of H.R. 3505 (see above), provide national banks greater organizational flexibility but stop short of permitting national banks to fundamentally change their current organizational structure.

- **Title IV. Savings Association Provisions.** Would amend the definitions of bank and regulatory agencies to include savings associations and the Office of Thrift Supervision (OTS), which would give associations the same treatment as banks regarding broker-dealer registration requirements. This title also eliminates the cap on the valuation of purchased mortgage servicing rights and raises the cap on loans to one borrower to $500,000 for development of domestic residential housing units.
- **Title V. Credit Union Provisions.** This title would give military and civilian authorities discretion to extend federal land leases to credit unions at minimum charge. It also increases the maturity limitation on federal credit union loans from 12 to 15 years. These provisions would also allow credit unions to expand electronic transfer services to persons eligible for membership. This title would also clarify the definition of net worth to conform with other depository institutions and the new accounting standards.
- **Title VI. Depository Institution Provisions.** Would repeal three reporting requirements related to insider lending. This title would also extend the same treatment to thrifts that banks already have in investing in bank service companies (companies that provide services to banks), while maintaining activities limits and maximum investment rules. It would allow member institutions of the Federal Reserve Board to count as reserves the deposits in other banks that are passed through by those banks to the Federal Reserve Banks as required reserve accounts. This title requires a review of all report requirements by federal regulators, and it would expand eligibility for the 18-month examination cycle from institutions with $250 million or less in assets to those with assets of $500 million or less. It would streamline depository institutions' merger application requirements. It would also allow depository institution subsidiaries of a bank holding company to engage in cross-market activities. This title also raises the asset size of institutions that are exempt from interlocking management prohibitions from $20 million to $50 million.
- **Title VII. Banking Agency Provisions.** These are regulatory housecleaning measures that clarify, extend, amend, remove, and correct financial services laws and regulations. The 28 sections under this title are focused on improving the regulatory process, thereby improving industry regulation. For example, Section 701 provides greater consistency in the federal law governing how much time is available to challenge the determination by the Office of the Comptroller of the Currency to appoint a receiver for a national bank by providing a 30-day period for a party to judicially challenge an OCC appointment. Section 711 underscores the authority of state regulators for institutions chartered on the state level and clearly establishes that the chartering state is the primary state supervisor. It also limits the host state supervisory authority in cooperative regulatory agreements. Section 728 directs regulatory agencies to finalize a proposal for a uniform, simplified privacy notice to satisfy the requirements of the Gramm-Leach-Bliley Act.

- **Title VIII. Fair Debt Collection Practice Act Amendments.** Would extend the current exemption for debt collection by state and local agencies to private collection entities working for state and local agencies.
- **Title IX. Cash Management Modernization.** Would make changes to 31 U.S.C. 9301 and 31 U.S.C. 9303 to allow the Secretary of the Treasury to determine the type of securities that may be pledged in lieu of surety bonds, and requires that the securities be valued at current market rates.
- **Title X. Studies and Reports.** Would require a study by the Comptroller General on the volume of currency transaction reports (CTRs) filed with the Treasury, including, if appropriate, recommendations for changes to the filing system. It also requires a study by the Comptroller General on the cost of regulatory compliance and the efficacy of consolidating federal financial services regulators.

What's Being Implemented?

The Federal Reserve Board and the Securities and Exchange Commission asked for comments on their joint proposal to clarify the rules governing banks' securities activities.[1] This is in response to Title I of the Financial Services Regulatory Relief Act of 2006, which directed the SEC and the federal bank regulatory agencies to jointly issue proposed rules within 180 days of the law's enactment. This proposal is the latest effort to meet the mandate of the Gramm-Leach-Bliley Act (GLBA) of 1999 that repealed a broad registration exemption for bankers' securities activities and replaced it with specific exemptions. The SEC had issued several proposals that were criticized by bankers and their regulators. The bank regulatory agencies and the SEC will take comments for 90 days, using the remaining 90 days to develop the proposed rules. The SEC has also extended the exemption for banks until July 2, 2007.

The Federal Reserve Board has also invited public comments on its rules that would implement Section 601 of the Financial Services Regulatory Relief Act of 2006, which eliminates several statutory reporting and disclosure requirements related to insider lending by insured depository institutions.[2] The bank regulatory agencies supported eliminating these requirements because the agencies have not found them useful in monitoring insider lending or preventing insider abuse. When these rules become final, they would amend the Federal Reserve Board's Regulation O, which places restrictions on the ability of insured depository institutions to extend credit to their executive officers, directors, and principal shareholders.

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[1] This joint effort is supported by many analysts. See Christian Bruce, "Fed Agrees to Seek Comment On Proposed Bank Broker Rules," *BNA Banking Daily,* December 12, 2006, 2 p. See [http://pubs.bna.com/ip/bna/bbd.nsf/ch/A0B3V8F2N2], and [http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20061218/attachment.pdf].

[2] For the Federal Reserve Board's press release and other documentation, see [http://www.federalreserve.gov/boarddocs/press/bcreg/2006/200612062/default.htm].

Section 728 of the Financial Services Regulatory Relief Act of 2006 mandated that federal regulatory agencies develop a model format for conveying a financial institution's privacy policies. The model must be easily understood by consumers. It should clearly explain consumers' right to opt out of permitting the sharing of their nonpublic personal information with nonaffiliated third parties. The law mandated that the regulatory agencies develop the model and issue it for public comment no later than 180 days after the date of its enactment, which is April11, 2007. The model, if approved in final rulemaking, would serve as a safe harbor for institutions that use it to satisfy their account opening and annual privacy notification requirements.

The privacy notices were required by the Gramm-Leach-Bliley Act of 1999, effective July 1, 2001. But as the new proposal mentioned, many of the notices that were offered to comply with GLBA were long and complex, causing complaints of confusion from consumers. The sample model provides simple introductory information telling consumers why the financial institutions share customer information and what types of information are shared. It also details the uses of the shared information and indicates whether the consumer can limit the sharing. Most important, the model provides a simple opt-out form that can be returned to the financial institution.

The federal bank regulatory agencies have proposed interim rules to implement Section 605 of P.L. 109-351. This provision of the law extends the range of small institutions eligible for an extended 18-month on-site examination cycle to well-capitalized, well-managed banks and savings associations with up to $500 million in total assets. This change reduces the cost of preparing for on-site examinations for more small institutions. Before this regulatory change — effective April 3, 2007 — only banks with less than $250 million in total assets could qualify for the extended 18-month cycle.

Reintroduced Provisions

Analysts expect more provisions of H.R. 3505 and S. 2856 that were not included in P.L. 109-351 will be reintroduced in the 110th Congress as well as new provisions. Favorable provisions for credit unions, thrifts, and small and large banks are likely to be reintroduced as separate bills, or titles attached to non-financial-services legislation as was the case in other regulatory relief bills in past Congresses.

The Seasoned Customer CTR Exemption Act of 2007 (H.R.323), a key measure in H.R. 3505 in the 109th Congress, was the first provision to be reintroduced in the 110th Congress. CTRs are currency transaction reports. This provision would exempt institutions' seasoned customers from the requirements under federal anti-money-laundering laws that require currency transactions of more than $10,000 to be reported to the Internal Revenue Service. H.R. 3505 would have exempted suspicious activity reports (SARs) as well as CTRs for seasoned customers. It was argued that SARs exemptions could seriously undermine the U.S. antiterrorism financing efforts.

Title I in H.R. 3505, which was excluded from P.L. 109-351 by the Senate, would allow national banks to elect to be organized as S corporations. S corporations are Limited Liability Corporations (LLCs) that avoid double federal taxation of profits. In the 110th Congress, the Senate approved a package that includes $757 million in tax benefits for banks, including $351 million aimed directly at S corporation banks. This provision was part of H.R. 1591, the bill to provide war supplemental funding that the President has threatened to veto. Nearly a third of all American banks are S corporations. They are usually smaller banks; however, one of these banks has assets of $14 billion and 42 have assets of more than $1 billion.[3]

The Credit Union Regulatory Improvement Act of 2007 (CURIA) was introduced in the 110th Congress on March 15, 2007 (H.R. 1537).[4] The new bill has 21 provisions, which is three more than there were in the Credit Union Regulatory Improvement Act (CURIA) of 2005.[5] In the enactment of P.L. 109-531, only five of the 15 provisions in H.R. 3505 were included in the law. This suggests that while the number of credit union regulatory relief provisions are growing, Congress has been very selective in the ones it enacts. The new bill's additional provisions tend to be more multifaceted. For example, in Title I Capital Modernization, it proposed lowering the capital requirements, amended the risk-based net worth requirements, and amended the net worth restoration plans. In CURIA 2007, Section 201 would simply raise the cap on credit union member business loans to 20% from the present 12.5%.

Conclusion

To date, not all the provisions of P.L. 109-351 have been implemented. It may take years and new legislation to complete the implementation as demonstrated by the provisions of the Gramm-Leach-Bliley Act of 1999, which is being implemented by P.L. 109-351 in 2007. At the same time, provisions that were considered but excluded from P.L 109-351 are now being reintroduced as separate bills in the 110th Congress. At some point later in the legislative session, these individual relief bills may be bundled in a single regulatory relief bill. Regulatory relief legislation often changes the playing field for depository institutions because many regulations restrict or expand the activities of institutions. Consequently, regulatory relief legislation often has significant impact on particular institutions in the financial services markets.

Whether relieving the regulatory burden would have an impact on reversing the growing concentration in the financial services industry is uncertain because knowledgeable observers agree that the banking industry concentration is partly attributable to economies of scale. Larger institutions experience declining average cost as they grow. These same institutions experience economies of scale in complying with the federal banking regulations. This implies that additional regulation relief legislation makes it increasingly difficult for smaller institutions to comply and compete in the marketplace.

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[3] Credit Union National Association, "Senate Passes bill with tax breaks for banks," *CUNA News Now,*"March 31, 2007, p. 2.

[4] Marcia Kass, "Kanjorski Seeks to Raise Cap on Credit Union Lending," *BNA Banking Report*, March 5, 2007, p. 1, [http://ippubs.bna.com/NWSSTND/IP/BNA/bar.nsf/SearchAllView/DB9B49D830CA39508525729300112635?Open&highlight=CREDIT,UNIONS].

[5] See CRS Report RS22212, *Credit Union Regulatory Improvements Act of 2005 (CURIA)*, by Pauline Smale.