For Release Upon Delivery
10:00 a.m., March 14, 2002

TESTIMONY OF

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Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

of the

COMMITTEE ON FINANCIAL SERVICES

of the

U. S. HOUSE OF REPRESENTATIVES

March 14, 2002

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairman Bachus, Ranking Member Waters, and members of the Subcommittee, I appreciate this opportunity to discuss with you ways in which we can reduce unnecessary regulatory burden on America's banking system, and to express the views of the Office of the Comptroller of the Currency (OCC) on the Financial Services Regulatory Relief Act of 2002 (FSRR Act).[1] Let me also thank Ms. Capito, for sponsoring a bill that includes sensible and appropriate regulatory burden relief for national banks and other financial institutions.

Effective bank supervision demands that regulators achieve a balance among several competing, but equally important, objectives. These objectives include fostering banks' ability to conduct their business profitably and competitively, free from burdensome constraints that are not necessary to further the purposes of the banking laws. Unnecessary burdens drive up the costs of doing business for banks and their customers and prevent banks from effectively serving the public. Periodic review of the banking statutes and regulations is an essential means of ensuring that banks are not needlessly encumbered by requirements that are no longer appropriate for today's banking environment.

The OCC itself has a continuing commitment to review its regulations and make changes, consistent with safety and soundness, to enable banks to keep pace with product innovation, new technologies, and changing consumer demand. We also constantly reassess the effectiveness and efficiency of our supervisory processes to focus our efforts on the institutions and activities that present the greatest risks, and to reduce unnecessary burdens on demonstrably well-run banks. However, the results that Congress can achieve by removing or reducing regulatory burden imposed by Federal statutes can be broader and more far-reaching than regulatory changes. The FSRR Act contains a number of important provisions that will help national banks remain profitable and competitive by eliminating unnecessary burden. The first portion of my testimony will highlight several of these provisions.[2]

A second, and fundamentally important, objective of our supervision is to promote and maintain the safety and soundness of the banking system. The FSRR Act also contains provisions that further this objective, and I will mention a few of these provisions in the second section of my testimony. I will also take this opportunity to briefly discuss certain additional legislative changes that you may wish to consider as the legislation is developed, which would help promote safety and soundness.

[1] As of the time this testimony was required to be submitted, the FSRR Act had not been formally introduced. Accordingly, the views of the OCC set forth in this testimony are based on the March 5, 2002 Discussion Draft of the FSRR Act, including certain changes that we have been advised will be made to the draft. References to sections of the Act are based on the March 5th Discussion Draft. The OCC will be pleased to work with Subcommittee staff, as appropriate, as the legislation progresses.

[2] A detailed section-by-section review of the provisions of Title I, IV, and VI of the March 5, 2002 Discussion Draft of the FSRR Act, which are relevant to the OCC's responsibilities, is attached to this testimony as an appendix.

National Bank Provisions

The FSRR Act contains several provisions that would streamline and modernize aspects of the corporate governance and interstate operations of national banks. The OCC strongly supports these provisions.

For example, section 101 of the Act relieves a restriction in current law that makes it difficult for some national banks to operate as "Subchapter S" corporations. The National Bank Act currently requires all directors of a national bank to own at least $1,000 worth of shares of that bank or an equivalent interest in a bank holding company that controls the bank. The requirement means that all directors must be shareholders, making it difficult or impossible for some banks to comply with the 75-shareholder limit that defines eligibility for treatment as a Subchapter S corporation. These banks are thus ineligible for the benefit of Subchapter S tax treatment, which avoids a double tax on the bank's earnings. Community banks suffer most from this result.

Section 101 authorizes the Comptroller to permit the directors of banks seeking Subchapter S status to satisfy the qualifying shares requirement by holding a debt instrument that is subordinated to depositors and general creditors of the bank. The holding of such an instrument would not cause a director to be counted as a shareholder for purposes of Subchapter S. The subordinated liability is closely equivalent to an equity interest, however, since the directors could only be repaid if all other claims of depositors and nondeposit general creditors of the bank were first paid in full, including the claims of the FDIC, if any. The new requirement would thus ensure that directors retain the requisite personal stake in the financial soundness of their bank.

Similarly, section 102 of the Act eliminates a requirement in current law that precludes a national bank from prescribing, in its articles of association, the method for election of directors that best suits its business goals and needs. Unlike most other companies and unlike state banks, national banks cannot choose whether or not to permit cumulative voting in the election of their directors. Instead, current law requires a national bank to permit its shareholders to vote their shares cumulatively. Section 102 provides that a national bank's articles of association may permit cumulative voting. This amendment would conform the National Bank Act to modern corporate codes and provide national banks with the same corporate flexibility available to most corporations and state banks.

Section 401 of the Act also simplifies the requirements that apply to a national bank that wishes to expand interstate by establishing branches *de novo*. Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, interstate expansion through bank mergers generally is subject to a state "opt-out" that had to be in place by June 1, 1997. Under the time frames set by the statute, interstate bank mergers were permissible in all 50 states as of September 2001. By contrast, *de novo* branching still requires states to pass legislation to affirmatively "opt-in" to permit out-of-state banks to establish new branches in the state.

This effect of current law is to require that, in many cases, national banks must structure artificial and unnecessarily expensive transactions in order to establish a new branch across a state border -- which in some cases, is simply across town in a multi-state metropolitan area. Section 401 repeals the requirement that a state expressly must adopt an “opt-in” statute to permit the *de novo* branching form of interstate expansion for national banks and contains parallel provisions for state member and non-member banks. National banks and their customers would benefit significantly by this change, which would permit a bank to freely choose which form of interstate expansion is most efficient for its needs and customer demands.

Safety and Soundness Provisions

The FSRR Act also contains a number of provisions that further the objective of promoting and maintaining the safety and soundness of the banking system. One of the most important of these provisions (section 406 of the March 5, 2002 Discussion Draft), expressly authorizes the Federal banking agencies to enforce written agreements and conditions imposed in writing in which an institution-affiliated party or controlling shareholder agrees to provide capital to the depository institution. This provision would supersede recent Federal court decisions that conditioned the agencies’ authority to enforce such conditions or agreements on a showing that the non-bank party to the agreement was “unjustly enriched.” These changes will enhance the safety and soundness of depository institutions and protect the deposit insurance funds from unnecessary losses.

The Act also contains two provisions that promote safety and soundness by providing the Federal banking agencies with greater flexibility to manage resources more efficiently and deal more effectively with problem situations. Current law mandates that most banks be examined on-site on prescribed schedules. This can, in certain circumstances, interfere with the ability of the banking agencies to concentrate their supervisory oversight on deteriorating or problem institutions. Section 601 of the bill would permit the agencies, when necessary for safety and soundness purposes, to adjust their mandatory examination schedules to concentrate resources on particularly troublesome institutions.

Current law also provides for criminal penalties to be imposed on a Federal bank examiner who examines a bank from which the examiner receives an extension of credit, including a credit card issued by that institution. This limits the flexibility of the OCC and the other banking agencies to assign examiners to particular institutions or examination teams, even if the examiner's skills or expertise would contribute materially to the examination. Section 602 provides that Federal banking agency employees may have credit cards without disqualification or recusal, but subject to the safeguard that the cards must be issued under the same terms and conditions as cards issued to the general public.

Additional Safety and Soundness Enhancements

The OCC has identified several additional areas in which amendments to current law would enhance the banking agencies' safety and soundness authority, reduce risk to the deposit insurance funds, and facilitate our enforcement efforts when wrongdoing does occur. We would be happy to work with the other banking agencies to further develop these recommendations and with Subcommittee staff to facilitate inclusion of the agencies' recommendations in the FSRR Act as it is developed through the legislative process.

Under the Change in Bank Control Act (CBCA)[3], all acquirers of insured depository institutions are required to provide notice to the appropriate Federal banking agency before proceeding with an acquisition. The CBCA gives the agency a specified time period within which to object to the transaction and specifies several bases on which the agency may disapprove a change in control notice. It does not, however, expressly permit the agency to impose conditions on the institution in connection with the agency's failure to object to an acquisition of control. While we think the ability to impose conditions designed to ensure the safety and soundness of the bank being acquired may be fairly inferred from the purpose of the statute, in order to eliminate any ambiguity, we recommend that the CBCA be amended to expressly permit the appropriate Federal banking agency to impose conditions it determines advisable for safety and soundness reasons, in connection with its decision not to pose objection to a CBCA notice.

We also recommend amending the CBCA so that acquirers of entities possessing dormant bank charters would be subject to the same standards and conditions -- including participation by the FDIC -- as are required when an applicant seeks a *de novo* bank charter. In such a case, acquirers are effectively buying a bank charter without the requirement for prior approval and without the scope of review that the law imposes when applicants seek a new charter, even though the risks presented by the two sets of circumstances may be substantively identical.

Another change that we would support is to clarify that an appropriate Federal banking agency may issue cease and desist orders against an insured depository institution or an institution-affiliated party who violates conditions imposed by agreements made with another appropriate Federal banking agency. This issue can arise, for example, when a bank that is subject to requirements imposed by one agency in connection with an application or an enforcement action, converts its charter so that it is regulated by a different agency. Another example occurs when the FDIC imposes conditions in connection with granting deposit insurance but the FDIC is not the appropriate Federal banking agency for the insured bank, e.g., a national bank or a state member bank.

In addition, we recommend amending the FDIA to remove the "knowing or reckless" element from the definition of "institution-affiliated party." Under current law, an accountant or other independent contractor of an insured depository institution may be subject to sanctions as an institution-affiliated party in an administrative enforcement

[3] 12 U.S.C. § 1817(j).

action only if the accountant’s (or other independent contractor’s) wrongful conduct was “knowing or reckless.” Accountants who serve as independent contractors to insured depository institutions play a key role in keeping institutions' books and records accurate. In recent years, banking regulators have seen an increase in audit and internal control deficiencies at many insured depository institutions, some of which have caused significant operating losses and led to failures of institutions. Elimination of the “knowing or reckless” standard would remove a significant impediment to the agencies’ ability to hold these individuals and firms accountable for violations of law, breaches of fiduciary duty, or unsafe or unsound practices.

Conclusion

Once again, Mr. Chairman, on behalf of the OCC, I thank you for your leadership in pursuing this legislation. As I have indicated, the OCC supports the Act and believes that many of its provisions will go far to promote the objectives I have described today. In those areas where we have recommended that you consider additional amendments, we would be pleased to work with your staff to develop appropriate legislative language for the Subcommittee’s consideration.

I am pleased to have had this opportunity to provide our views on this important initiative, and I would be happy to answer any questions you may have.