

# CRS Report for Congress

Received through the CRS Web

## **Financial Services Regulatory Relief in the 109<sup>th</sup> Congress: H.R. 3505 and S. 2856**

**Updated July 24, 2006**

Walter W. Eubanks  
Specialist in Economic Policy  
Government and Finance Division

# Financial Services Regulatory Relief in the 109<sup>th</sup> Congress: H.R. 3505 and S. 2856

## Summary

The Financial Services Regulatory Relief Act of 2005 (H.R. 3505) was passed by the House on March 8, 2006. On May 4, 2006, the Senate Banking Committee unanimously reported the Financial Services Regulatory Relief Act of 2006 (S. 2856). On May 25, 2006, the full Senate passed S. 2856 and sent it to the House. Since the two bills contain differing provisions, a conference will be required to iron out differences between them.

This report gives an overview of the major regulatory relief provisions in H.R. 3505 and S. 2856, focusing on their potential impact on bank concentration. The report examines both bills' provisions to assess whether they are likely to support or discourage bank consolidation. The consolidation of the banking industry arguably reduces competition, which could tend to raise the price of banking services. On the other hand, there is empirical evidence that shows economies of scale in banking, including economies in complying with banking regulations, suggesting larger banks might be able to provide banking services at lower cost than smaller banks.

H.R. 3505 and S. 2856 would provide regulatory relief for large and small depository institutions. The net potential impact of these provisions is ambiguous at this stage. It is difficult to predict how many institutions (from credit unions to bank holding companies) will adopt the provisions, and what impact the provisions will have on the adopting institutions' positions in the marketplace. Some consumer groups are concerned that H.R. 3505 could weaken consumer protection. Because of similarity in the two bills' provisions, it is likely that consumer groups will have similar concerns about S. 2856.

Overall, the bills are more alike than different. The key differences between H.R. 3505 and S. 2856 are in the manner in which H.R. 3505 deals with depository institution affiliates (in Title V), the regulatory burden of complying with the Bank Secrecy Act (in Title VII), clerical changes and technical amendments to current banking laws and regulations (in Title VIII), the manner in which S. 2856 deals with the definition of a broker in the Securities Exchange Act of 1934 (in Title I), the authorization of the Federal Reserve Board to pay interest on depository institutions' reserves held by its banks (in Title II), the financial instruments eligible to be used as collateral (in Title IX), and mandates for studies and reports on regulatory burden from the Comptroller General and Secretary of the Treasury (in Title X).

This report will be updated as developments warrant.

## Contents

Introduction .....	1
Brief Legislative History .....	4
Overview of the Provisions of H.R. 3505 and S. 2856 .....	4
The Financial Services Regulatory Relief Act of 2005 (H.R. 3505) .....	5
Title I. National Bank Provisions .....	5
Title II. Savings Association Provisions .....	5
Title III. Credit Union Provisions .....	5
Title IV. Depository Institution Provisions .....	6
Title V. Depository Institution Affiliates Provisions .....	6
Title VI. Banking Agency Provisions .....	6
Title VII. “BSA” Compliance Burden Reduction .....	6
Title VIII. Clerical and Technical Amendments .....	6
Title IX. Fair Debt Collection Practices Act Amendments .....	7
The Financial Services Regulatory Relief Act of 2006 (S. 2856) .....	7
Title I. Broker Relief .....	7
Title II. Monetary Policy Provisions .....	7
Title III. National Bank Provisions .....	7
Title IV. Savings Association Provisions .....	7
Title V. Credit Union Provisions .....	7
Title VI. Depository Institution Provisions .....	8
Title VII. Banking Agency Provisions .....	8
Title VIII. Fair Debt Collection Practice Act Amendments .....	8
Title IX. Cash Management Modernization .....	8
Title X. Studies and Reports .....	9
Shared Titles of H.R. 3505 and S. 2856 .....	9
National Bank Provisions .....	9
Savings Association Provisions .....	10
Credit Union Provisions .....	10
Depository Institution Provisions .....	11
Banking Agency Provisions .....	12
Fair Debt Collection Practices Act Amendments .....	13
Titles Exclusive to Each Bill .....	13
Some Implications and Consumer Protection Issues .....	14
Additional Readings .....	16

# Financial Services Regulatory Relief in the 109<sup>th</sup> Congress: H.R. 3505 and S. 2856

## Introduction

Even though the intended purpose of regulatory relief for depository institutions is to lower the cost or burden of regulation on these institutions, relief provisions could have a significant impact on the growing concentration in the U.S. banking industry. Depository institution regulations exist for many different 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. Besides 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, regulators, and industry analysts necessarily face the issue of whether or not existing laws and regulations restrain efficiency and/or competitiveness in the financial services marketplace.

In addition, the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA, 110 Stat. 3009-394) requires that federal financial regulators review their regulations at least once every 10 years in an effort to eliminate any regulatory requirements that are outdated, unnecessary, or unduly burdensome. Some refer to these EGRPRA activities as regulatory “housecleaning,” which include technical amendments as well as substantive changes in law and regulation. Regulatory housecleaning is designed to remove obsolete and inefficient regulations. Regulatory relief, however, can change the playing field for depository institutions because many regulations restrict the activities of institutions. Moreover, some observers claim that relieving regulatory burdens often results in changing regulations in favor of one set of institutions over others and is viewed by some competing institutions as giving their competitors unfair advantages.

Regulatory relief legislation could either help slow or accelerate the decline in the number of smaller depository institutions. According to the 2004 testimony of John M. Reich, former Vice Chairman of the Federal Deposit Insurance Corporation (FDIC), and presently the Director of the Office of Thrift Supervision:

Over the last 20 years, there has been substantial consolidation in the banking industry. This can be seen most dramatically in small community banks. At the beginning of 1985, there were 11,780 small community banks with assets of less than \$100 million in today’s dollars. At yearend 2003, their number had dropped by 63 percent to just 4,390.... Even more dramatically, the total market share of those institutions decreased from nine percent at the beginning of 1985 to two

percent at yearend 2003.... The decline had three main components: mergers, growth out of the community bank category, and failures. The decrease was offset somewhat by the creation of 2,403 new banks. In this calculation, a community bank is defined as a bank or thrift holding company or an independent bank or thrift, and bank asset size was adjusted for inflation. Thus, a bank with \$100 million in assets today is compared with one having about \$64 million in assets in 1985.<sup>1</sup>

As it was back then, part of the decline in recent years could be explained by the fact that big banks are more profitable. In March 31, 2006, the 85 FDIC-insured commercial banks with \$10 billion or more in assets have an average return on assets of 1.42%, whereas smaller FDIC-insured commercial banks with less than \$100 million in assets have a return on assets of 1.01%, and smaller thrifts in this same asset category had a return on assets of 0.86%.<sup>2</sup>

Although there are few studies on the estimated cost of complying with banking regulations, one Federal Reserve Board study found that total regulatory cost accounted for 12% to 13% of non-interest expense or \$15.7 billion in 1991 when the study took place. Further, the same study concluded that “the average compliance costs for regulation are substantially greater for banks at low levels of output than banks at high levels of output.”<sup>3</sup> This conclusion has important implications. Higher average regulatory costs at low levels of output may inhibit the entry of new firms into banking or stimulate consolidation of the industry into fewer, larger banks.<sup>4</sup> This suggests that regulatory relief might lower the cost of regulatory compliance, encourage the entry of new firms, and slow the decline in the number of smaller community banking institutions. However, the opposite effects might occur, depending on the nature of the regulatory relief provided. If the regulatory relief eliminates restrictions on mergers and acquisitions, for example, the decline in the number of smaller institutions could be accelerated.

Studies have offered empirical evidence that economies of scale occur in complying with federal regulations. That means that as the industry becomes more regulated, larger banks’ costs for compliance with these regulations, as a percentage of assets, are lower than smaller institutions’ costs, allowing the large banks greater latitude to lower the prices of services to their customers than smaller competitors.

---

<sup>1</sup> U.S. Congress, House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, *Cutting Through Red Tape: Regulatory Relief for America’s Community Based Banks*, hearings, 108<sup>th</sup> Cong., 2<sup>nd</sup> sess., May 12, 2004, p.128.

<sup>2</sup> For more recent information on the profitability of commercial banks and thrifts, see CRS Report RL32542, *The Condition of the Banking Industry*, by Walter W. Eubanks.

<sup>3</sup> Gregory Elliehausen, “The Cost of Bank Regulation: A Review of the Evidence,” Staff Report #171, Board of Governors of the Federal Reserve System, April 1998, p. 29. For a summary of this report see *The Federal Reserve Bulletin*, April 1998, p. 252.

<sup>4</sup> *Ibid.*, pp. 25-27; and Neal Murphy, “Economies of Scale in the Cost of Compliance with Consumer Credit Protection Laws: The Case of the Implementation of the Equal Credit Opportunity Act of 1974,” *Journal of Bank Research*, vol. 10, winter 1980, pp. 248-250; and Neil Frank Crowne, “Industry Reporting Requirements: Benefit or Burden?” Report prepared for the United States Bank of Denver, 1980.

Specifically, the evidence indicates that in complying with the Truth in Lending regulations, for example, larger banks' compliance costs, as a percentage of assets, are lower than smaller banks. Similar evidence exists for other federal banking regulations.<sup>5</sup>

The number of banking regulations is growing: between 1989 and 2004, federal bank regulatory agencies promulgated a total of 801 final rules.<sup>6</sup> Some in the industry argue that these rules have created a heavy burden for smaller depository institutions, even when the regulations prove not to be directly applicable to them.<sup>7</sup> The evidence also suggests that simply changing regulations frequently imposes a relatively greater burden on smaller institutions.<sup>8</sup> The main reasons for the increased burden on smaller depository institutions are that regulation compliance is labor intensive and requires the time and analysis of highly paid bank officers and managers. When necessary, adding staff to perform these compliance duties may represent a small percentage increase in the staff of a large bank, but a relatively large percentage increase for a small community bank.

Some analysts maintain that with more than 8,000 federally insured banking institutions, there are fewer smaller banking institutions because the larger banks are more efficient and consumers are benefitting from the industry's shakeout.<sup>9</sup> Even though the number of banking firms is declining, the number of branches has been increasing. Analysts suggest that the relatively less efficient producers of financial services are performing poorly, whereas the most efficient producers are allowing consumers to enjoy the benefits of economies of scale and improved technological innovations that help them to lower cost and increase the number of new products and services.<sup>10</sup> These analysts argue that deregulation, such as the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (108 Stat. 2338) and regulatory relief legislation and regulations have helped to loosen the constraints on the industry, allowing inefficient institutions to be acquired or merged with healthier institutions.

---

<sup>5</sup> Gregory Elliehausen, "The Cost of Bank Regulation," pp. 25-27.

<sup>6</sup> U.S. Congress, House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, *Cutting Through Red Tape: Regulatory Relief for America's Community Based Banks*, hearings, 108<sup>th</sup> Cong., 2<sup>nd</sup> sess., May 12, 2004, p.126.

<sup>7</sup> Gregory Elliehausen, "The Cost of Bank Regulation," p. 29.

<sup>8</sup> *Ibid.*

<sup>9</sup> Ronald Spieker, "Bank Branch Growth Has Been Steady — Will It Continue?" *FDIC Future of Banking Study*, Aug. 2004, pp. 2-8.

<sup>10</sup> Kenneth Jones and Tim Critchfield, "Consolidation in the U.S. Banking Industry: Is the 'Long Strange Trip' About to End?" *FDIC Banking Review*, vol. 17, [2005], pp. 36-37. Available at [<http://www.fdic.gov/bank/analytical/future/index.html>].

## Brief Legislative History

Regulatory relief for depository institutions is of continuing interest to Congress. The current relief legislation can be traced back to the Financial Regulatory Relief and Economic Efficiency Act of 1999 (S. 576) when it became law as Title XII in the American Homeownership and Economic Opportunity Act of 2000 (114 Stat. 2944, 3032). It provided a number of provisions that modernized regulations concerning corporate governance of federally regulated depository institutions.

During the 107<sup>th</sup> Congress, the Financial Services Regulatory Relief Act of 2000 (H.R. 3951) was reported out of committee, but never reached the floor of the House. The provisions of this bill were similar to current bills in Congress today with many of the same titles, such as national bank, credit unions, and banking agency provisions. This bill also addressed repealing cumulative voting in shareholder elections.

The Financial Services Regulatory Relief Act of 2005 (H.R. 3505) was introduced on July 8, 2005. H.R. 3505 was passed by the House on March 8, 2006. It shares many of the provisions of the Senate's bill (S. 2856), with important differences.

Members of the Senate have been working on a regulatory relief bill for nearly two years. On May 4, 2006, the Senate Banking Committee marked up and unanimously reported Financial Services Regulatory Relief Act of 2006 (S. 2856). On May 25, 2006, the full Senate passed S. 2856 and sent it to the House. Since the two bills deal with the same subjects, a conference will be required to iron out differences between them. The following two sections briefly outline these similarities and differences.

### Overview of the Provisions of H.R. 3505 and S. 2856

Although both bills' provisions include regulatory changes affecting both small and large depository institutions, the net effect on bank concentration remains uncertain. Some provisions could directly help smaller institutions by reducing their costs, for example, by eliminating some reporting requirements that are costly to smaller institutions. At the same time, reduced reporting could undermine the government's anti-money-laundering and anti-terrorist-financing efforts.<sup>11</sup> S. 2856 does not have a reporting elimination provision. Instead, it would require the Comptroller General to conduct a study to determine whether and to what extent currency transaction reports are burdensome to financial institutions and how the suspicious activities reports could be modified to lower their burden without undermining the intended purpose.

---

<sup>11</sup> U.S. Congress, House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, *Financial Services Regulatory Relief: The Regulators' Views*, hearings, 109<sup>th</sup> Cong., 1<sup>st</sup> sess., June 9, 2005, p. 237.

Provisions in both bills that would eliminate restrictions on mergers and acquisitions might facilitate bank concentration. H.R. 3505's national bank provisions allowing national banks to organize themselves as S corporations and limited liability companies (LLCs) could have the same effect by giving these reorganized institutions clear tax advantages over competing depository institutions.<sup>12</sup> Such a provision could make it financially easier for bigger banks to acquire and merge with smaller institutions, thus accelerating the disappearance of these smaller institutions. S. 2856's national bank provisions would not go as far as the House bill, but would give all national banks greater flexibility in their organizational structure. On the other hand, many analysts believe that the cost of reorganization and new difficulties in managing under the new forms (i.e., LLCs) would prevent many bank corporations from making the changes permitted under H.R. 3505.

The concentration effects of other provisions in these bills might not be as straightforward. A beneficial provision to credit unions could be viewed as favoring smaller depository institutions because most credit unions are relatively small. But, in this case, the decline in thrifts and banks could come from the growth in credit unions resulting in no change in concentration — the result of one form of small institution being replaced by another form.

## **The Financial Services Regulatory Relief Act of 2005 (H.R. 3505)**

- **Title I. National Bank Provisions.** Cover banks regulated by the Office of the Comptroller of the Currency (OCC). The most important of the 11 provisions under this title would authorize OCC to provide these banks organizational flexibility to take the forms of S corporations and LLCs. This provision could give these institutions significant tax advantages over their competitors.
- **Title II. Savings Association Provisions.** Cover savings associations that are regulated by the Office of Thrift Supervision (OTS), and would move savings associations' activities closer to those of banks. Since savings associations are generally smaller than banks, expanding their activities would enable them to increase profitability and resist takeovers. For example, saving associations might be able to expand their securities business by obtaining more parity with banks under the Securities Exchange Act of 1934.
- **Title III. Credit Union Provisions.** Would allow credit unions, which are regulated by the National Credit Union

---

<sup>12</sup> LLCs are corporations for all purposes except federal income tax. Owners of LLCs have limited liability and double taxation protection. S Corporations enable business owners to retain the nontax advantages of limited liability and other corporate attributes without the tax disadvantages of double taxation of profits and limited deductibility of losses. See CRS Report RL31538, *Passthrough Organizations Not Taxed As Corporations*, by Jack H. Taylor.



Administration (NCUA) Board, to provide some services to non-members, and increase the maturity of their loans, which are now restricted to 12 years. These provisions would also allow privately insured credit unions to borrow at lower interest rates from the Federal Home Loan Bank System. Increasing the competitiveness of credit unions arguably would help strengthen these smaller institutions and might help them to capture a larger share of the depository market.

- **Title IV. Depository Institution Provisions.** Would provide relief to all federally regulated depository institutions, making it easier to branch across state lines, consolidate, and change internal governance. These provisions generally relax the internal governance regulations of such institutions. For example, this title would eliminate certain reporting requirements on management borrowing from the institution. One section would make it easier for these institutions to invest in bank service companies.
- **Title V. Depository Institution Affiliates Provisions.** Would eliminate cross-market restrictions between banks and financial firms and allow saving associations to act as agents for depository institutions' affiliates. These provisions could lead to more efficiency within these institutions resulting in increased profitability but, conversely, could raise concerns about consumer privacy.
- **Title VI. Banking Agency Provisions.** Are focused on federal depository institutions' regulators. The provisions seek to reduce supervisory regulatory burdens by reducing the number of examinations made of smaller institutions and streamlining merger applications. Other provisions are largely concerned with regulatory housecleaning (discussed below), which some maintain would increase competitiveness by removing unnecessary regulations.
- **Title VII. "BSA" Compliance Burden Reduction.** Is an extension of the previous title. It is intended to reduce the burden of compliance with the Bank Secrecy Act ( 84 Stat. 1114) and the USA Patriot Act (115 Stat. 272) requirements, including eliminating the cash transaction reports (CTRs) and suspicious activity reports (SARs) for seasoned customers (well known, with an established financial record). Section 707 supports bringing money-services businesses (MSBs) into the mainstream of the financial services sectors. The MSBs could help to reduce financial services provider concentration by increasing the number of small financial services providers in the mainstream.
- **Title VIII. Clerical and Technical Amendments.** These amendments are regulatory housecleaning provisions directed at specific laws and institutions, and are generally not directly related to the bank concentration issue.

- **Title IX. Fair Debt Collection Practices Act Amendments.** Would extend the current exemption for debt collection by state and local agencies to private collection entities. Debt collection amendments affect all depository institutions and are expected to have no significant impact on the structure of the banking industry. However, consumer advocates are opposed to these changes because they further reduce consumer protection.

## **The Financial Services Regulatory Relief Act of 2006 (S. 2856)**

- **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.** Authorize 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.** 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, 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 serving 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 call 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 provision 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 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.

## Shared Titles of H.R. 3505 and S. 2856

### National Bank Provisions

The national bank provisions in H.R. 3505 contain 12 sections that pertain mainly to the chartering and governance of national banks, which are supervised by the Office of the Comptroller of the Currency. The first provision could provide significant tax savings to national banks by allowing a substantial change in national bank charters. This provision would make it easier for national banks to convert to an S corporation or a limited liability company (LLC) status. Since most banks are a C corporation, they are subject to the corporate income tax and their income distributed to shareholders is taxed again as individual income. S corporations' income is not subject to the corporate income tax. Consequently, the average effective tax rate banks pay would be lower than they are now paying as C corporations. The Congressional Budget Office (CBO) estimates that, overall, banks converting to S Corporations would pay \$60 million less in taxes over the 2006-2011 period and \$140 million less in taxes over the 2006-2016 period.<sup>13</sup> Although small and large national banks would have an advantage over other banking institutions, the larger tax saving is more likely to be obtained by the larger banks because they tend to be the most profitable. Thus, with the resulting tax savings, national banks could become even more competitive, enabling them to strengthen their financial positions and acquire less profitable banks that they could not acquire otherwise. However, because charter changes for the larger institutions could create managerial difficulties in distributing earnings to large numbers of owners, many of these banking corporations are not likely to change their organizational structures.<sup>14</sup> S. 2856, while allowing national banks greater flexibility in their organizational structure, does not necessarily mean that banks will be able to achieve tax savings based on organizational changes.

Other sections of this title in H.R. 3505 are mainly regulatory housekeeping provisions that would provide relief to national banks. For example, section 105 would eliminate the requirement that national banks meet state capital requirements for new intrastate branches. Since national banks tend to be larger than most state banks, this provision could allow national banks to increase their presence in most states, thus possibly increasing bank concentration. Section 111 would allow the Office of the Comptroller of the Currency to set capital requirements for foreign bank branches and agencies that cannot be less than those imposed by state law. S. 2856's

---

<sup>13</sup> U.S. Congressional Budget Office, *Congressional Budget Office Cost Estimate, H.R. 3505, Financial Services Regulatory Relief Act of 2005*, Feb. 16, 2006, p. 4.

<sup>14</sup> *Ibid.*

national bank provisions are more in line with regulatory housecleaning. Its provisions would repeal obsolete limitations on the Comptroller of the Currency and obsolete provisions in revised statutes.

## **Savings Association Provisions**

Savings association provisions in both bills seek to relieve savings associations of regulations that prevent them from operating more like banks. In H.R. 3505, there are 17 sections under this title. There are 5 sections under this title in S. 2856. Both bills would give thrift institutions a greater degree of parity with banks, with S. 2856 going further in this regard than H.R. 3505. They both would eliminate differences between banks and savings associations in the treatment of investment adviser and broker-dealer registration requirements, make the treatment of trusts that own thrifts the same as trusts that own banks, and eliminate the current restrictions on “loans to one borrower” pertaining to loans for domestic residential housing units. Provisions in H.R. 3505 would allow multiple savings association holding companies to acquire thrifts in other states under the same rules applicable to bank holding companies. Section 206 in H.R. 3505 and section 402 in S. 2856 would remove restrictions on thrifts purchasing mortgage servicing rights by amending the Home Owners Loan Act (HOLA, 48 Stat. 128).

Some observers have raised safety and soundness concerns in allowing savings associations to operate more like banks because the portfolios and income sources of savings associations are usually not as diversified as those of banks. Advocates of these provisions assert that since savings banks and savings associations are generally smaller institutions, removing restrictions on them is likely to make them more profitable, increase their survivability, and slow the rate of concentration in the industry. There are, however, many large thrifts which might use these regulatory changes to acquire smaller depository institutions. This could, at least in part, offset the effects just mentioned, resulting in little or no change in the rate of concentration in the industry.

Savings association holding companies were restricted from undertaking certain risky activities, such as credit card lending, by the Competitive Equality Banking Act of 1987 (CEBA, 101 Stat. 552), enacted in response to the savings and loan crisis of the 1980s. Some argue that, due to current technology developments and the historically low interest rate environment of recent years, thrifts are safer and sounder than they were when CEBA was enacted. Both bills contain provisions that would allow thrifts to engage in many activities that were once prohibited to them. In short, the effect is likely to make these institutions more competitive with banks and less subject to mergers and acquisitions, but, they also encourage more risk taking. Proponents assert that increased competition with banks is usually beneficial to consumers. Others call into question the safety and soundness issues these provisions raise.

## **Credit Union Provisions**

The overall impact of the 15 credit union provisions in H.R. 3505 and the five in S. 2856 is to expand credit unions’ banking powers, moving them closer to the financial services provided now by banks and thrifts. It is difficult to determine the

likely impact of these provisions on bank concentration. These provisions could help to increase bank concentration because the provisions would allow credit unions to be more competitive with smaller banks, drawing away the banks' customers. If credit unions become increasingly dominant in the small bank and thrift market, the smaller banks could become more susceptible to takeovers and mergers, due to reduced profitability. In addition, the result of the competition between credit unions and small banks could arguably be beneficial to consumers due to lower financial services costs. Since credit unions are not banks, as the number of credit unions grows at the expense of smaller banks, greater concentration of banks might result. But, the total number of financial services providers could expand, benefitting consumers.

Specifically, sections 301 to 305 in H.R. 3505 would expand credit unions' authority to provide financial services by amending the Federal Home Loan Bank Act (FHLB, 47 Stat. 725) to permit privately insured credit unions to become FHLB members, which would give these credit unions access to cheaper funding for their housing investments. (FHLB makes advances to its members at lower-than-market interest rates.) Other provisions would allow credit unions to open offices for business in lower-cost locations, such as federally owned properties. Another provision would increase the amount of credit union assets that could be invested in securities, and another would increase the maximum maturity date of credit union loans from 12 to 15 years. Still another would allow credit unions to offer electronic money transfer services to nonmembers to lower the costs of remitting funds domestically and abroad. Section 309 and 312 would make it easier for credit unions to merge and consolidate. In short, credit unions would be able to be more directly competitive with banks. S. 2856 would authorize only four of the provisions in H.R. 3505: it would allow leases of land on federal facilities for credit unions, increase the 12-year limitation of the maturity of credit union loans to 15 years, extend credit union fields of membership for check cashing and money transfers,<sup>15</sup> and clarify the definition of net worth to conform with the accounting standards of other depository institutions.

## **Depository Institution Provisions**

The depository institution provisions are regulatory housecleaning provisions that reflect direct compliance with the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). Some of these provisions would arguably benefit larger depository institutions, whereas others may benefit smaller institutions. For example, section 401 in H.R. 3505 would remove some remaining restrictions on new interstate branching for financial institutions. Most of the depository institutions seeking interstate branches are profitable, larger institutions, which compete with smaller in-state banks. Moreover, this section in H.R. 3505 would permit interstate mergers of insured banks of different home states. Larger and profitable banks would be better positioned to use this provision. S. 2856 provisions under this title are similar but more constrained. For example, while section 404 of H.R. 3505 would increase from \$20 million to \$100 million the asset sizes of depository

---

<sup>15</sup> This provision was already passed by the House in 2005 in separate credit union legislation (H.R. 749).

institutions that are exempt from restrictions on interlocking management, section 610 in S. 2856 would increase it from \$20 million to \$50 million. The expected effect of this provision is to increase smaller institutions' managerial pool, enabling them to better compete in the marketplace. Another provision beneficial to smaller institutions is contained in section 406 of H.R. 3505, which would permit savings associations and banks to invest more in bank service companies. S. 2856 would do the same thing, but it would preserve the existing activity limits and maximum investment rules.

Many of the provisions under the depository institution provisions in H.R. 3505 and in the Senate's bill tend to favor concentration as they tend to be more useful to larger institutions. For example, section 410 in H.R. 3505 would extend Community Reinvestment Act (CRA) credits for depository institutions that support establishing Employee Stock Ownership Plans (ESOPs). CRA credits are useful mainly in the approval process of banks applying to regulators to expand their banking activities. Section 606 in S. 2856 would streamline depository institution merger application requirements. Another section in H.R. 3505 would extend the review and disapproval time of a proposed acquisition of an insured depository institution. These kinds of regulatory relief provisions have little relevance to smaller institutions that are not seeking to expand their business.

## **Banking Agency Provisions**

Regulatory housecleaning provisions could benefit some institutions and be disadvantageous to others. In both bills, the banking agency provisions are concerned mostly with regulatory housecleaning, and are aimed at eliminating obsolete and inefficient regulations. These provisions are in Title VI in H.R. 3505 and Title VII in S. 2856. For example, in the Senate bill Section 701 would provide greater consistency in 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. Section 711 would reaffirm the authority of state regulators as the primary regulators for the institutions they charter.

While H.R. 3505 has "neutral" provisions (not more beneficial to large or small institutions) in its banking agency provisions, it also has provisions that may be more beneficial to some institutions. For example, Section 601 would allow federal agencies to adjust the examination cycle for insured depository institutions, if necessary, to allocate examiners' available resources. This would give added flexibility to regulators, replacing the current law mandating annual on-site examinations. The estimated cost impact is greater for smaller institutions, which could more likely benefit from the savings of fewer examinations than larger institutions. Similarly, Section 607 would expand eligibility for the 18-month examination cycle for institutions from \$250 million up to \$1 billion in assets. In some parts of the country, a \$1 billion bank is considered a large bank. If such a bank is competing with smaller banks, this provision would be most beneficial to the larger bank. Section 608 would allow smaller banks to use the short call report forms, which would lower the regulatory cost of these reports. Section 610, on the other hand, would streamline depository institutions' merger application requirements, a favorable change for larger banks. Section 617 would exempt financial institutions from providing the annual privacy notice of Title V of the

Gramm-Leach-Bliley Act (113 Stat. 1338), which would be primarily useful to larger institutions because of their large customer base and credit card business. In general, these provisions are designed to help improve the regulatory process of the banking system, even though their impacts may often not be neutral.

## **Fair Debt Collection Practices Act Amendments**

Both H.R. 3505 and S. 2856 have Fair Debt Collection Practices Act amendments identified as Title XI and Title VIII respectively. These provisions are also regulatory housecleaning provisions and have no significance for bank concentration. The Fair Debt Collection Practices Act (19 Stat. 1692) protects consumers from unreasonable debt collection practices. The first of two provisions under the proposed new titles extend current exemptions from state and local agencies to private entities that operate bad check pre-trial diversion programs on behalf of state and local district attorneys. The second section deals with content of the initial communication for informing consumers of their right to dispute and obtain validation of an alleged debt. Consumer advocates object to these provisions, viewing the changes to the Fair Debt Collection Practices Act as further weakening of consumer protection in general.<sup>16</sup>

## **Titles Exclusive to Each Bill**

H.R. 3505 has three titles containing provisions that are not in S. 2856, and S. 2856 has four titles not in H.R. 3505. The exclusive titles in the House's bill are Title V, Depository Institution Affiliates Provisions; Title VII, "BSA" Compliance Burden Reduction; and Title VIII, Clerical and Technical Amendments. Title V, Depository Institution Affiliate Provisions, arguably deserves more attention in this report than the others because overall, its provisions are likely to promote bank concentration more than the other titles. Section 501 of H.R. 3505 would eliminate the cross-marketing restrictions between banks and merchant banks of financial holding companies. This could make the larger bank holding companies more profitable, as it would allow these companies to share client information among the various businesses in the companies. For example, the bank could share its customers' information with its merchant banking part of the holding company, which could lower the merchant bank's cost of attracting customers. Furthermore, this title would eliminate restrictions on the geographic limitations savings associations must place on their loans and investment. This regulatory relief would effectively geographically expand savings associations' operations, thus expanding their lending markets. Section 504 would extend to financial companies the home state interest rate advantages that federally chartered banks and savings associations currently use to get around state usury ceilings. This provision could potentially undercut states' usury laws that protect state residents from higher interest rates. The provision is likely to make more funds available in states with very low usury ceilings by opening the market to savings associations providing loans with the

---

<sup>16</sup> Testimony by Travis Plunkett, Margot Saunders and Edmund Mierzwinski, U.S. Senate, Committee on Banking Committee on Banking, Housing, and Urban Affairs, Mar. 1, 2006. Available at [[http://banking.senate.gov/\\_files/consumergp.pdf](http://banking.senate.gov/_files/consumergp.pdf)].



higher interest of their home states. If the out-of-state institutions are successful, in-state institutions could become less profitable, increasing the likelihood of being taken over or merged with other institutions.<sup>17</sup>

The “BSA” Compliance Burden Reduction would seek to exempt qualified customers from currency transaction reports. It would also require reports from the Secretary of the Treasury and the Comptroller General on reducing financial services providers’ regulatory burden of complying with the Bank Secrecy Act. S. 2856’s exclusive title X calls for similar reports on reducing the burden of complying with the BSA. Title VIII, Clerical and Technical Amendments, contains four strictly regulatory housekeeping provisions, ranging from correcting the table of contents of the Home Owners’ Loan Act (HOLA) to repealing obsolete provisions in the Bank Holding Company Act of 1956 (70 Stat. 133). These provisions do not favor or discourage bank concentration. They make corrections to banking laws that were overlooked in the initial legislative process.

S. 2856 has four titles not found in H.R. 3505: Titles I and II and Titles IX and X. Title I is regulatory housecleaning because it directs the SEC to consult with the federal banking regulators in implementing rules for brokers that are mandated by the Gramm-Leach-Bliley Act. The resulting regulations would supercede any existing rules concerning this issue. Title II would authorize the Federal Reserve Board to pay interest on balances held by depository institutions at Federal Reserve Banks. Another provision under this title would give the Federal Reserve Board greater flexibility in setting reserve requirements on checking accounts, which would enhance its power in conducting monetary policy. Both provisions were passed by the House in H.R. 1224. Titles IX and X of the Senate’s regulatory relief bill would give the Secretary of the Treasury authority to change the securities that could be pledged as collateral and would require the Government Accountability Office to conduct studies on the effect of regulatory burden on the financial services industry. The Secretary of the Treasury would also be required to report to Congress on diversity and consolidation in the financial services industry.

## **Some Implications and Consumer Protection Issues**

H.R. 3505 and S. 2856 would provide regulatory relief for both large and small depository institutions. Although it is not difficult to determine the probable impact of individual provisions on bank concentration, the overall impact of these provisions on bank concentration is ambiguous. It is difficult to predict how many of the various categories of institutions (from credit unions to bank holding companies) would take advantage of the provisions made available to them, and how the provisions would, in turn, affect the adopting institutions’ performance in the marketplace. However, in cases where a regulatory relief provision is made available to both small and large institutions and is adopted by both, even though the efficiencies realized might prove to be more beneficial to the smaller institutions, it is not likely to be enough to overcome other advantages of the larger institutions that

---

<sup>17</sup> Ronald Spieker, “Bank Branch Growth Has Been Steady — Will It Continue?” *FDIC Future of Banking Study*, Aug. 2004, pp. 2-5.

are driving consolidation. This is partly due to economies of scale — the decline in average cost of operation as the scale of operation is increased. Thus, the regulatory relief provided might do little to reverse the trend in greater bank concentration. In addition, many of the provisions in H.R. 3505 and S. 2856 are more useful to large institutions. Regulatory relief to ease interstate branching, mergers, and acquisitions would be of very little use to most smaller institutions. If large banks take full advantage of these “big bank” provisions, the result might be increased bank concentration, as they would allow larger banks to become even more profitable.

As mentioned in the introduction to this report, some housecleaning provisions were driven by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). EGRPRA requires Congress and regulators to identify and remove unnecessary regulatory burdens that require legislative action. The relationship between EGRPRA and some of the other provisions is less obvious. For example, the provisions to allow national banks to change their organizational structure to S corporations or LLCs are likely to increase paperwork rather than reduce it. C corporations would have to develop new ways to distribute earnings to their owners. On the other hand, reducing the number of on-site examinations and allowing institutions to use shorter and fewer reports to comply with the BSA and the U.S.A. Patriot Act are consistent with EGRPRA and could have a positive impact on the finances of many depository institutions.

Consumer groups have argued that allowing banks to forgo or delay examinations could undermine the Community Reinvestment Act (CRA, 91 Stat. 1147), which rewards banks for lending to low- and moderate-income communities. Fewer examinations, consumer advocates argue, mean less CRA monitoring, which could allow banks to escape the scrutiny of regulators with respect to making the often less profitable CRA loans. Consumer groups also oppose the clarification of geographic applicable rate provision. They argue that section 504 of H.R. 3505 would allow higher interest rates to be exported to lower interest rate states. Importing high interest rates could boost the interest rate income of federal thrifts and place smaller state banking institutions at a competitive disadvantage. Consumers in states with low usury ceilings could pay more to borrow money. Consumer groups support the credit union provision that allows credit unions to provide check cashing and money transfer services to anyone in their field of membership because it is likely to increase competition and lower the costs of these services. Consumer groups, however, oppose the credit union provision to allow privately insured credit unions to obtain advances from the Federal Home Loan Banks because of safety and soundness concerns. Their argument is that if privately insured credit unions get the benefits of the FHLB system while competing with taxpayer-backed insured credit unions, the privately insured companies that face cheaper costs could cause more credit unions to withdraw from the government deposit insurance system, which could reduce the federal deposit insurance fund available to back the system’s deposits.

Knowledgeable observers agree that the banking industry concentration is partly attributable to economies of scale. Larger institutions experience declining average cost as they grow. They also experience economies of scale in complying with the federal banking regulations, making it more difficult for smaller institutions to compete with the larger ones. Since the Financial Services Regulatory Relief Act

of 2005 (H.R. 3505) and the Financial Services Regulatory Relief Act of 2006 (S. 2856) provide regulatory relief to all sizes of institutions, neither is likely to measurably reverse the trend of increasing bank concentration.

## **Additional Readings**

The following list of CRS reports is provided for additional reading on issues raised in H.R. 3505.

- CRS Report RL32672, *Financial Institutions and Markets: Major Federal Statutes*, by William D. Jackson.
- CRS Report RL33036, *Federal Financial Services Regulatory Consolidation: An Overview*, by Walter W. Eubanks.
- CRS Report RS22057, *Preemption of State Law for National Banks and Their Subsidiaries by Regulations Issued by the Office of the Comptroller of the Currency: A Sketch*, by Maureen Murphy.
- CRS Report RS20197, *Community Reinvestment Act: Regulation and Legislation*, by William Jackson.
- CRS Report RL30816, *The Anticipated Effects of Depository Institutions Paying Interest on Checking Accounts*, by Walter W. Eubanks.
- CRS Report RL32542, *The Condition of the Banking Industry*, by Walter W. Eubanks.
- CRS Report RS22210, *Communities First Act: Banking and Taxation Measure*, by William D. Jackson and Jane G. Gravelle.
- CRS Report RL32767, *Industrial Loan Companies/Banks and the Separation of Banking and Commerce: Legislative and Regulatory Perspectives*, by William D. Jackson.
- CRS Report RL33020, *Terrorist Financing: U.S. Agency Efforts and Inter-Agency Coordination*, by Martin A. Weiss, coordinator.
- CRS Report RS21104, *Should Banking Powers Expand into Real Estate Brokerages and Management?* by William D. Jackson.