AMERICAN BANKERS ASSOCIATION

1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

11

World-Class Solutions, Leadership & Advocacy Since 1875

Paul A. Smith
Senior Counsel
Phone: 202-663-5331
Fax: 202-828-4548
psmith@aba.com

September 15, 2003

Public Information Room
Office of the Comptroller of the Currency
250 E Street, SW, Mailstop 1–5
Washington, DC 20219
regs.comments@occ.treas.gov

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
comments@fdic.gov

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
regs.comments@ots.treas.gov

Re: **FDIC** 12 CRF Chap. III; **FRB** Docket No. R–1151; **OCC** Docket No. 03–10: **OTS** Docket No. 2003–20; Agency Compliance with Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996; 68 Federal Register 35589; June 16, 2003

Ladies and Gentlemen:

Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) requires the federal banking agencies (the "Agencies") to review their regulations at least once every 10 years in an effort to find more streamlined and less burdensome ways to regulate. The Agencies intend to conduct their first EGRPRA review in a three-year joint effort under the umbrella of the Federal Financial Institutions Examination Council (FFIEC). The Agencies have now published the first request for comment from the industry and the public, seeking comment not only on specific regulatory categories but also on their procedures for EGRPRA review. Regulatory burden adversely affects all members of the American Bankers Association. The American Bankers Association brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and bank holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest bank trade association in the country.

Part I: Comments on the Agencies' Plan for Compliance with EGRPRA

EGRPRA requires the agencies to categorize the regulations; publish the categories for comment; report to Congress on any significant issues raised by the comments, including recommendations for legislative changes; and eliminate unnecessary regulations. The Agencies have identified regulations in over 100 subjects, and they have divided these into 12 categories. The Agencies intend to seek public comment on the regulations in these12 categories between now and 2006. The categories, in alphabetical order, are Applications and Reporting; Banking Operations; Capital; Community Reinvestment Act; Consumer Protection; Directors, Officers and Employees; International Operations; Money Laundering; Powers and Activities; Rules of Procedure; Safety and Soundness; and Securities.

In fact, the Agencies have held several regional banker outreach meetings to solicit input to this process. ABA staff have participated in these meetings, and we make two observations from them. First, most bankers have seen previous efforts at regulatory relief come and go without noticeable effect, while the overall level of regulatory burden has kept rising. Thus most bankers participating in these outreach meetings have little expectation that there will be any significant reduction in the overall regulatory burden. Nonetheless, bankers and regulators are somewhat more optimistic about this effort, since the Congressional mandate encompasses more than just regulatory action: it calls for the Agencies to advise the Congress on unnecessary burden imposed by statute, which the Agencies cannot change but the Congress can.

Second, it is clear from the comments of bankers at these meetings so far that the overwhelming amount of burden is in the statutes and regulations classified by the Agencies as Consumer Protection and Money Laundering. This corresponds with the most recent increases in regulatory burden: recent additions to the burden include massive new HMDA reporting requirements, annual privacy notices, and massive new U. S. Patriot Act requirements, including customer identification programs, mandated responses to urgent law enforcement information requests, etc. In fact, it appears that the great bulk of comment and suggestions for reduction in regulatory burden will fall into these two categories. Rather than overconcentrate the review process in just one 90-day comment period, ABA instead recommends that the scheduled plan for the EGRPRA review be changed to further divide the Consumer Protection and Money Laundering categories into several smaller categories, which would provide more time for review of by our members.

Overall the ABA supports the approach taken by the Agencies in meeting the requirements of Section 222 of EGRPRA and intends to work with its member bankers to provide the Agencies with further suggestions for improvement in their regulations. Recommendations on the first three categories of regulations follow.

Part II: Comments on the First Three Categories of Regulations

As part of the June 16 publication, the Agencies are requesting comments on three categories of regulations: Applications and Reporting, Powers and Activities, and

International Operations. Although ABA consulted with a number of its banker committees and used every one of its communications avenues to solicit comment, bankers offered relatively few suggestions for regulatory burden relief in these categories. ABA believes that this is due in large measure to the efforts of the Agencies over the last several years to put their regulations into plain English and to reduce burden. In fact, the Agencies have made considerable progress in the last five years in improving some of their regulations. Examples of regulatory review and rewriting that have made significant improvement in clarity, consistency and burden reduction include the Federal Reserve Board's revisions to their applications regulations, the revisions to Regulation Y on bank holding company and financial holding company regulation, and the addition of Regulation W as a guide to the provisions of Sections 23A and 23B of the Federal Reserve Act on restrictions on transactions with affiliates. The FDIC has made significant improvements in its applications procedures and its deposit insurance coverage regulations. The OCC has made considerable improvements in its applications procedures and in its provisions on Public Welfare Investments. And the OTS has made significant improvement in its applications procedures. We believe that the Agencies should be commended for these efforts to reduce regulatory burden. Nonetheless, not all of the Agencies' regulations have been so revised, and so ABA does offer some recommendations for regulatory burden relief under this request for comments.

1. Applications and Reporting Interagency Regulations

The Bank Merger Act:

First, there continue to be differences between the application of bank merger standards by the Agencies on the one hand and the Department of Justice on the other. Bankers and merger attorneys have told us that at times this almost creates two separate application processes. While the Department of Justice is not covered under the EGRPRA review, we urge the Agencies and the Department of Justice to make more consistent their standards for merger review. If they cannot, we would urge the Agencies to request that the Congress give the Agencies sole authority to conduct bank and savings association merger reviews.

Second, ABA has requested several times that the Federal Reserve Board include credit union deposits in its analysis of mergers using the HHI screen. The FRB continues to only consider credit union deposits as a mitigating factor in the much more rigorous review of a merger application after it has failed the HHI screen. The Board has stated that it would continue to include credit unions in merger analysis only on a case-by-case basis since credit unions were not yet a significant factor in business lending to merit automatic inclusion into the competitive analysis of bank mergers. However, a case-by-case analysis requires considerably more effort on the part of the merger applicant in preparing the application and responding to the competitiveness questions of the FRB before such an analysis will fully consider the impact of credit union competition in the financial services market.

Since that last correspondence, credit union business lending and services have continued to grow. According to the Credit Union National Association's 2001 Credit Union Services Profile, 30% of credit unions, comprising 45% of total credit

union members, now offer business services for members. Of these, 85% offer business checking (on which credit unions may pay interest and banks may not -- a significant competitive advantage) and over one-third make business loans. Additionally, business lending is the fastest growing line of business for credit unions in 2001, and this is likely to accelerate, given recent changes in the credit union profile. First, due to a relaxation in the rules, a number of credit unions are adopting a "community charter" that will allow them to offer services to more businesses in their communities. Second, the Small Business Administration has recently amended its Section 7a regulations to allow credit unions to make these popular SBA business loans. All of this leads ABA to conclude that it is time that the FRB recognize that credit unions are full competitors with banks in the financial services marketplace and change the FRB's merger analysis to fully include credit unions.

FDIC Regulations

Call Reports and Other Forms, Instructions and Reports

At every banker outreach meeting so far, the burdens of the Call Report (properly the Consolidated Reports of Condition and Income) have been cited as an area for regulatory relief. Bankers at these meetings recall when the Call Report was only 10 pages, or six pages, or one banker recalls that when he started banking the entire Call Report was only two pages. Today's Call Report for a small community bank, as posted on-line, is 41 pages, containing hundreds of items and the Instructions are 415 pages. It is a widely held belief of bankers that much of the Call Report is not necessary for supervision but rather is useful for economists and statisticians, who have never met a datum that they did not like and want to keep getting reported, no matter the burden. Therefore, first our bankers request the Agencies to conduct a thorough review of the Call Report to cull items not necessary for supervision.

However, since Call Reports are largely automated today, the removal of some small amount of unnecessary burden may be more burdensome that leaving the Call Report alone. The real concern about unnecessary burden lies in the addition of more items for reporting. One example of this problem concerns the reporting of insurance revenue. In 2001 the Agencies added to the Call Reports certain items for the reporting of insurance revenue. In October 2002, a group of bankers from ABA's affiliate, the American Bankers Insurance Association, wrote to the FFIEC's Call Report Task Force with requests for changes in the reporting items and instructions, to reduce the reporting burden and confusion of these new items. (A copy of the letter is attached.) The bankers pointed out that the Call Report appeared to mix statutory reporting for insurance purposes with GAAP reporting for bank purposes, resulting in a fundamentally incompatible reporting item. Further, the bankers recommended that the FFIEC actually add items to the Call Report, in order to make the items reported correspond better to banks' own internal reporting and monitoring. We note that the FFIEC Call Report Task Force was extremely cooperative and made some of the suggested changes for the 2003 Call Reports. However, the ABIA bankers believe that further improvements can be made in line with their 2002 letter, and they urge the FFIEC to adopt the other recommended changes. ABA believes that this example illustrates the real burden of the Call Report today: the expense and effort of adding items and the need for the Agencies

to ensure that any new items added to the Call Report correspond as closely as possible to banks' own reporting.

Bankers also suggest that the number of signatures for the Call Report, including three directors, is excessive and unduly burdensome. Finally, bankers believe that penalties for errors in the Call Report are excessive, particularly with respect to items not necessary for supervision, and cause undue apprehension in bank directors and executive officers.

Mutual-to-Stock Conversion

See listing under OTS.

OTS Regulations

Mutual-to-Stock Conversion

ABA's Committee on Mutual Savings Associations has developed a number of ideas for reducing the burden in these conversions. A brief summary of these follows and we will provide more detail upon request:

The OTS currently permits the formation of an intermediate stock MHC, but only a federally chartered one. The OTS should permit such intermediate MHCs to be state chartered. We believe that there is no compelling legal or supervisory reason to require federal chartering. This would permit MHCs to take full advantage of state limited liability and indemnification laws available to fully converting institutions and also would facilitate state MHCs converting to federal charter without the cost and expense of shareholder approval to change from state to federal stock MHC.

While the OTS has indicated that it is acceptable for mutuals to set up phantom stock type plans, the OTS provides no "road map" to address and surmount the regulatory implications of such plans, i.e., how is the "stock" valued, what are the permissible amounts that can be granted to officers and directors individually or as a group, what are appropriate vesting periods, etc. and so on. We urge the OTS to provide a comprehensive "road map" that addresses tax, ERISA and accounting issues, as well as regulatory issues.

OTS should provide a streamlined regulatory process for small thrifts to be able to undertake MHC and full conversions. The regulatory burden of conversion requirements falls heaviest on the smaller institutions, and we believe special consideration should be given to them.

Finally, the OTS and FDIC should articulate a fully synchronized and consistent policy regarding merger conversion of small institutions. Recent transactions pointed out the business uncertainty and potential regulatory arbitrage created by unclear government polices regarding such transactions, and when permitted, permissible features of such transactions such as depositor payouts. Also, the OTS' policy of carefully reviewing transactions of greater than $25 million in assets is being perceived by many as a *de facto* moratorium on all such merger conversions.

Requiring mutual institutions with less than $50 million in assets to undertake a costly mutual to stock conversion under circumstances where the company's stock will in all likelihood be illiquid and unable to maintain listing on the NASDAQ for three years, as the OTS requires "best efforts" to do, does not seem practical.

II. Powers and Activities

OCC

Debt Cancellation Contracts and Debt Suspension Agreements

Earlier this year the OCC's new rules on DCC and DSA became effective. Just before that, the OCC temporarily suspended certain portions of the rule as they related to the requirement that the bank offer a periodic payment option and associated disclosures to DCCs and DSAs sold by unaffiliated, non-exclusive third parties in connection with closed-end consumer loans. The reason for the delay was that these requirements would have had the unintended consequence of reducing automobile loans by national banks, and would, in turn, limit financing alternatives for consumers, since national banks were being told by third parties that they would not offer DCC or DSA in connection with their loans, if these requirements were in effect.

ABA and its affiliate the American Bankers Insurance Association filed comments urging the OCC to make permanent this temporary suspension. We further recommended that the OCC extend the scope of its exception to the requirements of the regulation to eliminate the periodic payment option and related disclosures for all closed-end consumer loans, other than real estate loans, regardless how such loans are sold. These requirements were not part of the originally proposed regulation, go farther in their scope than similar credit-related insurance requirements (which typically only require periodic payment coverage for real-estate secured loans), and have the practical effect of eliminating single-fee DCCs and DSAs on consumer loans. We believe that this result places an enormous regulatory burden on national banks by effectively barring them from providing these contracts in many circumstances. The final decision on this interim suspension is still pending, and so we reiterate our recommendations from our comment letter of July 14, 2003.

FRB

Holding Companies (Regulation Y):

The American Bankers Association has requested several times that the Board increase the existing limit of less than $150 million in assets set in the Board's Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors. Among other things, this policy allows holding companies below $150 million in banking assets significantly higher levels of debt leverage than is allowed for larger holding companies. The Board adopted the Policy Statement originally in 1972, largely to assist in the formation of small bank holding companies

and to assist, as it states in the policy, "existing small bank holding companies that wish to acquire an additional bank or company and [in] transactions involving changes in control, stock redemptions, or other shareholder transactions." While the Board has updated the Policy Statement in several areas, most importantly in the 1997 revision of Regulation Y, the $150 million limitation has remained constant. ABA believes that in the 30 years since the adoption of the Policy Statement the world in which community banks operate has markedly changed. For one, $150 million in 1972 is over $659 million today. ABA believes that inflation and changes in the financial services industry require that the Policy be updated to allow larger community bank holding companies to avail themselves of the advantages offered by the Policy.

The majority of ABA's members are community banks. Over the last few years, ABA has increasingly heard from these members that they believe that the Board's Policy needs to be updated if they are to have any ability to survive in this era of bank consolidation. They have suggested not only that the limit needs to be increased but also that the debt-to-equity ratio for small BHCs should also be increased. If the policy is to be meet its stated goal of providing meaningful assistance to community banks in making acquisitions and other shareholder transactions, then it must be updated to the realities of today's market. The retention of this unreasonably low and outdated threshold of $150 million greatly burdens community banks over that threshold. ABA recommends that the threshold be raised to at least $500 million in assets.

State Member Banks (Regulation H):

With respect to state member banks, ABA has long objected to the Board's refusal to recognize the application of Citicorp v. Board of Governors of the Federal Reserve System[1] outside of the territorial ambit of the 2nd Circuit Court of Appeals. Citicorp held that a subsidiary of a bank was not a subsidiary of the bank holding company for purposes of regulations of the Board restricting activities of that holding company. However, because state member banks must apply under Regulation H to conduct additional activities in a subsidiary but state nonmember banks do not have to so apply, the Board's policy creates disparate treatment between subsidiaries of state member banks in holding companies and subsidiaries of state nonmember banks. ABA believes that this flies in the face of clear case law rejecting the legal theory of the FRB. Worse, it has the FRB, as regulator of state member banks, denying the conduct of an activity that has already been approved by the FDIC for state nonmember banks. This is inconsistent and unnecessary, especially when it prevents agency activities authorized by state law and recognized by the FDIC as not posing any safety and soundness concerns to the deposit insurance funds.

As a result of the Board's refusal to accept Citicorp outside of the 2nd Circuit, the Federal Reserve Bank of Richmond recently has refused to allow a subsidiary of a state member bank to conduct an activity that is not authorized for a bank holding

[1] Citicorp v. Board of Governors, 936 F. 2d 66 (2d Cir. 1991), *cert. denied sub. nom.* Independent Insurance Agents of America v. Citicorp, 502 U.S. 1031 (1992).

company to conduct but is authorized for a subsidiary of a Virginia state bank to conduct.[2] ABA believes that that Board's position on this is simply incorrect and unduly burdensome on state member banks in states outside of the 2nd Circuit. ABA urges that the Board finally accept the ruling in the Citicorp case and instruct its District Banks outside of the 2nd Circuit to follow the law as it is observed by the FRB in the states of the 2nd Circuit.

Sincerely,

Paul Allen Smith

Paul Smith
Senior Counsel

[2] The activity is real estate brokerage, a newly authorized state bank activity for Virginia. See the text of the letter from the Virginia Bankers Association dated July 16, 2003, to the Federal Reserve Bank of Richmond, attached.

ABA
AMERICAN BANKERS INSURANCE ASSOCIATION
An affiliate of the AMERICAN BANKERS ASSOCIATION

1120 Connecticut Avenue, NW
Washington, DC 20036

202-663-5163
Fax: 202-828-4546
www.theabia.com

October 28, 2002

ATTACHMENT No. 1

Mr. Robert Storch
Chief Accountant
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: FFIEC Call Report Task Force: Items Reporting Insurance Revenue

Dear Mr. Storch:

In June of this year, ABIA Managing Director Ken Reynolds collected data on insurance activities income from the new noninterest income items added to the Bank Report of Condition and Income and the BHC Y-9C ("bank financial reports") in 2001 and prepared a report ranking banking organizations by annual insurance revenues. However, when he sent the draft report out to the ABIA Board for review, it became quickly apparent by the responses from the Board that the numbers did not seem consistent with internal management reports. Ken asked for volunteers for a working group to review the bank financial reports' items and instructions and to determine what were the likely reasons for the apparent reporting confusions by a number of banking organizations. The resulting working group was composed of Ed Agnew and Dave Powell, US Bancorp; Chuck Bennett, Bank One; Elizabeth Hagman, National City; Kwan Lee, JP Morgan Chase; and Mehboob Vellani, SunTrust.

Initially, the working group focused on how each of their institutions had determined what information to report, in order to identify differences in how banking organizations were interpreting the instructions. These causes are discussed below under the heading Problems in Reporting.

The working group felt that just identifying problems with the bank financial reports' items on insurance revenues was inadequate. Therefore, the working group has tried to suggest improvements to the current reporting structure that would improve clarity, efficiency and consistency. Those suggestions are below in the section entitled The Working Group's Suggestions for Reporting of Insurance Revenue. The actual steps for implementation of these suggestions are in Appendix A, which provides a line-by-line description of suggested changes to the Report of Condition and Income and the FR Y-9C.

The working group recognizes that its suggestions will involve adding items to the reports and memoranda, which appears to be a request to add to the overall regulatory reporting burden. However, the working group makes these suggestions

in the belief that the current reports are so confusing that adding more items that more correctly reflect BHC and bank practice in accounting for insurance revenue and clarifying the instructions for the items will in fact reduce regulatory reporting burden. As it would be best if these changes were effective with March 31, 2003 bank financial reports, to provide consistent, year-through reporting of insurance revenue, the working group would be happy to discuss any of their suggestions with the FFIEC Call Reports Task Force. If, after the Task Force has reviewed these suggestions, it has any questions or would like to discuss any aspect of this letter further, please call Ken Reynolds, ABIA's Managing Director.

Problems in Reporting

1. The instructions for line item 5.h create an inconsistency by calling for the reporting of premium revenue partially on a GAAP basis and partially on a statutory reporting basis. Although current instructions do not specifically mention GAAP or statutory basis for premium recognition, the request for **earned** property-casualty premiums and **written** life and health premiums inherently raises this issue. Earned insurance premiums for both property and casualty and life and health products are readily available in the GAAP financial statements of banks BHCs that have insurance company affiliates. However, written premiums are generally available on statutory financial statements prepared in accordance with the instructions of the individual state insurance regulators. Statutory basis reporting is used only by insurance carriers and not by insurance agencies, or any other corporate entities. Statutory reporting generally recognizes revenue and expense items on a cash basis to help insurance regulators monitor the liquidity and claims paying ability of insurance carriers. Combining GAAP basis figures with statutory amounts is not done in any other context and is certainly an apples and oranges example. As banks and BHCs' ledgers are maintained on a GAAP basis, it is extremely difficult, *if even available*, to combine premium information requests on both GAAP and statutory bases. This has led to considerable confusion among reporters.

This is complicated further by the timing of reporting. The currently required "written premiums" information for the bank financial reports is actually reported on a statutory basis under state insurance regulations. The deadline for such state reporting is 45 days after quarter-end and between 60 and 90 days at year-end, depending on the state. Since these dates fall after the deadline for bank financial reports, written premium information is generally unavailable. To attempt compliance, some banks and BHCs may have inadvertently used GAAP earned revenue in order to make reporting deadlines.

2. The bank financial reports require that commissions and fees from annuity sales be reported differently, depending upon the sales channel. Banks and BHCs may (and do) use a variety of legal entities and reporting structures with which to manage the sale of annuity and insurance products. Attributing the revenue on the basis of which particular entity (out of several selling annuities) seems inconsistent with the product based information necessary to support functional regulation. Reporting fixed annuities and insurance products as part of brokerage revenues, if a particular bank or BHC's broker-dealer happens to sell insurance products, obfuscates the true insurance-related revenue of that bank or BHC and dilutes the true risk profile of that broker-dealer. It is also unclear where other insurance products, such as variable life insurance, sold by broker-dealers or under fiduciary trust powers should be reported.

Example: Two different banks could own broker-dealers, each reporting $60 million of revenues on line 5d. The first broker-dealer may be solely responsible for its bank's fixed and variable annuity sales that result in $50 million of that reported $60 million revenue. The second broker-dealer may

have very little involvement in its bank's fixed and variable annuity sales that result in only $5 million of annuity revenues out of the total $60 million reported. By splitting out the annuity revenues from the broker-dealer, as recommended in the Appendix for changes to line 12.a, the examiners receive a much clearer risk profile of the two different banks.

3. Additionally, bank financial reports appear to treat revenue from insurance sales and revenue from insurance underwriting as the same. The working group concluded that ignoring these selling and underwriting structural differences appears to result in reporting confusion. Currently, insurance agency commissions and fees, underwriting premiums and reinsurance premiums are requested on a single line. This does not give an examiner insight into how bank or BHC insurance activities are structured or the true risk profile of those activities. Agency commissions and fees are essentially riskless while revenue from underwriting premiums are of course subject to the underwriting risk. Not separately reporting these revenue streams results in masking the risk profile of the institution. $50 million in commissions and $10 million in net premiums is a completely different risk profile than $50 million in net premiums and $10 million in commissions.

4. On both the Income Statement and the Balance Sheet Memoranda, questions require aggregating mutual fund and annuities information as a single number. The working group concluded that this is confusing to reporters, and the working group questions whether this combined number has any inherent relevance or particular utility for regulators.

5. Finally, the working group concluded that the current bank financial report instructions provide no guidance on whether to include (or how to include) a bank's or BHC's internal insurance companies or captives that insure against risks of the bank or BHC or that reinsure these internal insurance policies. The working group found a variety of different structures, depending upon the bank or BHC's internal structures. For example, corporate insurance and human resource departments may separately manage and report their related captives and inter-company insurance premium and claim expense activities outside of the "(external – customer) insurance sales and underwriting" areas. Because some of this will be netted to zero on a consolidated basis, it appears that items will be reported on the bank reports for an individual bank for inter-company revenues and expenses that will not be reported after consolidation for the BHC FR Y-9C reports. This appears to create a reporting anomaly that may create considerable confusion for bank financial report users. We will provide examples, if you wish.

The Working Group's Suggestions for Reporting of Insurance Revenue

1. With respect to the GAAP versus statutory basis inconsistency, the working group recommends that all requested insurance premiums, commissions and balance sheet items should be reported on a GAAP basis. The instructions should make clear that all reporting is on a GAAP basis. This simple change in the current instructions will also enable Federal bank examiners to directly and more easily review the general ledgers of the bank or BHC to determine from which reporting unit the insurance information was collected. Furthermore, change to a GAAP basis will make the insurance numbers consistent with all the other income and balance sheet items within both reports, thereby eliminating considerable confusion among the report preparers and resolving the timing issues as to how to gather the requested information.

The working group also suggests that the instructions should clarify that debt cancellation and/or deferment products are not (credit) insurance products. Therefore, any resulting revenues from these products must be recorded as "Other noninterest income" (Item 5.l). This can be

accomplished by listing debt cancellation/deferment products under the specific examples for 5.l in the instructions or, as we suggest, by creating a new line for this item which would help regulators monitor the growth of this activity.

2. To eliminate the confusion caused by treating annuity sales income differently depending upon the sales channel, all revenues related to annuity and insurance products sales should be reported under Insurance, even if sold through the broker-dealer legal entity. Any annuity sales revenues recognized as part of a fiduciary trust arrangement would still reported in 5.a.

3. To eliminate the confusion created by combining insurance sales revenue with insurance underwriting revenue, the working group suggests that separate lines on the Call Report (FFIEC 031) and the FR Y-9C reports be used to separately report the commission and fee revenues earned by insurance agencies from the earned premiums earned by insurance underwriting companies and reinsurance captives. (See Appendix A.) This will not only assist examiners in understanding the true risk profile of the widely different insurance subsidiaries within a bank or BHC and allow better comparison between banks and BHCs of the effects of insurance-related activities, based on the components of those activities, but also will be easier for reporters to achieve.

4. To prevent confusion arising from the aggregating of mutual fund revenue and annuity sales revenue, the working group suggests that additional lines be added to these questions in order to clearly separate mutual fund numbers from annuities. This will allow examiners to easily distinguish the trends between these growing distinct product areas and allow comparison between banks and BHCs that are managing or selling these two products.

5. To prevent the anomalies arising from consolidation of affiliates under the FR Y-9C resulting in the netting of self-insurance and internal insurance/risk management, the working group suggests that the report instructions instead require that any internal insurance/risk management and self-insurance or other intercompany insurance activities be aggregated and reported in the Insurance-related activities questions.

Please see the Appendix for a line-by-line description of suggested changes to the Report of Condition and Income and the FR Y-9C.

Sincerely,

Ken Reynolds
Managing Director
ABIA

Paul Smith
House Counsel

Attachment

ATTACHMENT No. 2

July 16, 2003

J. Alfred Broaddus, Jr.
President
Federal Reserve Bank of Richmond
701 East Byrd Street
P.O. Box 27622
Richmond, Virginia 23261

Dear Al:

The 2003 session of the Virginia General Assembly passed legislation authorizing subsidiaries of state banks to engage in real estate brokerage activities. This represented a significant achievement for Virginia's bankers. We were therefore very chagrined to learn recently, based on a negative answer a state-chartered bank received from the Richmond Federal Reserve, that the Federal Reserve has taken action to block the exercise of this newly granted state authority based on a Federal Reserve regulation. The regulation is §225.22(e)(2) of Regulation Y, the Bank Holding Company Act regulation. A copy of the section is enclosed for your reference.

As a result of the Federal Reserve's apparent adherence to this regulation, the activities of certain state bank subsidiaries - those of state member banks with holding companies – will be held impermissible, whereas the same activities will be legal for all other state bank subsidiaries. This unequal result occurs because the Federal Reserve regulation essentially provides that a subsidiary of a state member bank with a holding company cannot engage in any activity that a national bank subsidiary cannot engage in, or that the state-chartered bank cannot engage in directly, unless the Federal Reserve gives prior approval. In other words, state law to the contrary notwithstanding, the regulation prohibits a subsidiary of a state-chartered bank reached by the regulation from engaging in activities that are entirely permissible for all other state bank subsidiaries.

As indicated, the application of this regulation has become a problem in Virginia. We are therefore writing to seek your help addressing the problem.

By way of background, the legislation enacted by the Virginia General Assembly represented a delicate compromise reached by the Virginia Bankers Association and the Virginia Association of Realtors. Importantly, the legislation authorizes a controlled subsidiary corporation of a state bank, rather than the bank itself, to engage in real estate brokerage. During the drafting process, we thought placing real estate brokerage in a subsidiary corporation of the bank was appealing from a practical standpoint: it ensures real estate brokerage activities occur separate and apart from banking activities, and insulates the bank from a safety and soundness standpoint.

Enforcement of the aforementioned regulation would create an unanticipated problem with the approach the Virginia General Assembly adopted. Specifically, as you know, real estate brokerage is not currently authorized for national banks. (Such potential authority is part of the current controversy in Washington.) And, as described above, the Virginia legislation authorized subsidiaries of state banks, rather than the banks themselves, to engage in the activity. Thus, based on the answer already given to Virginia banks, those state member banks with holding companies cannot engage in the activity unless the Federal Reserve Board gives prior approval, and apparently that approval is being withheld.

I should point out that Virginia was the twenty-eighth state to authorize real estate brokerage for state banks. Real estate brokerage authority for state banks is not a new development. And, like Virginia, a number of states have authorized the activity for bank subsidiaries, rather than banks directly. Thus, the Federal Reserve's regulation will be a problem with respect to bank real estate brokerage authority in other states as well.

Quite frankly, we were shocked to learn that the Federal Reserve has taken the position that the Bank Holding Company Act, which addresses the permissible activities of bank holding companies and their non-bank subsidiaries, limits the permissible activities of a state bank's subsidiary. We never envisioned that federal regulation would override an activity the Virginia legislature had authorized for Virginia-chartered banks through their subsidiaries, particularly an agency activity (i.e., an activity that does not involve acting as principal).

What makes this even more surprising is that a federal appeals court addressed this very issue in 1991, and ruled that the Federal Reserve had no authority to limit the activities of state bank subsidiaries. The case is Citicorp v. Board of Governors of the Federal Reserve System (copy enclosed), decided by the Second Circuit Court of Appeals. The court described the Federal Reserve's regulation (the same one that is before us today) as an "entirely untenable construction" of the Bank Holding Company Act and refused to give effect to such regulation with respect to a subsidiary of a Delaware state bank. Notwithstanding the court's ruling, the Federal Reserve apparently continues to enforce the regulation in states other than those covered by the Second Circuit, encouraging, we believe, further litigation that should be unnecessary.

This begs two obvious questions: Why would the Federal Reserve want to have a regulation that interferes with the state-authorized powers of the banks it regulates, when on its face the regulation runs totally counter to the conventional wisdom that it is prudent from a safety and soundness standpoint to conduct certain activities in a subsidiary? Moreover, why would the Federal Reserve ignore a federal appeals court that has ruled that there is no statutory authority for such regulation and that the regulation doesn't make sense?

We believe the practical AND legal arguments supporting the elimination of this regulation are compelling:

1. Because of the Second Circuit's decision in the Citicorp case, state member banks (with holding companies) in the geographic area covered by the federal Second Circuit are not affected by the Federal Reserve regulation. (As a legal matter, the Federal Reserve cannot enforce the regulation in those states.) But apparently the Federal Reserve has chosen to still apply the regulation to state member banks (with holding companies) in other geographic areas. This is not only unfair, it seems legally indefensible. **The Federal Reserve should abort any regulation that has no basis in statuory law that disadvantages one group of banks, but not another, based on geography.** As a policy matter, the Federal Reserve should have one uniform standard. That uniform standard should be based on the Citicorp decision.

2. The regulation doesn't restrict what a state-chartered bank can do, but does restrict what the bank's wholly-owned subsidiary can do. This distinction elevates "form over substance." A bank's subsidiary generally is treated as part of the bank for all regulatory purposes. The jurisdiction of a state over a bank it regulates doesn't end at the corporate structure of the bank itself; it extends to the assets of the bank, including its subsidiary. **State legislatures should not be forced by a federal regulation to lodge directly in the bank an activity the state might otherwise prefer to authorize for a subsidiary of the bank simply to get around the regulation. Such a result is nonsensical.**

3. In order to satisfy the dictates of the regulation, a state legislature that authorizes a new activity will be forced to extend such authority to the banks directly, rather than to bank subsidiaries. **By limiting a state's ability to require that certain banking activities take place in a bank subsidiary rather than the bank, the Federal Reserve regulation negates a state legislature's ability to determine that safety and soundness for its banks might be enhanced by requiring that certain activities take place in subsidiaries.**

4. The Federal Reserve regulation puts some state banks in a given state at a disadvantage relative to other state banks in the same state. In particular, the regulation only applies to state member banks with holding companies. It does not apply to state member banks without holding companies, nor to any state non-member banks whether they have holding companies or not. In Virginia, most state banks will be able to take advantage of the new authority to engage in real estate brokerage, but others will not simply because they are member banks with holding companies. This makes no sense. **Having inequality among state-chartered banks in the same state based on "structure" is simply bad policy.**

5. The effect of the regulation in Virginia is to limit an agency activity (i.e., real estate agency). Real estate brokerage authority for state banks (through subsidiaries) in certain other states is similarly affected.

Moreover, other agency activities authorized by the states will be (or already have been) adversely affected by this regulation. This is in spite of the fact that agency activities pose little risk to banks. Indeed, the Federal Deposit Insurance Corporation's regulations dealing with the permissible investments and activities of state banks do not restrict the agency activities of state banks and their subsidiaries. **The effect of the Federal Reserve's regulation is especially frustrating given that it restricts agency activities.**

6. Certainly the Federal Reserve would agree that the Bank Holding Company Act left to the states the authority to determine the permissible activities for state-chartered banks. It is therefore hard to understand why the Federal Reserve would seek to limit the authority of the bank's subsidiary. The Second Circuit said as much in its Citicorp opinion, concluding that the Bank Holding Company Act could not "sensibly" be interpreted to apply on a generation-skipping basis to the bank's subsidiary. **The Federal Reserve should treat a bank's subsidiary the same as the bank itself for purposes of the Bank Holding Company Act.**

7. Stated simply, we believe the Federal Reserve should eliminate this regulation. **Given the counter-intuitive nature of the regulation, the fact that it overrides state law, and the difficulty seeing any basis for having it, particularly after the Second Circuit's Citicorp decision, bankers will have a hard time accepting the consequences of the regulation, and will be motivated to determine corporate structure simply to avoid a regulation that defies logic, practical application, and conventional wisdom regarding safety and soundness considerations.** We are obviously concerned about the effect of the apparent enforcement of this regulation on Virginia's new real estate brokerage authority for state banks. But the issue is much broader than Virginia and real estate. The enforcement of this regulation also affects other states and other activities a state legislature must authorize for bank subsidiaries (or otherwise be forced to lodge directly in the bank). The problem cries out for a resolution.

* * *

We would very much appreciate your help with this matter. We would hope that once you have reviewed the information we have provided, you would have your administrative assistant call with a date or dates we might meet and further discuss a workable resolution.

Thank you so much for your consideration of this important issue. Best regards.

Sincerely,

Joseph L. Boling
Chairman and CEO
The Middleburg Bank
President-Virginia Bankers Association

Walter C. Ayers
Executive Vice President

JESIII/sk
Enclosures

cc: VBA Board of Directors