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REGULATORY BURDEN

Recent Studies, Industry Issues, and Agency Initiatives

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The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

This report responds to your request that we review regulatory costs imposed on the nation's insured depository institutions. As you are aware, the banking industry has raised considerable concern about the cumulative burden of regulation and its effect on a bank's ability to make sufficient credit available to worthy borrowers.

Our report provides an overview of the regulatory burden studies conducted recently by, or on behalf of, the federal banking agencies and several of the major banking industry trade associations. Additionally, as part of this report we have included a description of the major regulatory burden issues reflected in those studies and agency actions or initiatives related to each issue. The results of our review should prove helpful in assessing the appropriateness and effectiveness of administrative, legislative, and regulatory initiatives proposed and/or undertaken to alleviate burdensome regulation and to enhance the availability of credit.

During the course of our review we periodically briefed the Committee on the progress of our work and our preliminary results. This report compiles the information discussed with the Committee during those briefings. Information regarding our objectives, scope, and methodology is contained in appendix I.

Background

Over the past few years, a growing chorus of protest has arisen from the banking and thrift industries regarding the increasingly costly and inhibitive effects of what many see as an overly complex patchwork of federal banking laws and regulations. This chorus has become far louder with the passage of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) and the comprehensive Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Bankers generally agree with the need for vigilant supervision of federally insured financial institutions. However, they expressed alarm about the cumulative burden that they perceive such laws, regulations, and supervision impose on the industry, especially with the adverse consequences such regulation

may have on the industry's competitiveness with nonbank financial institutions. Consequently, the industry has made regulatory burden a major focal point of its legislative agenda. At the time of this review, 10 separate pieces of legislation had already been introduced before the 103rd Congress for the purpose of reducing the regulatory burden faced by the nation's depository institutions.

Results in Brief

Recently, all the federal banking agencies and several of the major banking industry trade associations released studies on issues related to regulatory burden on financial institutions. Individually, none of the studies we reviewed provided a comprehensive discussion of the nature, magnitude, and cumulative effects of regulatory burden or the cost-benefit trade-offs associated with individual banking laws and regulations cited as burdensome. Furthermore, we found the estimates of regulatory compliance costs reported in the industry studies to be of little value due to serious methodological problems evident in these studies. These methodological deficiencies stem primarily from the survey techniques employed, poor survey designs, apparent industry biases, and low response rates.

While these studies did not produce reliable estimates of the aggregate cost of regulation, they nevertheless did provide valuable insights into what the industry believes to be the predominant regulatory burden issues. On the basis of results from these studies, combined with information from other sources, we were able to identify issues that were of particular concern to the banking industry. Among these major issues were concerns regarding safety and soundness regulations that focused primarily on appraisal requirements and duplicative examinations; consumer protection requirements embodied in the Community Reinvestment Act (CRA), the Truth in Lending Act, and the Home Mortgage Disclosure Act; and reporting requirements relating to Call Reports, the Bank Secrecy Act, and to Internal Revenue Service (IRS) regulations.

In light of the concern that the cumulative effect of regulation may be having an adverse affect on the banking industry's competitiveness and a dampening effect on the availability of credit in an already slack economy,[1] the federal regulatory agencies have recently launched a series of initiatives designed to reduce unnecessary regulation and to streamline numerous supervisory processes. Among these initiatives are recently

[1]For information on the adverse effects of regulatory burden on small business lending, see Banking Regulation: Regulatory Impediments to Small Business Lending Should Be Removed (GAO/GGD-92-121, Sept. 7, 1993).

proposed revisions to existing real estate appraisal requirements. Agency officials indicated that the proposed changes were well received by the industry and held significant benefits for consumers by reducing both the time and closing costs associated with many real estate transactions. Greater cooperation among the supervisory agencies has also been promised. Agency officials believe increased agency cooperation has the potential to relieve some of the burden placed on banks because multiple agency examinations could be avoided, and more uniform policies and procedures could be adopted.

Review of Regulatory Burden Studies

We began our review of regulatory burden by undertaking a critical evaluation of the recent major agency and industry studies that addressed, in whole or in part, the issue of bank regulation and its effect on bank or thrift activities.[2] In the past 18 months, each of the federal banking agencies and several of the major banking industry trade associations have released studies on issues related to regulatory burden on financial institutions.

In response to former President Bush's January 1992 initiative to reduce the burden of government regulation, the four federal banking regulatory agencies undertook internal reviews of current regulatory practices with the objective of identifying areas where streamlining would be beneficial.[3] These internal reviews were limited to those issues considered within the discretion of agency officials; consequently they did not include actions involving changes to statutes, such as the Community Reinvestment Act. As a result of these reviews, each agency initiated or proposed actions within its authority to reduce unnecessary burdens. In addition to their own reviews, the regulatory agencies, as required by FDICIA, worked together on a study conducted under the auspices of the Federal Financial Institutions Examination Council (FFIEC)—an interagency committee created in 1978 to establish uniform principles and standards to be used in the examination and supervision of financial institutions. This study involved a much broader review of all banking laws and regulations and discussed in some detail the merits of a variety of industry proposals for reducing regulatory burden.

[2]See appendix II for a summary and discussion of the studies we reviewed.

[3]The four federal bank and thrift supervisory agencies are the Federal Reserve Board of Governors (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

In addition to these agency reviews, several of the banking industry trade associations also conducted studies of regulatory burden. For the most part, these studies tended to be survey-based efforts to document individual bankers' perspectives on the areas of greatest concern and to quantify the cost of compliance with existing regulations. Industrywide cost estimates based on these survey results were widely reported in the press and presented in congressional testimony.

Individually, none of the agency or industry studies we reviewed provided a comprehensive discussion of the nature, magnitude, and cumulative effects of regulatory burden or the cost-benefit trade-offs associated with individual banking laws and regulations. As described above, the studies conducted by the regulatory agencies were narrow in scope—that is, constrained to issues and regulations within their authority. For example, most of the agencies' reports recommended such actions as streamlining their application processes, improving examination coordination, simplifying forms, and limiting reporting changes. They did not, however, address some of the issues considered most burdensome by the industry, such as the Community Reinvestment Act and other fair lending laws, which the agencies believed to be outside their purview and subject only to statutory changes. Thus, agency officials conceded that the internal regulatory changes made as a result of their reviews would produce only modest regulatory relief.

While the agency reviews did provide some limited estimates of cost savings from proposed regulatory changes, they did not attempt to estimate the aggregate costs of regulatory burden or the value of social benefits associated with federal bank regulation, nor did the FDICIA-mandated FFIEC study. Instead, the FFIEC study essentially compiled the issues and presented, with little qualification, the range of estimated aggregate regulatory costs gathered from other studies.

We also found the estimates of regulatory compliance costs from the major banking industry-sponsored studies to be of limited value. While these studies proved useful for identifying regulatory burden issues considered important to the industry, we found a large variance in industrywide cost estimates among the studies and in estimates for particular regulatory requirements. The magnitude of the variance alone suggests that the methods used for estimating regulatory impacts were insufficient for constructing reliable estimates of the true costs of regulatory burden. From the information available, we could not verify, validate, or support any of the wide range of cost estimates. Furthermore,

we believe that the estimates of aggregate industry compliance costs lack reliability because survey methodologies, when used in expenditure studies, have certain inherent limitations that were not overcome, response rates obtained in surveys of industry participants were low, and the survey techniques used in these studies did not control for known biases.

To illustrate, consider the studies conducted by, or on behalf of, the various banking industry trade associations. These studies relied almost entirely on self-reporting surveys of financial institutions to determine compliance costs. While such surveys produce easily quantified estimates of the regulatory costs, this estimation approach poses several problems.[4] First, respondents to the surveys may have biases. For example, a bank or thrift responding to the survey may have an incentive to inflate its estimated costs so that policymakers will be more likely to consider proposals for regulatory relief. The reflection of such bias in the responses seems highly likely given the "coaching" evident in the instructions that accompanied the trade association surveys. Furthermore, techniques designed to minimize potential bias, such as follow-ups with nonrespondents, direct observation, and specifically defined expected responses, were not employed in any of the survey-based studies we reviewed.

Second, and perhaps more importantly, the surveys generally did not distinguish between actual compliance costs and those costs that would have been incurred by banks and thrifts as a normal business expense regardless of regulation. For example, many community banks would probably choose to make loans or investments in their local communities even without a regulation requiring them to do so. By including the costs associated with such activity in regulatory compliance costs, the studies overstate the burden of the regulation. Of the studies we reviewed, only one attempted to make the distinction between normal business costs and the incremental costs of regulation.[5] Not surprisingly, when the incremental approach was employed, the estimate of regulatory compliance costs, as a percentage of noninterest operating expenses, was significantly lower than that obtained in other studies which failed to make the distinction.

[4]For a full discussion of these problems see Hahn, Robert W. & Hird, John A., The Costs and Benefits of Regulation: Review and Synthesis; 8 Yale J. on Reg. 233 (1991).

[5]McKinsey & Company, Inc., When Bad Regulation Happens to Good Banks: Formulating a Proactive Response to the Earnings Threat Posed by Increasing Regulatory Burdens, on behalf of the Association of Reserve City Bankers, Washington D.C., April 1992.

Another major drawback of the industry-sponsored studies, including the one reflecting incremental costs, is their failure to consider the social and institutional benefits of regulatory oversight. Regulation of the banking industry is intended to benefit society by increasing stability of the monetary and banking systems, protecting against monopolistic practices, and ensuring the fair and equitable distribution of banking services. Additionally, institutions themselves benefit by having the ability to raise insured deposits, having access to the Federal Reserve's discount window, and, to a limited extent, by being geographically protected from other bank competitors. While the institutional and social benefits of bank regulation may be difficult, if not impossible in some cases, to quantify, we believe it is still important to include them in the discussion of regulatory burden so that a balanced view of the overall impact of regulation emerges.

Industry Regulatory Burden Issues

While the studies of regulatory burden conducted by the trade associations and others failed to produce reliable estimates of the aggregate cost of regulation, they did provide valuable insights into what the industry considers to be the predominant regulatory burden issues. By combining the results from the industry opinion surveys with others' perspectives gathered through interviews, we were able to identify 15 issues that were of particular concern to the banking industry. Those 15 issues can be separated into 3 groups: (1) safety and soundness, (2) consumer protection, and (3) other regulatory requirements. The issues are as follows:

Safety and soundness
Appraisal requirements

- Loans to insiders
- Regulatory examinations
- FDICIA
- Formal written policies

Consumer protection
Real Estate Settlement Procedures Act

- Community Reinvestment Act
- Expedited Funds Availability Act
- Truth in Lending Act
- Equal Credit Opportunity Act

- Home Mortgage Disclosure Act

Other requirements

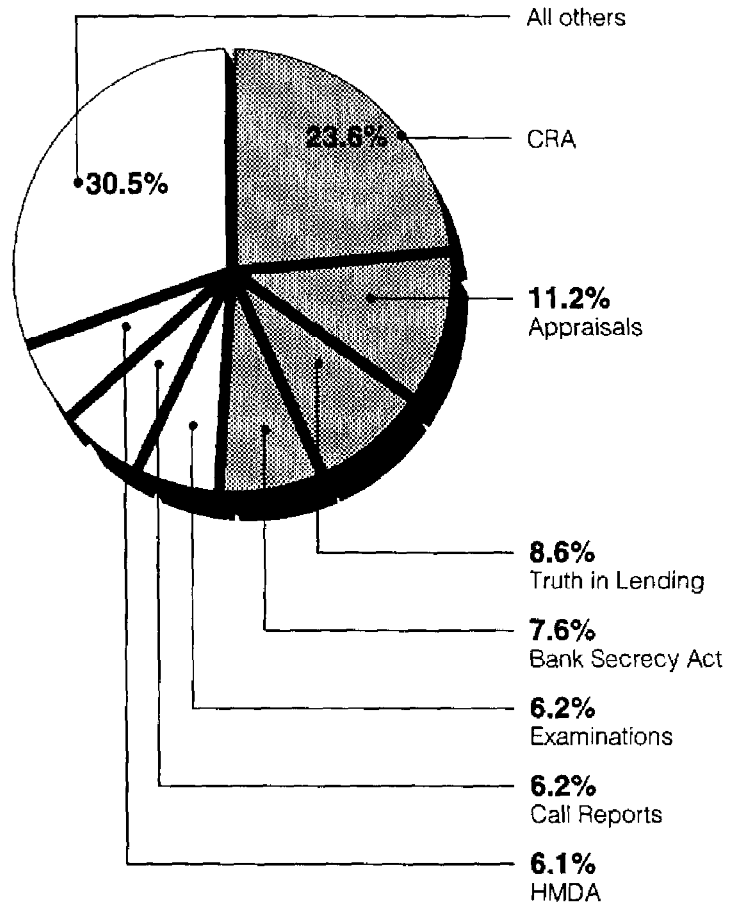
- Call Reports
- Bank Holding Company Reports
- Bank Secrecy Act
- IRS reporting

Unfortunately, the survey results did not provide sufficient detail to enable us to ascertain the industry's specific concerns about each of these major burden issues. To obtain a better understanding of the nature of the concerns, we analyzed about 1,770 related comments included in over 860 public comment letters and testimonies submitted during 1992 to the federal regulatory agencies by various depository institutions, trade associations, consumer groups, and other interested parties. From each letter or testimony we extracted information about the specific concerns relating to these 15 issues and categorized the type of burden being experienced— e.g., recordkeeping and reporting requirements, disclosure requirements, or redundancy (see app. I for a list of the burden categories we used and their definitions).

From among the 1,770 specific comments we analyzed, 418 (over 23 percent) were related to some aspect of CRA. Concern about CRA was pervasive, with institutions of all sizes expressing some type of problem with the law and its implementation. Prominent among these concerns were comments about the prescriptive nature of the law, its recordkeeping requirements, and its examination procedures.

As reflected in figure 1, in addition to CRA, other frequently cited concerns included appraisal requirements (11 percent), the Truth in Lending Act (9 percent), and the Bank Secrecy Act (8 percent). Collectively, these 4 issues accounted for just over half (51 percent) of all comments related to the 15 regulatory burden issues. The Bank Secrecy Act (BSA) was regarded as the most prescriptive banking regulation. Among the consumer protection laws, the industry judged the Truth in Lending Act provisions to be the most onerous. In contrast, comments from consumer groups generally reflected opposition to proposals advocating the relaxation of consumer protection laws, particularly CRA.

Figure 1: Distribution of Comments on Major Regulatory Burden Issues



Only 47 comments related to FDICIA were recorded in the public letters and testimonies we reviewed. This accounted for approximately 2.7 percent of all comments recorded on the 15 burden issues. However, FDICIA had not yet been fully implemented at the time these letters and testimonies were submitted, and the act was not included in the industry surveys by the American Bankers Association (ABA) and the Independent Bankers Association of America (IBAA). While FDICIA covers a broad range of issues, including extensive safety and soundness provisions, the industry's greatest concerns were related to the act's Truth in Savings provisions, reporting requirements, and operational and accounting standards.

A closer examination of the public comments and testimonies also revealed a general pattern of mutual concerns expressed by commercial banks and thrifts, although concerns often differed by size of institution. For example, the primary concerns of large banks were CRA, the Bank Secrecy Act, regulatory examinations, expedited funds, and the Home Mortgage Disclosure Act (HMDA). In contrast, the comments from smaller depository institutions emphasized CRA, appraisal requirements, and the Truth in Lending Act.[6]

Industry Concerns and Related Agency Initiatives

The major industry concerns pertaining to each of the 15 burden issues are summarized in appendix III along with the positions of other interested parties, including consumer groups.[7] In this summary, we present these concerns and positions without qualification. We did not attempt to confirm the validity of the concerns and positions expressed. Additionally, in this appendix, we included an update of related regulatory and/or operational initiatives proposed or enacted by the bank and thrift regulatory agencies, FFIEC, and the U.S. Department of the Treasury.[8] We have also synopsized new legislation and planned or ongoing GAO studies pertaining to a particular issue.

Recent Agency Initiatives

In response to the growing controversy about regulatory costs and the availability of credit, the federal banking regulatory agencies have

[6]The term large banks refers to depository institutions with more than $500 million dollars in assets; institutions with assets totaling less than $100 million are considered small banks.

[7]Our analysis of the public comment letters and testimonies showed that consumer groups were not well represented in these forums. We obtained additional perspectives and positions of consumer groups through interviews of their Washington, D.C., representatives and reviews of their testimonies or published reports.

[8]Information concerning the actions and positions of the regulatory agencies, FFIEC, and Treasury covers the period ending August 31, 1993.

launched or proposed some initiatives to relieve regulatory burden in several of the 15 major issues. A case in point is the March 30, 1993, interagency policy statement that included, among other things, an initiative to improve the availability of credit to small and medium-sized businesses by allowing strong and well-managed banks to create a limited portfolio of loans that would be exempt from the regular documentation requirements and criticism of agency examiners. This action was intended to promote more "character" lending based on bankers' professional judgments about a borrower's overall creditworthiness. Similarly, the interagency proposal to change appraisal regulations represents another example of recent efforts to achieve regulatory relief for depository institutions and to enhance the availability of credit. This proposal would exempt from the appraisal requirements all real estate loans under $250,000 (currently $100,000) and all business loans under $1 million that do not depend on real estate as the primary means of repayment. Additionally, the proposal would make existing requirements governing appraisal content and appraiser independence more flexible.

Other agency initiatives to reduce burden include proposals to (1) amend the regulations implementing the Real Estate Settlement Procedures Act (RESPA) to allow for greater exemptions and to reduce transaction time, (2) make permanent higher aggregate lending limits on loans to insiders for small banks, and (3) reform CRA regulations and procedures to emphasize results over paperwork and documentation. The potential impact of such new initiatives is strengthened by the fact that many of the recently announced regulatory changes have resulted from interagency study and review. Greater cooperation among the regulatory agencies promises to relieve some of the burden placed on banks because multiple agency examinations would be avoided, and more uniform policies and procedures would be adopted.

While several of the initiatives promise some measure of regulatory relief, we did not assess their adequacy for addressing the burden issues or concerns. Such an evaluation would require a more in-depth review of the individual issues, their perceived problems, and their industrywide effects. However, we recently initiated a comprehensive study of CRA and the related fair lending laws (Equal Credit Opportunity Act (ECOA), HMDA, and the Fair Housing Act) to identify potentially less burdensome and more effective ways to implement and enforce these laws. We also have some ongoing work pertaining to appraisal requirements and loans to insiders,

and we recently completed studies related to the Bank Secrecy Act, Call Reports, and regulatory impediments to small business lending.[9]

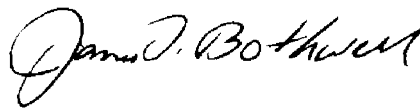
Regulatory burden encompasses an array of important issues, some of which are inextricably entwined with each other, and broader banking-related matters. Consequently, a more deliberate and comprehensive approach, rather than the agencies' regulation-by-regulation approach, is important for understanding how best to alleviate the cumulative effect of regulatory burden without sacrificing industry stability, safety and soundness, or consumer protection. The information contained in this report should provide some additional perspective on the issues the industry considers burdensome.

Senior division-level officials from the FRB, FDIC, OCC, and OTS reviewed a draft of this report and generally agreed with its contents. Their comments have been incorporated where applicable.

We are sending copies of this report to the Secretary of the Treasury; Chairman, Federal Reserve Board; acting Chairman, Federal Deposit Insurance Corporation; Comptroller of the Currency; Acting Director, Office of Thrift Supervision; and to other interested congressional committees. We will also make copies available to others upon request.

The major contributors to this report are listed in appendix IV. If you have any questions about this report, please call me on (202) 512-8678 or Mark Gillen, Assistant Director, on (202) 942-3810.

Sincerely yours,



James L. Bothwell
Director, Financial Institutions
and Markets Issues

[9]Recent GAO work pertaining to the Bank Secrecy Act is presented in Money Laundering: State Efforts To Fight It Are Increasing but More Federal Help Is Needed (GAO/GGD-93-1, Oct. 15, 1992); and Money Laundering: The Use of Bank Secrecy Act Reports by Law Enforcement Could Be Increased (GAO/T-GGD-93-31, May 26, 1993). Our recent work on Call Reports is reflected in Banks: Call Report Automation (GAO/IMTEC-92-60R, May 28, 1992). Our recent work on small business lending is reflected in Bank Regulation: Regulatory Impediments to Small Business Lending Should Be Removed (GAO/GGD-93-121, Sept. 7, 1993).

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Abbreviations

ABA	American Bankers Association
APR	Annual Percentage Rate
ARM	Adjustable Rate Mortgage
ATM	Automated Teller Machine
BP	Basis Point (.01 percentage points)
BSA	Bank Secrecy Act
CEO	Chief Executive Officer
CMIR	Currency and Monetary Instrument Report
CRA	Community Reinvestment Act
CTR	Currency Transaction Report
ECOA	Equal Credit Opportunity Act
EFAA	Electronic Funds Availability Act
EPA	Environmental Protection Agency
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FFIEC	Federal Financial Institutions Examination Council
FHA	Fair Housing Act
FHHLDS	Fair Housing Home Loan Data System
FIRREA	Financial Institutions Reform, Recovery and Enforcement Act
FRB	Federal Reserve Board of Governors
GAAP	Generally Accepted Accounting Principles
HMDA	Home Mortgage Disclosure Act
HUD	U.S. Office of Housing and Urban Development
IBAA	Independent Bankers Association of America
IRS	Internal Revenue Service
LARS	Loan Application Register
MSA	Metropolitan Statistical Area
NCUA	National Credit Union Association
OCC	Office of the Comptroller of the Currency
OMB	Office of Management and Budget
OTS	Office of Thrift Supervision
QTL	Qualified Thrift Lender
RESPA	Real Estate Settlement Procedures Act
RTC	Resolution Trust Corporation
SEC	Securities and Exchange Commission
S&L	Savings and Loan (Thrift)
TIL	Truth in Lending Act
TIN	Taxpayer Identification Number
USPAP	Uniform Standards of Professional Appraisal Practice

Objectives, Scope, and Methodology

The objectives of this review were to (1) identify the issues pertaining to the regulatory burden being faced by the nation's insured depository institutions; and (2) critique the recent regulatory burden studies conducted by, or on behalf of, the federal banking agencies and the major banking industry trade associations, paying particular attention to their analytical methodologies.

We began our review of the regulatory burden issue by critically reviewing the recent bank regulatory agency and banking industry-sponsored studies that addressed, in whole or in part, the issue of bank regulation and its effect on the activities of banks and the banking industry. During this review, we evaluated each study on the basis of its methodological approach, its objectivity, and the reliability of its findings. To ascertain a study's objectivity we searched survey questionnaires for "leading language" that may have pushed a respondent to answer in a desired way and assessed the degree to which a study's results were based on facts. Specific comments regarding our assessment of these studies are contained in appendix II.

In addition to our critique of the recent agency and industry studies on regulatory burden, we also conducted a much broader review of the issues identified in the studies by incorporating information from other sources, including the academic literature, FRS staff research, public comments and testimonies, news articles, and interviews with agency and industry officials. Through this broader review, we identified 15 regulatory burden issues that appeared to be of greatest concern to the banking industry. To provide a better understanding of the specific problems associated with each of these 15 issues, we systematically reviewed over 860 public comment letters and testimonies submitted to FFIEC, FDIC, OCC, and OTS during 1992 by various depository institutions, trade associations, consumer groups, and other interested parties. From each letter or testimony, we extracted information about the specific concerns and effects relating to each of these issues and categorized the type of burden described. We then analyzed these comments and categorized them by issue, type of institution, and type of burden. We used seven burden categories to characterize the various types of burden being experienced: economic prescriptive, economic restrictive, recordkeeping requirements, reporting requirements, public disclosure, examinations, and redundancy. (See table I.1.) These burden categories were partially based on the work

we did for the Commission on Federal Paperwork.[1] We added other categories based on the findings of the recent agency and industry studies and the descriptions of the types of burden found in the public comment letters and testimonies.

Table I.1: Regulatory Burden Categories and Definitions

Burden category	Definition
Economic prescriptive	A regulation (requirement) that specifies that the institution undertake an activity that it might not undertake in its economic interest absent the requirement.
Economic restrictive	Restriction that prohibits any activity that the institution might undertake for its own economic benefit absent this restriction.
Recordkeeping requirements	Requirements that the institution "keep" and/or "maintain" information in specified or nonspecified format, including storage.
Reporting requirements	Requirements to furnish information to another organization whether periodic or ad hoc.
Public disclosure	Requirements to disclose information to a private organization or individual.
Examinations	Requirements for regulatory agency examinations.
Redundancy	The furnishing of duplicative (similar or exact) information to another organization for the same or similar purpose.

The major industry concerns pertaining to each of the 15 burden issues, as contained in the public letters and testimonies, are summarized in appendix III. This summary represents only a documentation of the industry's concerns. We did not attempt to determine whether their concerns were valid or if they were the result of misunderstandings or misinterpretations of the regulations. For each of the major issues we also summarized the positions of other interested parties, including consumer groups and private citizens. Because we determined that consumer groups were underrepresented in the public comment letters, we supplemented the perspectives of these groups with information obtained through interviews of officials from various community groups headquartered in the Washington, D.C., area.

In addition, through discussions with agency officials and from other sources, such as industry newsletters, public testimonies, and newspapers, we compiled an issue-by-issue listing of all recent major regulatory and/or operational initiatives pertinent to the 15 issues, that have been proposed or enacted prior to August 31, 1993, by the various federal bank and thrift

[1] A Report of the Commission on Federal Paperwork: Information Value/Burden Assessment, U.S. Government Printing Office, Washington, D.C., September 1977; Estimating Paperwork and Privacy Impacts of Proposed Legislation: A Checklist Approach, U.S. General Accounting Office, Washington, D.C. 1981.

regulatory agencies, including FFIEC and the Department of the Treasury. Additionally, information on recent legislation and any planned or ongoing studies pertaining to a particular issue has also been included. Officials from the four federal bank and thrift regulatory agencies confirmed the accuracy and completeness of this compilation in discussions with GAO.

Our work was done in accordance with generally accepted government auditing standards between October 1992 and August 1993.

Review of Regulatory Burden Studies

As part of our general review of regulatory burden issues, we critically reviewed the most recent studies dealing with the subject. We included studies by each of the federal banking regulatory agencies and several of the major bank trade associations. For each study included in our review, we provided a brief summary of the study's scope and results and comments regarding the study's strengths and weaknesses and its methodological approach. We did not attempt to verify a study's results. Table II.1 provides a listing and a brief description of the studies we reviewed.

Studies by Federal Regulatory Agencies

In response to former President Bush's January 1992 initiative to reduce the burden of government regulation, the four federal banking regulatory agencies undertook internal reviews of current regulatory practices with the objective of identifying areas where streamlining would be beneficial. As a result of these reviews, each agency initiated or proposed actions within its authority to reduce unnecessary burdens. In addition to their own reviews, the regulatory agencies, under the auspices of the Federal Financial Institutions Examination Council (FFIEC), conducted a study on regulatory burden as required by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). The FFIEC study involved a much broader review of all banking laws and regulations and discussed in some detail the merits of a variety of industry proposals for reducing regulatory burden.

A brief summary of each study and a discussion of its strengths and weaknesses appear in table II.2.

Industry-Sponsored Studies

In addition to the agency reviews, several of the bank trade associations also conducted studies of the regulatory burden faced by financial institutions. For the most part, these studies tended to be survey-based attempts to document individual bankers' perspectives on the areas of greatest concern and to quantify the cost of compliance with existing regulations. Industrywide cost estimates based on these survey results were widely reported in the press and presented in congressional testimony.

A brief summary of each industry-sponsored study and our comments regarding its strengths and weaknesses are found in table II.3.

Table II.1: List of Regulatory Burden Studies Reviewed by GAO

Name of study	Date issued	Type of study
Board of Governors of the Federal Reserve System (FRB), Regulatory Review and Reduction of Regulatory Burden	May 1992	Internal review of agency regulations.
Federal Deposit Insurance Corporation (FDIC), Report of the Regulatory Review Committee of the Federal Deposit Insurance Corporation	April 28, 1992	Internal review of agency regulations.
Office of the Comptroller of the Currency (OCC), Final Report on the President's Regulatory Initiative	September 2, 1992	Internal review of agency regulations.
Office of Thrift Supervision (OTS), Regulatory Review, 57 Fed. Reg. 40,350 (1993) (Notice of Proposed Rulemaking)	September 3, 1992	Internal review of agency regulations.
The Federal Financial Institutions Examination Council (FFIEC), Study on Regulatory Burden	December 17, 1992	FDICIA section 221—mandated regulatory review.
American Bankers Association (ABA), Survey of Regulatory Burden, parts A, B, & C	June 1992	Constituent opinion survey of total estimated compliance hours and costs and most burdensome regulatory areas.
Independent Bankers Association of America (IBAA), Regulatory Burden: The Cost to Community Banks, by Grant Thornton & Co., Accountants & Management Consultants	Phase I - June 1992 Phase II - September 1992 Phase III - November 1993	Phase I-A national opinion survey of community banks; Phase II-Field cost studies; Phase III-A national cost survey of compliance costs in 13 regulatory areas.
McKinsey & Company, Inc., When Bad Regulation Happens to Good Banks: Formulating a Proactive Response to the Earnings Threat Posed by Increasing Regulatory Burdens	April 6, 1992	Cost analysis of compliance costs in 4 regional bank holding companies.
American Bankers Association, The Burden of Bank Regulation, by CHG Consulting, Inc.	August 31, 1989	Chapters on the history of bank regulation, regulatory burden and its consequences, and regulating the regulators. Also, a summary of commercial bank regulations.
University of Wisconsin at Madison, Common Ground: Increasing Consumer Benefits and Reducing Regulatory Costs in Banking, by Barefoot, Marrinan & Associates, Inc.	March 1993	Survey of commercial banks and thrifts to collect compliance cost in 3 regulatory areas: CRA, RESPA, & BSA. Policy recommendations.

Table II.2: Brief Summary and Discussion of Regulatory Burden Studies Conducted by Federal Agencies

Scope/methodology	Reported results	GAO comments
FRB's study		
FRB staff reviewed all existing and pending Federal Reserve regulations that are not specifically required by law and provided a summary and analysis of each regulation based on the following two questions: (1) Do regulations impose substantial costs to the economy? Answered no, de minimis, modest, or material. (2) Are costs outweighed by benefits? In most cases, benefits were described in terms of efficiencies or opportunities gained. The report also included proposed regulatory and legislative changes to reduce burden. Staff proposals were reviewed by a group of senior staff led by Governor Phillips and then by the entire Board of Governors. The Board issued its report in May 1992. A follow-up report in September provided some estimated cost savings, where possible, from certain regulatory changes implemented by the Board.	The report stated that the Board had authorized steps to streamline its application and approval processes, eliminate duplicative examinations, simplify and standardize forms, limit report changes, improve coordination with other bank agencies, review CRA documentation requirements, minimize appraisal requirements, review HMDA exemption levels for small banks, approve additional nonbanking activities for bank holding companies, revise capital requirements, and reduce reserve requirements. The report stated that FRB would also continue its ongoing process of reviewing the costs and benefits of each regulation every 5 years and reporting requirements every 3 years. For each regulation, FRB staff determined if the Federal Reserve Board should make regulatory changes. Additionally, the report also proposed the following statutory changes—increase the HMDA exemption, reduce branching restrictions, eliminate unnecessary applications, facilitate community development project financing, and reduce Expedited Funds Availability Act burden.	The report provided a summary analysis of the purpose, costs, and, to a lesser extent, the benefits associated with major regulations. Agency officials conceded that the internal regulatory changes made as a result of this review would result in only modest regulatory relief and that statutory changes are needed to make significant improvement. The report provided estimates of cost savings associated with some of the proposed regulatory changes and acknowledged certain limitations of these cost estimates, including: (1) many cost savings and benefits could not be quantified; and (2) cost figures provided were based on FRB's best estimates rather than actual data collected.

(continued)

Scope/methodology	Reported results	GAO comments
FDIC's study		
Staff reviewed FDIC's regulatory history from 1967, FDIC regulations (112), policy statements, and related forms used to implement regulations. The criteria used in the review were as follows: (1) Did regulations impose a substantial cost to the economy? (2) Was language of regulation clear and precise? (3) What unintended consequences have developed to hinder rather than facilitate compliance? (4) What modifications would not compromise safety and soundness standards, increase risk to the insurance funds, nor detract from compliance with, or enforcement of, the underlying statute? The study included input from field and regional office staff, FDIC-supervised banks, and public comments. The report summarized the 420 public comments and the purpose, chronology, and associated costs and benefits for each regulation. The cost/benefit analysis considered the indirect impact on affected financial institutions and consumers, as well as direct costs on the economy. Where possible, estimated cost savings were quantified on the basis of estimates of total reductions in annual burden hours times an hourly cost of $30. The estimates of burden hours saved were derived from information collected under the Paperwork Reduction Act and estimates by staff with subject matter expertise. A committee of high-ranking officials led by Acting Chairman Hove reviewed and approved the report conclusions and recommendations. The report was issued in April 1992.	The report noted that the most burdensome areas identified in the public comments were CRA, Reg. O/Loans to Insiders, Bank Secrecy Act, Reg. CC/Expedited Funds Availability Act, the exam process, Call Reports, insurance premiums, appraisal requirements, and FDICIA. The report recommended that FDIC review the CRA examination program, improve exam coordination with other bank agencies, increase recordkeeping exemption for securities transactions, streamline the application process, limit Call Report changes, and simplify forms. The report noted that FDIC discontinued its periodic regulation review program during the 1980s but recommended that it be renewed. The report also recommended that Congress increase the HMDA exemption and review the Truth in Lending Act's right of rescission for homeowners and the disclosure requirements of the Real Estate Settlement Procedures Act. Finally, the report estimated that FDIC's proposals would result in reducing almost a million burden hours and saving $29.9 million per year.	FDIC's report provided a summary of the purpose and an assessment of the costs and, to a lesser extent, the benefits associated with major banking regulations. In reviewing each regulation, the FDIC staff decided, on the basis of perceived cost-benefit trade-offs, whether changes should be considered. In some cases, the decisions were not well supported by the analysis presented. For instance, the cost estimates presented were not based on actual data collected but on the agency's "best guess" as to the real costs. Also, the report concluded, among other things, that recent major legislation had reduced the banking agencies' supervisory discretion, resulting in a significantly increased number of prescriptive regulations. In particular, it was mentioned that FDICIA would increase the banking industry's reporting burden, but the agency did not analyze FDICIA as part of its study.

(continued)

Scope/methodology	Reported results	GAO comments
OCC's study		
Staff reviewed OCC Circulars (75) and regulations on the basis of the following criteria set out in the President's January 28, 1992, memo to all agencies on reducing the burden of government regulation: (1) Expected benefits should outweigh costs to society? (2) Maximize net benefits to society. (3) Set performance standards instead of prescriptive command-and-control requirements. (4) Incorporate market mechanisms to the maximum extent possible. (5) Provide clarity and certainty to avoid needless litigation. OCC also solicited public comments and input from bank chief executive officers (CEOs) and examiners. It received over 200 comments, which are summarized in the agency's report. The staff submitted a list of proposed regulatory changes to a policy group made up of senior agency officials. Their review resulted in OCC's report issued in March 1992 with recommended changes in 12 regulatory areas where OCC could make immediate improvements. The report described the benefits, impact, estimated cost savings, and status of implementation for each of the 12 areas. The cost estimates are based on projected savings for bank staff hours x $30/hour, plus senior bank personnel hours x $150/hour, plus OCC staff hours x $100/hour.	OCC's report identified 12 regulatory initiatives that OCC would implement to reduce burden in the following areas: • real estate appraisals; • technical amendments to risk-based capital guidelines; • investment securities regulation; • capital treatment of intangible assets; • capital requirements for residential construction loans; • securities disclosure rules, 2 parts; • messenger service; • collective investment funds; • securities recordkeeping and customer confirmation; • changes in bank control; • merger, consolidation, purchase, and assumption; and • fair housing home loan data system. The report estimated that implementation of these initiatives would result in total annual savings of about $21 million. OCC tracked the implementation status of these initiatives through weekly status reports. OCC reported that the most burdensome regulations identified in the public comments included the Community Reinvestment Act, the Home Mortgage Disclosure Act, Appraisals, Truth in Lending Act, Expedited Funds Availability Act, Bank Secrecy Act, and the Truth in Savings Act.	OCC's report outlined the savings to be achieved through the agency's 12 initiatives to alleviate regulatory burden. Information is not provided on other regulations reviewed by OCC. Along with the 12 actions taken, OCC also submitted proposals for reducing burden that would require action jointly with, or independently by, other agencies. Among other things, the report concluded that the most burdensome procedures are those required by FDICIA. However, the report does not provide any data to support this statement, and most of its regulatory initiatives are unrelated to FDICIA. OCC's report also provided details of how cost savings estimates were derived for each of the 12 regulatory initiatives. The report acknowledged that some estimated cost savings and benefits associated with the initiatives could not be quantified.

(continued)

Scope/methodology	Reported results	GAO comments
OTS' study		
OTS followed an approach similar to OCC's and used the same criteria. In addition to soliciting public comments in the Federal Register, OTS also held public hearings. It received 58 comment letters and testimony from 19 savings associations, law firms, and trade associations. Staff reviewed OTS' regulations to determine if they were no longer necessary or overly burdensome. On the basis of this analysis, OTS proposed a number of modifications to its regulations and published the proposals for comment in the Federal Register on September 3, 1992. OTS also provided estimates of cost savings from its proposed reforms to the Department of the Treasury for its report on cost savings as part of former President Bush's regulatory reform initiatives. OTS cost estimates were based on a $75 per hour composite of the average cost of salary, benefits, and overhead for consultants, auditors, attorneys, and regulatory staff. OTS detailed how it derived its cost assumptions in an appendix.	OTS proposed regulatory changes in 2 parts—Part I reforms have been completed and estimated cost savings provided as follows: • interstate branching-$45.5 million (MM), • residential bridge loans-$19 MM, • supervisory conversions-$82.5, MM • real estate appraisals-$37 MM, • fidelity bonds-NA, • exclusive lease arrangements- cannot be estimated, • trading versus investment-savings are minor, • applications restructuring-$3 MM, • FDIC/OTS joint exams-$4.5 MM, • monthly thrift financial report-$4MM, • holding company reports-$5.5 MM, and • uniform accounting standards-$10 MM. Part II reforms are partially completed with cost estimates as follows: • federal stock association, conversions-$.5 MM, • operating subsidiaries and service corps-NA, • regulatory capital-equity investments-$47 MM, • QTL Test-$5 MM, • other amends-$34 MM, and • insider transactions-$.5 MM. OTS also reported that the most common concern noted in the public comments was the overlap in examinations by OTS and FDIC. They recently signed a joint agreement to coordinate examinations. The most burdensome regulations cited were the Bank Secrecy Act, Truth in Savings Act, Truth in Lending Act, the Flood Disaster Protection Act, and the Expedited Funds Availability Act.	OTS did not issue a formal report; rather, it published the results of its review-proposals for regulatory changes in the Federal Register. Given this format, little of the agency's analysis is provided. In many cases the rationale provided for the proposed changes is that the regulation is unnecessary, obsolete, or inconsistent with those of banking regulators. It is not clear how OTS reached these conclusions. While OTS provided more detail on how the cost savings estimates were derived, we did not review the accuracy or validity of the assumptions used. The agency's savings estimates were not based on actual cost data but were "best guesses" of the savings that would result from the regulatory changes

(continued)

Scope/methodology	Reported results	GAO comments
FFIEC's study		
FFIEC was required in Section 221 of FDICIA to conduct a broad review of all federal banking laws and policies and procedures to identify any revisions that could reduce unnecessary burdens on insured depository institutions. The law specified that any revisions should not diminish either compliance with or enforcement of consumer laws or endanger the safety and soundness of insured depository institutions. The study was conducted by an interagency task force composed of representatives from each of the four federal banking agencies and the Department of the Treasury. The interagency group compiled the results of each agency's internal review of their policies, procedures, recordkeeping and documentation requirements. They also summarized public comments assembled by FDIC, OCC, OTS, and FFIEC from requests in the Federal Register or the June 1992 hearings held by FFIEC in Kansas City, Washington, D.C., and San Francisco. FFIEC issued its report in December 1992.	The study provided some general observations on major regulatory burden issues and identified specific agency proposals for regulatory change, proposals that the agencies agreed should not be implemented, and proposals for consideration by other agencies. FFIEC agreed to continue meeting to identify possible statutory changes to reduce regulatory burden. FFIEC also suggested that an independent, nonpolitical commission be established to conduct a comprehensive review of all aspects of regulatory burden and propose possible legislative improvements to reduce regulatory burden. The study concluded that the regulatory burden on banks is large and growing. It suggested that the annual cost of regulatory compliance may be as high as $17.5 billion, or from 6-14% of noninterest expenses (1991 industry noninterest expenses totaled $124.6 billion), without the opportunity costs of reserve requirements being included. The study also observed the following: (1) there appear to be economies of scale in compliance costs, favoring large banks; (2) the cumulative burden may be more than the sum of its parts; (3) unnecessary costs cause losses to society; (4) costs and benefits should be balanced; and (5) slowing the pace of legislative and regulatory change could reduce burden because start-up costs are part of the burden.	The FFIEC study provided an historical view of financial regulation and identified some key issues for consideration. However, the "findings" of the FFIEC study tend to be misleading because estimates of regulatory compliance costs are thrown into a "pool" of estimates without regard to their validity. FFIEC did not independently estimate compliance costs. Rather, it presented (with little qualification) cost estimates cited in past and contemporary studies. Many of the studies cited are either outdated or narrowly focused on a few banks or specific regulatory areas. For example, total compliance costs, minus the opportunity costs of sterile reserves, were cited by FFIEC as ranging as high as 14% of noninterest expenses. But this estimate is probably overstated because it is based on results from a 13-year-old cost study of a single bank (Darnell, 1980) that was conducted prior to the adoption of major cost-reducing technology (particularly in the areas of telecommunications and data processing). The FFIEC study did not make any recommendations regarding specific statutory changes needed to reduce regulatory burden.

Table II.3: Brief Summary and Discussion of Industry-Sponsored Studies on Regulatory Burden

Scope/methodology	Reported results	GAO comments
American Bankers Association study		
ABA sent a survey to about 10,000 members and received 974 responses. The survey asked for estimates of how many hours CEOs and Boards of Directors devote to regulatory matters, how many staff have regulatory management responsibility, and what is the proportion of total bank operating expenses spent on compliance—i.e., training and outside consultant costs—and indirect compliance—software, printing, postage, and noncompliance staff time. The survey asked for rankings of the most time-consuming regulations for CEOs, compliance managers, and noncompliance staff. It also asked for anecdotal evidence about how regulatory burden has adversely affected the bank. Although they had originally planned to complete additional work, ABA did not follow up their initial survey to increase the response rate and collect data on the actual implementation costs of specific regulations.	ABA's study concluded that in 1991 the nation's banks spent $10.7 billion on compliance costs alone—nearly 12% of the industry's total operating costs, or about 59% of the industry's net income. In addition to the $10.7 billion in compliance costs, the ABA study also estimated that the banking industry paid $5.2 billion in deposit insurance premiums and absorbed another $1.6 billion in opportunity costs for sterile reserves, bringing the total regulatory burden to $17.5 billion. The study also reported that smaller banks pay a disproportionately higher percentage of their operating costs and profits on compliance. CRA was cited as the greatest regulatory concern to 40% of CEOs, while the Bank Secrecy Act was cited as most burdensome to 35% of noncompliance staff. In addition, the study provided many anecdotes about specific effects of regulatory burden on bank activities. Among the effects cited were curtailment of certain consumer credit services and products, less time spent on customers, increased costs to customers, business lost to nonbanks, and decreased business volume in general.	The ABA study provided industry input on where regulatory burden is perceived to be greatest and anecdotes about specific effects of regulatory burden on bank activities. Several limitations of the study include poor survey design and low response rates. Because of these limitations, the survey data lack the statistical reliability (i.e., the ability to be repeated with similar results) to develop accurate estimates of aggregate regulatory compliance costs. The survey response rate was only about 10%, and almost 75% of the respondents had less than $100 million in assets and less than 50 employees. Combined, these smaller banks represented only about 10% of total industry assets. Fewer than 6% (21) of banks with asset size greater than $1 billion responded to the survey. Yet, ABA reported that large banks, i.e., those with over $1 billion in assets, paid about half of total industry regulatory costs—$5.5 billion. The consistency of the cost estimates are questionable and cannot be verified because the general cost categories were not well-defined. For example, it is unclear if computer-related costs or noncompliance costs were also included. This could increase the variability of the cost estimates and reduce the accuracy of the average estimate for each category.

(continued)

Scope/methodology	Reported results	GAO comments
Independent Bankers Association of America (IBAA) study		
The IBAA contracted with Grant Thornton to conduct a 3-phase study. In Phase I it surveyed its 9,700 community banks and asked them to rank the most costly and aggravating regulatory areas. IBAA received responses from about 20% of the banks surveyed. In Phase II it field-tested 9 demographically representative community banks to collect data on actual dollar costs for the most burdensome regulatory areas identified in phase I. The banks ranged in asset size from $16 million to $221 million. In Phase III Grant Thornton conducted a survey of the 13 most burdensome regulatory areas identified in phase I. IBAA sent questionnaires to a random sample of 2,600 banks, which were stratified into 3 asset-size groups. Each bank was asked to provide detailed information about the number of recurring compliance hours associated with 1 of 13 regulations (thus, the sample for each regulation was 200 banks). "Start-up" costs were not included. In addition to the time estimates, sampled banks were also asked to assess the value and effectiveness of each regulation according to the RUIN scale. The acronym RUIN stands for Redundant, Unnecessary, Inefficient, Necessary.	The 13 most burdensome regulatory areas identified in phase I were: 1. Community Reinvestment Act (CRA) 2. Truth in Lending Act 3. Formal written policies 4. Equal Credit Opportunity Act 5. Regulatory examination process 6. Bank Secrecy Act 7. Expedited Funds Availability Act 8. Loans to insiders 9. Geocoding—geographic loan coding 10. Real Estate Settlement Procedures Act (RESPA) 11. Call Reports 12. Appraisal requirements 13. Home Mortgage Disclosure Act (HMDA) Phase II results from the case studies of 9 community banks (average size $63 MM) indicated that total compliance costs for the 13 selected regulations averaged 0.47% of total assets, 5.34% of equity capital, and 28% of net income before income taxes. Compliance salary costs averaged about 14% of total salary costs. By applying the average cost per compliance hour computed in the case studies (phase II) to the best estimate of compliance hours reported by respondent banks (phase III), compliance costs were projected for all community banks. The total estimated compliance cost for the 13 regulations was $3.2 billion. The average cost of assets ranged from $12.06 for banks with less the $30 MM in assets to $3.10 for banks with over $65 MM in assets.	This study has provided the most detailed cost data collection effort to date. However, the IBAA survey suffers from the same sampling response limitations as the ABA survey. Hence, the aggregate estimate of regulatory compliance costs to all U.S. independent banks is not statistically valid. Furthermore, it is important to note that cost data were not collected in phase III. Cost estimates based on the phase III survey responses were constructed using the average cost per compliance hour observed from the case studies in phase II. Hence, all cost estimates are, in essence, actually based on only 9 banks. Another shortcoming of the IBAA study, one that is common to almost all the trade association studies, is that it does not attempt to quantify any of the benefits associated with the 13 regulatory areas. While going to great lengths to document costs, IBAA never polled its members on the benefits of holding a banking charter.

(continued)

Scope/methodology	Reported results	GAO comments
IBAA study (cont.)		
Respondents were asked to score each area from 1 to 5 as follows: Very redundant 1 2 3 / Not redundant 4 5 Unnecessary 1 2 3 / Essential 4 5 Not efficient 1 2 3 / Very efficient 4 5 Responses were received from 808 banks (between 50 and 85 responses per regulation). Survey results were used to estimate aggregate compliance costs for all community banks.	Phase III results from their national survey show the five regulatory areas with the lowest evaluation scores for value and effectiveness were: 1. CRA/Reg BB 2. HMDA 3. Geographic Loan Coding 4. Expedited Funds Act/Reg. CC 5. RESPA The five regulatory areas with the highest annual compliance hours were: 1. CRA 2. Truth in Lending Act 3. Equal Credit Opportunity Act 4. Formal written policies 5. regulatory exam process The five regulatory areas with the highest costs were: 1. CRA 2. Truth in Lending Act/Reg. Z 3. Formal written policies 4. Regulatory exams 5. Loans to Insiders/Reg. O	Also, in Phase III of the study, the RUIN scale used to assess the value and effectiveness of each regulatory area was not very objective; even its acronym implies a bias—suggesting to the respondent that evidence in support of burden is really what is wanted.

(continued)

Scope/methodology	Reported results	GAO comments
The McKinsey study		
The McKinsey study reviewed four regional bank holding companies (BHCs) to analyze industry earnings and how they are affected by regulatory burden. The study estimated the ongoing incremental costs of over 60 regulations covering the following major categories: deposit insurance, sterile reserves, safety and soundness, holding company, consumer compliance, and other compliance. The types of costs considered in the study included all regulatory costs unique to FDIC-insured institutions that were deemed incremental to what banks would do anyway under prudent management. Also included as a cost were lost savings from the failure to enact interstate branching. Excluded were start-up costs for all current regulations. Among the future FDICIA-related costs included in the estimated total compliance cost was a 7 basis point (BP) increase in deposit insurance premiums and a 30% increase in examination fees.	The study concluded that bank earnings have been eroding (for various reasons) under the current industry structure and that regulatory burdens exacerbate the earnings decline. The study estimated pre-FDICIA regulatory costs, including the cost of deposit insurance and the opportunity cost of sterile reserves, to be about 6.6% to 9.7% of the sampled BHC's 1991 noninterest expense. When FDICIA-related costs are included, regulatory costs rise from 7.7% to 12.6% of 1991 noninterest expense. When extrapolated to all Association of Reserve City banks the total pretax regulatory cost for 1991 was $6.7 billion. The after-tax regulatory cost was estimated to be $4.5 billion for all Association banks, or 46% of 1991 net income. Interestingly, the study attributed about 75% of bank operating costs to deposit insurance premiums and sterile reserves; the other 25% of operating costs was split about evenly among other safety and soundness, consumer, and compliance regulations.	The McKinsey report represents the only study of regulatory costs in regional bank holding companies. However, the study's cost-benefit comparison is questionable. For example, while the study noted that the cost-benefit trade-off is unclear, it included opportunity costs attributable to lost savings from the failure to permit interstate branching but limited the estimates of benefits to include only the value of a bank's funding advantage derived from FDIC insurance coverage (about $1 billion). No other benefits were alluded to or valued. Also, the study did not explore other factors that may have affected bank earnings, nor did it identify what regulations were deemed "unnecessary."
The Burden of Bank Regulation, prepared for the American Bankers Association by CHG Consulting, Inc. (1989).		
This report discusses the general rationale for regulation and analyzes the historical forces that have shaped the U.S. bank regulatory structure. The report includes an appendix that categorizes each regulation in 1 of 4 areas on the basis of its primary function: bank safety and soundness, consumer protection, fair distribution of credit, and government convenience.	The report discusses the economic rationale for banking and provides illustrative examples (based on case studies) of how regulation affects the operations of representative banks. The report also proposes some very general suggestions for reducing the adverse effects of regulatory burden. These recommendations cover three broad areas: (1) industry-initiated actions, (2) the structure of the regulatory process, and (3) policy changes.	This report provides a good overview of how regulation affects banks in general and offers some suggestions on how to improve regulation without adversely affecting the attainment of public policy goals. One particularly important contribution is the appendix, which details the major body of rules and regulations under which banks operated prior to passage of FDICIA.

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Scope/methodology	Reported results	GAO comments
Other studies		
University of Wisconsin/Barefoot, Marrinan & Associates study		
This study was contracted by the University of Wisconsin at Madison. The study had two objectives: (1) to quantify the costs of bank compliance with federal consumer protection laws and (2) to offer recommendations for reducing those costs without undermining the public policy goals of these laws. More specifically the study concentrated on three regulations viewed as most burdensome by the banking industry: (1) the Community Reinvestment Act, (2) the Bank Secrecy Act, and (3) the Real Estate Settlement Procedures Act. The study consisted of two surveys. Initially, a highly detailed questionnaire was sent to 3,700 mostly Midwestern banks and thrifts to collect cost data associated with overall consumer protection compliance and with the 3 laws. The survey collected data on the number of hours spent on compliance and training, as well as costs for salaries, legal fees, recordkeeping, and other related expenses for each of the 3 areas and for overall compliance. A total of 129 banks responded (a response rate of 3.49%). After the findings from the first survey were analyzed, a second questionnaire was sent to 6,400 commercial banks located primarily in the Midwest. A total of 1,105 banks responded (17.27%) but of these only 445 were used as the basis for empirical analysis. The researchers supplemented the survey data with 32 interviews with bankers and thrift compliance officers.	The primary findings of the study are: (1) Consumer compliance costs are substantial, with total regulatory costs representing almost 19% of net income on average across all banks; 60% of this amount resulted from the compliance with CRA, BSA, and RESPA. (2) Compliance costs are proportion-ately higher for small banks. (3) The compliance burden is greater for independent banks, i.e., evidence suggests that multibank holding company affiliation helps reduce regulatory costs as a fraction of net income. (4) Regulatory requirements are restricting consumer choice—many respondents decided not to offer certain products due to concerns about compliance costs and liability. Of these service reductions, about 18% were due to CRA, about 9% were due to BSA, and roughly 14% were due to RESPA. (5) Compliance costs are proportionately higher in larger markets due in large part to CRA.	While the study did offer some constructive suggestions for improving the effectiveness of these laws without sacrificing their public benefits, it failed to develop reliable cost information. The study's inability to produce reliable cost estimates is due primarily to its principal cost data collection technique—a survey questionnaire. Questionnaires of this type, which ask respondents to self-report estimates of total annual compliance costs and to estimate percentages of time employees spend on a particular activity over extended periods, cannot offer reliable or verifiable estimates of compliance costs. Moreover, low survey response rates and failure to followup on nonresponses suggests that the cost figures may be nonrepresentative. Consequently, the use of unreliable cost data negates the subsequent statistical analysis and hypothesis testing. Also, the empirical models employed to test the selected hypotheses appear to be somewhat simplistic. For example, no justification is provided for the model's statistical specification (it would appear that some key explanatory variables have been omitted) or for the model's functional form.

Industry Concerns and Related Agency Initiatives

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Scope

This appendix summarizes the major regulatory burden issues identified in recent agency and industry studies, public comments and testimonies, legislative proposals, and other relevant literature. The subsection on banking industry concerns only documents the industry's statements. We did not attempt to confirm the validity of the concerns and positions expressed. The appendix also provides an update of supervisory agency initiatives related to these issues. The primary purpose of this appendix is to identify those specific concerns that are at the core of the ongoing public debate on regulatory burden in the banking industry. The results of

this analysis should prove helpful to Congress in assessing the appropriateness and effectiveness of administrative, legislative, and regulatory agency initiatives that may be proposed and/or undertaken with the intent of alleviating regulatory burden.

Safety and Soundness: Appraisal Requirements

Background

Title XI of FIRREA (12 U.S.C. 3331 et seq.) and its accompanying regulations require independent and impartially prepared appraisals on all real estate transactions above a de minimis dollar value. The law also specifies that appraisals must be written, made by licensed or certified appraisers and be in conformance with standards promulgated by federal and, in some cases, state regulators. During 1992, OCC, FDIC, and OTS followed the lead of the Federal Reserve Board and increased from $50,000 to $100,000 the threshold at or below which the services of an appraiser would not be required. In amendments to Title XI in December 1992, Congress provided that the individual regulatory agencies may adjust the threshold levels if they determine in writing that the threshold does not represent a threat to the safety and soundness of financial institutions.

Separately, under the revised guidelines of the Uniform Standards of Professional Appraisal Practice (USPAP), appraisers are more limited in their ability to use discretion to depart from some USPAP requirements.

Banking Industry Concerns

These real estate appraisal requirements and procedures represented a major area of regulatory concern, especially for small banks. In general, bankers mentioned that increased costs to consumers and difficulty in obtaining timely appraisals were the root causes of their concerns. Few large banks expressed serious concern regarding the appraisal requirements.

Use of Certified Appraisers

The most common concern raised by bankers was that the increased demand for licensed or certified appraisers has resulted in higher appraisal fees, which are routinely borne by the borrower. Additionally, they suggest that substantial delays have been cited in obtaining the

services of a qualified appraiser. They say this problem has been most acute for rural lending institutions where shortages of certified appraisers have been noted.

Exemptions—"De Minimis" Threshold Level
Bankers claim that actual experience illustrates that real estate secured loans of less than $250,000 have not caused extraordinary losses. Also, concerns were expressed that the artificially low exemption threshold is regressive, making it more difficult for low- to moderate-income borrowers to qualify for loans.

Exemptions — Abundance of Caution
Bankers also feel that transactions involving real estate solely as an "abundance of caution" should be exempted regardless of the transaction amount; i.e., when real estate taken as collateral is not the primary or expected source of funds for loan prepayment.

Appraisal Rules and Standards
Some bankers feel that strict adherence to USPAP standards is not possible in some cases. For example, in some small towns and rural areas they say that increased costs and needless delays result because it is difficult to get "comparables", i.e., similar properties that have been sold or rented within a relatively recent time frame.

Competition
Bankers suggest that the increased costs to borrowers and the delays caused by a bank's or thrift's adherence to the appraisal requirements has put these lending institutions at a competitive disadvantage compared to other mortgage lenders not bound by the regulations, such as finance and mortgage companies and insurance companies.

Other Interested Parties' Concerns

In contrast to the banker's positions on the appraisal rules, The Appraisal Institute, a national professional organization of appraisers, argued against a loosening of the $100,000 threshold. In support of its position, the Institute maintained that (1) there is no shortage of licensed or certified appraisers and that fees for appraisal services have shown no appreciable change, (2) loosening the threshold would discriminate against low- and moderate-income applicants by failing to provide these consumers with the protection afforded by an independent professional appraisal, (3) raising the threshold would not reflect the realities of the secondary market, and (4) failure to independently appraise real estate below the

threshold could have a negative affect on the safety and soundness of some lending institutions.

Regulatory Agency Initiatives

Proposed Rule Change
On June 4, 1993, the federal agencies submitted for public comment an interagency proposed rule to amend the regulations on real estate appraisals. The proposed amendments would increase to $250,000 the threshold level at or below which the regulations would not apply, expand and clarify existing exemptions to appraisal requirements, and identify additional circumstances when appraisals are not required. In part, the proposed changes would broaden exemptions in cases where real estate collateral was taken as an "abundance of caution" and make requirements governing appraisal content and appraiser independence more flexible. Additionally, a new exemption from appraisal requirements would be granted in the case of business loans with a value of less than $1 million where the sale of, or rental income derived from, the real estate taken as collateral is not the primary source of repayment. The public comment period ended July 19, 1993, and a final rule is expected to be published soon.

Exemptions
In March 1992, FDIC, OCC, and OTS adopted various amendments to limit the scope and coverage of their appraisal requirements. Among these was an exemption for loans used to finance the purchase of real estate but not secured by real estate.

Related GAO Studies

We recently completed a study of regulatory burden related to small business lending and concluded, in part, that the proposed interagency initiative to reduce appraisal requirements where the real estate was taken as collateral as an abundance of caution would help ease bankers' concerns and would not undermine safety and soundness. See Bank Regulation: Regulatory Impediments to Small Business Lending Should Be Removed (GAO/GGD-93-121, Sept. 7, 1993). Because it was beyond the scope of our small business lending study, we did not take a position on raising the de minimis threshold. However, as required by section 954 of the Housing and Community Development Act of 1992, we have recently begun a study of the adequacy and quality of appraisals or evaluations conducted in connection with real estate financial transactions below Title XI appraisal thresholds.

A summary of our prior reports and testimonies related to appraisals can be found in Appraisal Reform: Implementation Status and Unresolved Issues (GAO/GGD-93-19, Oct. 30, 1992).

Safety and Soundness: Loans to Insiders

Background

Federal Reserve Act sections 22(g) and 22(h) (12 U.S.C. 375a, 375b) impose restrictions on loans to insiders and their related interests. Federal Reserve Regulation O (12 C.F.R. 215 et seq.), which implements the provisions of sections 22(g) and 22(h), imposes, among other things, a prohibition on loans to insiders on preferential terms, a lending limit on loans to individual insiders, and an aggregate lending limit on loans to all insiders.

Banking Industry Concerns

In general, bankers argued that these restrictions would impair the ability of their institutions to attract and retain good officers and directors. Small community banks were especially sensitive to this concern.

Aggregation Limits
Small community bankers said that with the low aggregation lending limits, they will be forced to disrupt long-standing business relationships and force local businessmen to either resign from bank boards or seek credit from nonlocal lenders.

Loss of Business
Many bankers, especially small community bankers, expressed concern that the lending limits would force them to send their officers and directors, who are often their best customers, to competitors.

Recordkeeping
Larger banks and bank holding companies regarded the required recordkeeping and review of their directors' correspondent relationships with other banks and business concerns as particularly time consuming.

Other Interested Parties' Concerns

None known.

Regulatory Agency Initiatives

Regulation O

In the FFIEC study, the Federal Reserve Board indicated that it will review Regulation O in its entirety and the effect of the regulation on bank operations. The Federal Reserve Board also indicated that it will consider modifications that are shown to be necessary or appropriate.

Aggregate Lending Limit for Small Banks

As amended by FDICIA, section 22(h) of the Federal Reserve Act generally limited aggregate lending to insiders to 100 percent of unimpaired capital and surplus. On May 18, 1992, the Federal Reserve Board exercised its authority under FDICIA and amended its Regulation O to permit banks with deposits under $100 million to increase the lending limit from 100 percent to 200 percent of unimpaired capital and unimpaired surplus, if they follow certain procedures. The higher limit was to be in effect for 1 year.

On May 7, 1993, the Board extended the higher limit for 6 months and requested comment on whether the Board should make permanent, modify, or terminate this provision. The closing date for public comments was July 15, 1993. A final rule is expected shortly.

Uniformity

Effective November 5, 1992, OTS amended its regulations pertaining to insider transactions by adopting a final rule that generally incorporates by reference the Federal Reserve Board's Regulation O. The new rule replaced OTS' "Conflicts Rule."

Related GAO Studies

We are near completion on a comprehensive study of insider lending activities. The final report is expected to be released in late 1993.

Safety and Soundness: Regulatory Examinations

Background

The federal banking regulatory agencies and the state banking authorities are currently responsible for conducting safety and soundness examinations of insured depository institutions. Under FDICIA, all depository institutions, with some exceptions, are to receive at least one full-scope, on-site examination for safety and soundness at least once

during each 12-month period (or 18 months under certain circumstances). Additionally, all federal agencies and some state authorities conduct separate examinations for compliance with consumer protection and fair lending laws.

Banking Industry Concerns

The most common concern bankers expressed was about duplication or overlap by the regulatory agencies. Many banks and thrifts testified that they had received multiple examinations from numerous agencies within a 1-year period and that these "disruptions" to business lowered productivity and increased costs. Thrifts and banking industry associations were particularly vocal about this concern.

Multiple Agency Examinations

Dual exams by OTS and FDIC were the most frequently cited problem regarding multiple examinations. The bankers pointed out that the existence of multiple federal regulators has clouded the lines of authority and accountability, increased both direct and indirect costs, and absorbed valuable staff time. Also, some large banks and bank holding companies noted that in addition to multiple regulators, they may also be subjected to audits by the Securities and Exchange Commission (SEC), the Environmental Protection Agency (EPA), IRS, and their own independent accountants.

Inexperienced Examiners

Lack of examiner experience is a problem that bankers frequently mention. Bankers contend that age and inadequate training result in increased examination time, inflexibility, and poor regulator-banker relations.

Misplaced Emphasis

Many bank officers feel that the examination process places too much emphasis on insignificant detail rather than on important safety and soundness problems. Additionally, bankers feel that examination reports should provide more guidance in lieu of simply condemning an institution's policies and practices.

Other Interested Parties' Concerns

An accounting firm noted that while thrifts are now subject to Generally Accepted Accounting Principals (GAAP), there are still occasions where examiners impose other accounting standards—for example, in the area of

loan loss reserves. The firm recommended that inconsistent accounting treatments be eliminated.

Regulatory Agency Initiatives

Coordination With External Auditors

On July 23, 1992, the regulatory agencies issued a policy statement through FFIEC to improve coordination and communication between external auditors and examiners. Among other things, the statement provided for coordinating and scheduling of audits and exams and granting auditors access to Reports of Condition and Examination Reports.

Coordination With State Regulatory Authorities

On April 12, 1992, FDIC and the Conference of State Bank Supervisors adopted a joint resolution encouraging renewed agreements between each state and FDIC regional office to work together through the sharing of information and examiner coordination. OTS has also initiated action to schedule joint examinations with state regulatory authorities. FRB already maintains joint agreements with about 25 states to coordinate examinations and share relevant information.

Interagency Examination Coordination Program

In response to concerns about multiple examinations, the agencies have implemented an interagency examination coordination program. The program was announced in a June 10, 1993, Joint Policy Statement on Examination Coordination and Implementation Guidelines. Under the guidelines the agencies will: (1) coordinate the planning, scope, and timing of inspections and examinations; (2) conduct, if possible, joint interagency examinations whenever it is necessary for an agency that is not the institution's primary regulator to participate in an exam to fulfill its regulatory responsibilities; (3) coordinate and conduct concurrent reviews and joint management meetings between banks and their regulators; (4) coordinate information requests; and (5) coordinate enforcement actions, where appropriate.

Accounting Treatment

On September 30, 1992, OTS approved a final rule that establishes GAAP as the minimum uniform accounting standard for OTS and consolidates all OTS accounting rules into one section to ease access and use.

Loan Documentation

As part of the administration's Credit Availability Program, in March 1993 the four regulatory agencies adopted a provision that allows well-managed

and strongly capitalized institutions to make and carry some loans (not to exceed 20 percent of capital) to small and medium-sized businesses and farms, with only limited documentation. This selected portfolio of "character loans" would then be evaluated only on the basis of the portfolio's performance and would not be reviewed for loan documentation.

Examination Reports

In June 1993 hearings before the House Subcommittee on Financial Institutions, witnesses from the four regulatory agencies reported that they were close to completing an interagency core report of examination that would standardize reporting forms. This initiative is expected to be fully implemented by the end of 1993.

Related GAO Studies

In reports issued in February 1993 (see list below), we assessed the adequacy of the bank and thrift regulators' examination programs and, among other issues, pointed out the need for better coordination, particularly between OTS and FDIC. We also recommended, as a result of these studies, that a blue ribbon panel review the implications of consolidating the federal banking regulatory agencies.

Thrift Examination Quality: OTS Examinations Do Not Fully Assess Thrift Safety and Soundness (GAO/AFMD-93-11, Feb. 16, 1993).

Bank Examination Quality: FDIC Examinations Do Not Fully Assess Thrift Safety and Soundness (GAO/AFMD-93-12, Feb. 16, 1993).

Bank Examination Quality: FRB Examinations Do Not Fully Assess Thrift Safety and Soundness (GAO/AFMD-93-13, Feb. 16 1993).

Bank Examination Quality: OCC Examinations Do Not Fully Assess Thrift Safety and Soundness (GAO/AFMD-93-14, Feb. 16 1993).

Bank and Thrift Regulation: Improvements Needed in Examination Quality and Regulatory Structure (GAO/AFMD-93-15, Feb. 16, 1993).

Safety and Soundness: Federal Deposit Insurance Corporation Improvement Act of 1991

Background

The FDIC Improvement Act (FDICIA) was passed by Congress in November of 1991 and signed by President Bush in December of the same year. FDICIA's most important features include deposit insurance reform, recapitalization of the FDIC insurance fund, prescribed auditing and accounting standards, early regulatory intervention, least-cost resolution provisions, and expanded consumer protection regulations. While the act is more than a year old, some of its implementing regulations are still being written. Nonetheless, numerous and vocal opinions have been expressed, both pro and con, concerning this sweeping legislation.

Banking Industry Concerns

Although some of the approximately 60 provisions of the new law have not yet been implemented, many bankers fear that the rules and regulations promulgated by the law will only exacerbate the industry's regulatory burden. Bankers are also concerned that through this statute the government will have the power to micromanage ongoing banking operations.

Truth in Savings

By far, the greatest concern regarding FDICIA was in reference to the Truth in Savings disclosure provisions. Bankers almost unanimously agree that compliance with this provision will represent a huge dollar cost to individual institutions and the industry but will provide little benefit to consumers, since the statute applies only to insured depository institutions and not to the myriad of nonbank competitors and the financial instruments they offer.

Reporting on Farm and Small Business Loans

FDICIA required insured depository institutions to collect and annually submit financial and demographic data relating to the number and amount of loans outstanding to small businesses and small farms to assist the

federal banking agencies in assessing credit availability. Bankers expect these requirements to be time-consuming and costly and say they are just another reporting obligation of questionable benefit.

Branch Closing Rules

Under FDICIA, banks are required to give regulators and customers 90 days advance notice of branch closings. Bankers say the requirement is unclear regarding the definitions of branches and customers and is particularly problematic with regard to automated teller machines (ATMS) and their users.

Annual Audits and Financial Statements

Section 112 of FDICIA requires, among other things, an insured depository institution to submit to its regulators and to FDIC audited financial statements prepared in accordance with GAAP. Bankers claim that this requirement will only duplicate the work done by bank regulators during annual on-site examinations.

Micromanagement

Section 132 of FDICIA requires the federal banking agencies to prescribe safety and soundness standards in the areas of operations and management, asset quality, and compensation for all insured depository institutions and bank holding companies. Bankers feel the provisions of this section represent an unwarranted intrusion into the management, or micromanagement, of their institutions. Additionally, they argue that the more detailed and inflexible the standards are, the more of a drag they will be on the operations and profitability of the bank.

Other Interested Parties' Concerns

Consumer groups strongly support FDICIA's Truth in Savings provisions, which prohibit banks from deceptive advertising about the interest rates they pay on accounts and require disclosures of key terms for comparison purposes. They suggest that consumers can now expect to get basic and accurate information about the yields they will receive for depositing their monies with a particular bank and should be protected from unfair and deceptive business practices. Consumer groups oppose any rollback of Truth in Savings.

Regulatory Agency Initiatives

Truth in Savings

FRB currently has a study underway to assess the changes in accounting practices and the cost to financial institutions of implementing the Truth

in Savings Act. Data collection was scheduled to be completed in mid-1993 with the study's findings expected in 1994.

Branch Closing Rules

On September 21, 1993, the agencies adopted a joint policy statement to provide guidance to institutions on complying with branch closing rules under FDICIA. Among other things, the policy statement defines a branch, clarifies what constitutes a branch closing, and provides guidance to institutions on identifying customers to be notified in the event of a branch closing. For these purposes, the agencies consider a branch to be a traditional brick-and-mortar branch at which deposits are received or checks paid or money lent. Thus, ATMs are not considered branches.

Section 112 of FDICIA

On June 8, 1993, FDIC adopted final rules implementing the auditing, accounting, and reporting requirements mandated in section 112 of FDICIA. The final rules, which went into effect July 2, 1993, represent a combination of regulatory requirements, procedures, and interpretive guidelines. The guidelines elaborate on FDIC recommendations for complying with the law's requirements but give discretion to bank managers, auditors, and government examiners to determine the most appropriate means of achieving compliance. Additionally, because of concerns that many smaller institutions, especially those in small communities, would have problems meeting some of the new regulations, FDIC decided to impose these new auditing and reporting requirements only on institutions with $500 million or more in total assets as of the beginning of each fiscal year after December 31, 1992.

Section 132 of FDICIA

On July 15, 1992, the regulatory agencies solicited public comment on a proposed rule concerning section 132 that would require insured depository institutions to meet general safety and soundness standards relating to the following areas: (1) operations and management, (2) asset quality and earnings, and (3) compensation. Under this proposed rule the standards only establish the objectives of proper operations and management while leaving the specific methods for achieving these objectives to each institution. In implementing FDICIA, the agencies have favored the use of guidelines rather than strict regulations to allow institutions maximum operational flexibility.

Related GAO Studies

We have not undertaken any formal studies related to FDICIA provisions, but we have expressed our support for FDICIA's major safety and soundness reforms in congressional hearings and have suggested that the law be given a chance to be fully implemented before any changes are considered. See Banks and Thrifts: Safety and Soundness Reforms Need To Be Maintained (GAO/T-GGD-93-3, Jan. 27, 1993) and Bank and Thrift Regulation: Concerns About Credit Availability and Regulatory Burden (GAO/T-GGD-93-10, March 17, 1993). Additionally, we have expressed our concern with the FDIC's use of "guidelines" rather than detailed regulations for implementing statutory requirements (under section 112) for annual independent audits, internal controls, and audit committees of insured banks and thrifts. See FDIC Proposed Regulations (GAO/AFMD-93-81R, May 10, 1993).

Safety and Soundness: Formal Written Policies

Background

Under their supervisory authority, federal regulators require banks and thrifts to maintain formal written policies to document bank policy on numerous operational issues.

Banking Industry Concerns

Small banks and their industry associations have voiced concern that maintenance of such policies involves a considerable amount of bank officer time and serves little purpose.

Guidelines vs. Rules

Bankers believe that written policies merely serve as guidelines to assist bank managers in various operational areas. They say, however, that examiners have often given these written policies the force of binding rules, criticizing even slight deviations from policy and denying bank managers the flexibility needed to effectively handle unique business situations.

Frequency of Changes

Bankers have expressed concern about the ability of individual examiners to subjectively request changes to the bank's formal written policies. They

contend that the frequency with which changes must be made is a drain on bank resources and serves little purpose except to satisfy the examiner.

Other Interested Parties' Concerns

None known.

Regulatory Agency Initiatives

Value of Written Polices

In the FFIEC study, the regulatory agencies stated their belief that there is no better means of ensuring that directors are properly supervising the institution's affairs than requiring their direct participation in devising, modifying, and enforcing the institution's written guidelines.

Paperwork Reduction Initiative

On March 10, 1993, the four federal banking agencies issued an interagency policy statement outlining the administration's program to improve credit flows and reduce paperwork. As part of this program, all four agencies are undertaking a long-term review of all handbooks, bulletins, compliance guides, and other nonregulatory guidance materials, with the goal of streamlining and making the publications more user-friendly.

Related GAO Studies

None.

Consumer Protection: Real Estate Settlement Procedures Act of 1974 (RESPA)

Background

RESPA and its implementing regulation (HUD Regulation X, 24 C.F.R. Part 3500) include provisions intended to give consumers better and more timely information regarding the processes and costs associated with the application and settlement of a residential mortgage transaction. Among other things, RESPA and Regulation X require the lender to make numerous disclosures to applicants at various stages during settlement.

Banking Industry Concerns

Bankers are of the opinion that many of the required disclosures are too complex or are unnecessary and that the prescribed time frames for making the disclosures are difficult to meet.

Multiple Forms and Disclosures

Bankers contend that under current regulations borrowers are provided with so many forms and disclosures that it is practically impossible for them to read or understand all of them. They have said that borrowers often leave more confused than they were before they received the complicated disclosures. They further contend that providing and explaining these forms to all borrowers increases bank costs substantially.

Of particular concern to bankers among the RESPA disclosures are the "Mortgage Servicing Transfer Disclosure" and the "Good Faith Estimate Disclosure." Bankers believe that providing the mortgage servicing transfer disclosure to all mortgage applicants is especially costly, and it is absurd to send an adverse action notice to an applicant along with a "Good Faith Estimate" of what the costs would have been had the customer qualified for the loan.

Duplication with Truth in Lending

Bankers point out that RESPA disclosures are a duplication of the Truth in Lending forms that also outline a borrower's costs. They say this serves only to confuse the customers and increase the bank's costs.

Other Interested Parties' Concerns

None known.

Regulatory Agency Initiatives

Amendments to Regulation X

On November 2, 1992, the Department of Housing and Urban Development (HUD) issued a final rule revising Regulation X, the implementing regulation for RESPA. The rule became effective on December 2, 1992. HUD's new rule makes clarifying and editorial changes to Regulation X and incorporates certain matters that previously were covered only by informal legal or other advice.

New Legislation

On October 28, 1992, the Housing and Community Development Act of 1992 was signed into law by President Bush. There are two sections (Sec. 908 and 951) in this act that apply to RESPA.

As a consequence of this legislation, on May 13, 1993, HUD submitted for public comment revisions to Regulation X mandated in section 908 and 951. The new amendments involve four areas of RESPA coverage: (1) lending coverage, (2) refinancing transactions, (3) subordinate loans, and (4) disclosures under good faith estimates. The proposed amendments would also allow exemptions from RESPA coverage for certain classes of real estate transactions, such as loans involving farm property constituting 25 or more acres; transactions to change the terms of a federally related mortgage loan that involves only minimal charges and no change of title; loans secured by vacant or unimproved property; and loans involving temporary financing, such as a construction loan. Also of particular note is a proposed change that would no longer require that a booklet on closing costs be distributed, provided the application is denied within 3 business days. The closing date for public comments on these proposals was July 12, 1993. A final rule is expected to be issued soon.

Related GAO Studies

None.

Consumer Protection: Community Reinvestment Act

Background

The Community Reinvestment Act (CRA) was passed in 1977 as part of the Housing and Community Development Act. CRA requires each federal banking regulatory agency to use its authority, when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered, consistent with the safe and sound operation of such institutions. In connection with these examinations, the regulatory agencies are required to assess an institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, and to take this record into account in the evaluation of any type of application by the institution for a deposit facility (including relocation, branching, merger, or insurance coverage applications). As a result of FIRREA, the agency examination rating and a written evaluation of each assessment factor must be made publicly available.

Banking Industry Concerns

Bankers expressed more concern about the burden associated with CRA than about any other single area of bank regulation. While the complaints often varied by the size and location (urban vs. rural) of the depository institutions, unanimous concern was heard regarding the excessive level of documentation required. Geographic mapping of lending activity, or geocoding, was frequently mentioned as the source of much of the documentation burden. Small banks found CRA to be particularly bothersome in light of the fact that small banks believed that community lending is at the core of their operations, so they believe it should not be necessary to document that fact.

Small Bank Documentation

Small bankers believe it is excessively burdensome to require the same level of documentation of CRA compliance from small banks as for large banks. They argue that small banks cannot absorb the cost of documentation, monitoring, marketing, and training like larger banks can.

Community Banks and Local Lending

Community bankers expressed the sentiment that if they did not serve their communities, they would go out of business. They felt that requiring a small community bank to document what it would do anyway and to do unnecessary advertising only increases bank costs and takes time away from lending to the community, thereby reducing credit to low- and moderate-income borrowers.

Geocoding

For small community banks that do not have access to the type of data being required by the examiners, geocoding loans is considered by many bankers to be burdensome and impractical. Small banks in rural areas report they have no idea where to get demographic information and what kind of data they should be using. They believe the expense associated with geocoding is prohibitive to small banks, especially since their lending volume is so small that there is seldom any geographic pattern to be observed.

Ratings—Form Over Substance

Bankers suggest that CRA ratings are based on documentation, not on actual performance. It appears to these bankers that examiners are more interested in the size of the files rather than on how a bank really serves the community. They also feel that the level of documentation required to prove compliance with CRA is too time-consuming, costly, and excessive and only benefits the examiner.

Increased Consumer Expense

Bankers argue that time spent on documentation, training, and general management discussion of CRA is time that could be better spent serving the customer making loans. They add that the cost of complying with CRA is high, and the cost is passed on to the consumer in the form of higher service charges and interest rates.

Examinations—Documentation

Many bankers have the impression that the consumer compliance exams are too subjective and that what is expected of them varies from examiner to examiner. Bankers believe that in general, CRA examiners reward financial institutions for generating paperwork rather than meeting community needs and suggest that examiners should focus on actual community service rather than on documentation.

Examinations—Frequency

Bankers commented that institutions that receive low CRA ratings are subjected to more frequent repeat exams until they improve. They argue that these exams are costly and time-consuming and are not required by CRA statute.

Level Playing Field

Bankers argue that the insurance industry, which competes directly for a bank's core deposits, does not have to serve the entire community but can skim the deposit cream. Similarly, the securities industry, which competes nearly across the board for deposits and loans, is not subjected to a regulatory requirement to reinvest in the community. Bankers believe this is a double standard for compliance with CRA.

Protests and the Expansion/Merger Application Process

Sometimes a bank's application for expansion is delayed by a protest based on CRA grounds. But, as bankers point out, in many cases the regulators have already found a bank's CRA performance to be acceptable, yet the bank still has to defend itself against protests and often must enter into an agreement with a local special interest group to satisfy the group's demands.

Disclosures

Amendments to CRA created a new CRA rating system and, unlike before, require public disclosure of CRA ratings and evaluation reports. Bankers believe that this has created a significant paperwork burden on the banking industry and has subjected banks to a multitude of inquiries from

special interest community groups. Many bankers say that customers do not ask to see CRA statements and do not read CRA notices, yet the banking industry pays millions of dollars to update these types of disclosures, notices, and statements.

Redundancy

Bankers point out that CRA issues are covered directly and indirectly by other laws, such as HMDA, ECOA, and the Fair Housing Act (FHA). The CRA geocoding requirements, they say, are unnecessary because HMDA data can be used to detect whether a bank is redlining an area. Thus, they argue, banks must maintain parallel CRA and HMDA systems duplicating efforts for no useful purpose.

Vague and Subjective Law

Bankers say that the vagueness of the statute and subjectivity of the evaluation/exam process make compliance difficult. CRA ratings do not always provide accurate indications of an institution's CRA performance. The regulation is written in an unclear and ambiguous fashion and is subject to varied interpretation by regulators, the regulated, civic organizations, and compliance consultants.

Other Interested Parties' Concerns

Consumer groups feel that CRA is an extremely important law that plays a vital role in forcing banks to recognize their obligation to contribute to the economic welfare of the communities they serve. In contrast to the banking industry's complaints that the law creates an undue "paperwork burden," these groups contend that the compliance costs associated with CRA are negligible and far outweighed by the benefits the law provides to communities.

In general, consumer groups believe that CRA is not being enforced strongly enough, and they call for the regulatory agencies to uphold the law more vigorously.

Consumer groups also seek improvements in the examination process, stating that examiners rely too heavily on the CRA files of banks and do not verify what they read. More realistic ratings could be achieved, they suggest, if examiners solicited the opinions of community-based organizations and individuals in the bank's community during examinations.

Consumer groups oppose the idea of "safe harbors" for small and rural banks, stating that these banks are some of the worst offenders of the law and that CRA is more important for these banks since they are not HMDA reporters.

Regulatory Agency Initiatives

Public Hearings on CRA Reform

On August 2, 1993, the federal financial regulatory agencies announced the first of several public hearings on the Community Reinvestment Act. The hearings are intended to help the agencies develop new regulations and standards for assessing a financial institution's performance under CRA. On July 15, 1993, the administration asked the regulators to work together and consult with the public, community groups, and the banking and thrift industries to make CRA implementation more effective (see Administration's Program below).

Examinations and Documentation

In June 1992, the agencies issued revised, uniform CRA examination procedures to clarify the role that documentation should play in assessing CRA performance and the type of documentation that is expected and to focus the examiner's attention on performance rather than on process. Furthermore, examiners were encouraged to keep the institution informed about the recommended CRA rating during the examination to provide sufficient discussion time with the examiners and agency officials about the recommended rating.

In February 1993, the agencies issued revised interagency questions and answers regarding CRA. The revised questions and answers highlight the importance of lending and investment activities compared to documentation.

CRA in General

The FFIEC directed its Task Force on Consumer Compliance to look at other CRA enforcement procedures, such as tiering the examination process, clarifying aspects of the interagency CRA rating system, reviewing the need for all of the assessment factors in the CRA implementing regulations, and exempting limited purpose banks. Some of the Task Force's unpublished recommendations became part of the administration's Community Lending Initiative (see below).

Small Bank Compliance

As a result of its 1992 internal review, FDIC has stated, with regard to small

institutions' compliance with CRA, that it does recognize the differences in smaller institutions and that all FDIC compliance training efforts are now being planned to emphasize the differences of smaller institutions.

CRA Enforcement

To enhance CRA enforcement, FDIC recently established a separate consumer compliance examination force along with a Community Affairs Officer program which designates an officer for each of the eight Division of Supervision Regional Offices. FRB has had a separate consumer compliance examination force in place for a number of years, and OCC is in the process of forming such a specialized corps of examiners. This is expected to lead to more consistent enforcement of CRA.

Exemptions

Regarding various exemptions from CRA requirements, the regulatory agencies have said that they are not able, even if they were so inclined, to create the requested exemptions. The law itself specifies which regulated financial institutions are subject to CRA requirements (these institutions are defined by section 3 of the Federal Deposit Insurance Corporation Improvement Act). Accordingly, it is outside the scope of the regulatory agencies' authority to exempt any category of insured depository institution from CRA requirements. However, in the past, FDIC has drafted legislative language recommending that Congress consider adoption of an exemption from CRA for wholesale and special purpose banks.

Administration's Program

On July 15, 1993, President Clinton outlined the administration's Community Lending Initiative which, among other things, called for a reform of CRA. As part of the plan, the President requested that the four federal banking regulators take the following actions: (1) reform CRA enforcement by January 1, 1994, by developing new regulations and procedures that emphasize results over paperwork and documentation; (2) develop a well-trained corps of examiners who specialize in CRA; (3) institute more effective sanctions against banks and thrifts with consistently poor CRA performance; and (4) reform CRA standards to focus on more objective, performance-based criteria that will minimize the compliance burden on financial institutions while stimulating CRA performance.

Related GAO Studies

In February 1993, we were requested to examine the implementation and enforcement of the Community Reinvestment Act and other fair lending

laws. This comprehensive study of CRA and related fair lending laws is currently in progress.

Consumer Protection: Expedited Funds Availability Act

Background

Congress passed the Expedited Funds Availability Act (EFAA) in 1988 to make funds from deposited checks available in a more timely manner and to expedite the return of checks. The act is implemented by Regulation CC (12 C.F.R. 229), which, in part, requires banks, savings associations, and credit unions to disclose their funds availability policies.

Banking Industry Concerns

Both large and small banks expressed concern regarding the expensive disclosures and the short check-clearing times mandated by EFAA, although the issue appears to be more important to larger banks.

Increased Exposure to Fraud

The limited hold schedules dictated by Regulation CC give all local and nonlocal items 2-day and 5-day availability, respectively. Bankers argue that this time frame provides inadequate protection for check-cashing institutions and increases losses due to fraud.

Costs Exceed Benefits

Bankers maintain that Regulation CC costs depository institutions considerable time and money in training, paperwork, and administration, with the cost of disclosure forms and staff time being especially onerous.

Burdensome Notification Requirements

Current regulation requires notification of all customers of any change in availability policy at least 30 days before implementation, except that a change that expedites funds availability may be disclosed not more than 30 days after implementation. Bankers note that notification by mail is expensive, and they are dissatisfied with the fact that the notification requirement still holds even in cases in which the bank has chosen to offer quicker availability on items.

Redundancy

Many depository institutions claim that their funds availability policies in place prior to passage of the EFAA and implementation of Regulation CC already put them in compliance with the new law, making the law redundant. Consequently, these institutions now claim that they are burdened with the added expenses of meeting the disclosure and other requirements, while no benefits have accrued to the customer.

Other Interested Parties' Concerns

The position of consumer groups is that the provisions of EFAA be maintained intact.

Regulatory Agency Initiatives

Implementation Costs

As part of its 1992 internal review, FRB reexamined the provisions of Regulation CC and determined that those provisions not mandated by statute do not impose a material ongoing cost on the economy. In the few instances where it was determined that a discretionary provision may impose costs on depository institutions, FRB concluded that such costs are minimal and are outweighed by the benefits to consumers or the institutions themselves.

Related GAO Studies

In a statutorily mandated study, Financial Institutions: Time Limits on Holding Deposits Generally Met but More Oversight Needed (GAO/GGD-91-132, Sept. 30, 1991), we assessed the implementation of EFAA. In that study we found that, for the most part, EFAA had been effectively implemented by the regulatory agencies but we recommended that some improvements be made. However, due to the lack of data available on fraud losses, we were unable to determine the degree to which financial institutions were more vulnerable to fraud as a result of EFAA's payments schedule.

Consumer Protection: Truth in Lending

Background

The Truth in Lending Act was originally enacted in May 1968 but has undergone numerous updates since then. Regulation Z (12 C.F.R. 226), which implements the act, applies to all creditors except registered brokers. Generally, the purpose of the regulation is to provide consumers

with information regarding the terms and costs of consumer credit. It is also designed to protect the consumer against inaccurate and/or unfair credit billing and credit card practices. The regulation applies to all extensions of consumer credit involving a written agreement in which the credit is used for personal, family, or household purposes.

Banking Industry Concerns

Most of the concerns about Regulation Z are in reference to the numerous and complex disclosures that must be given to all loan applicants and to the provision granting the right of rescission. The disclosures associated with adjustable rate mortgages have drawn particular attention for being too complex and of little use to most borrowers. The costs of compliance with the regulation are deemed excessive, particularly by the smaller lending institutions.

Right of Rescission

Bankers argue that the provision allowing borrowers a 3-day rescission period causes unnecessary delays at closing. They say that the seldom used rescission right forces most borrowers to wait 3 days to obtain their mortgage money. Furthermore, since refinancings are subject to this provision, the right of rescission increases the processing expense borne by borrowers due to all the disclosures and the extra interest payments that accrue during the forced waiting period.

Excessive Penalties for Technical Errors

Bankers have expressed concern that Truth in Lending provisions are being enforced too rigidly. Penalties and forced rebates, they contend, are being levied against lending institutions even for unintentional miscalculation of interest rates. Also, bankers say that the severity of the penalties for technical errors has caused some institutions to cease offering certain lines of credit, principally variable rate home loans and home equity loans.

Complexity of Implementing Regulation

Bankers argue that a tremendous amount of time is required for management and compliance personnel to understand Regulation Z and that considerably more time is required to train and communicate the requirements of the regulation to the lending staff. The requirements are so numerous and convoluted, say bankers, that many lenders are unsure if they are in compliance.

Complexity of Annual Percentage Rate (APR) Disclosure
Lending officers feel that the APR calculation is so complex and so prone to errors that it cannot be quoted to consumers without reference to a specific transaction with a stated set of conditions. Hence, it does not represent a legitimate basis for comparing loan products.

Adjustable Rate Mortgage Disclosures and Product Restrictions
Bankers commented that the difficulty in calculating the annual percentage rate on adjustable rate mortgages (ARMS) combined with the severity of the penalties for disclosure errors has caused many institutions to severely restrict or avoid the use of these products altogether.

Disclosures and Customer Confusion
Many lenders feel that while the intent behind the Truth in Lending Act may be commendable, its implementation has resulted in such complex and numerous disclosures that the vast majority of consumers are simply overwhelmed. In most cases, they say, the consumer simply does not understand the information provided and becomes confused rather than enlightened.

Other Interested Parties' Concerns

None known.

Regulatory Agency Initiatives

ARM Disclosures and Product Restrictions
FFIEC's Task Force on Consumer Compliance is investigating the complaints, especially by small banks, that the ARM disclosure requirements are unnecessarily burdensome. Under consideration is the need to develop a compliance aid to help small banks; such a compliance aid might include a complete disclosure for a standard or typical ARM product.

In a separate effort, OCC recently developed and made available, free of charge, a computer software program that performs ARM calculations.

Right of Rescission
In its 1992 internal review, FDIC acknowledged that the right of rescission is an area of the law that should be reviewed and the findings brought to the attention of Congress. FDIC has gone so far as to draft legislative language that would eliminate for sophisticated consumers the 3-day rescission period under Truth in Lending.

Related GAO Studies

None.

Consumer Protection: Equal Credit Opportunity Act

Background

The purpose of the Equal Credit Opportunity Act (ECOA), passed in 1975 and implemented as Regulation B (12 C.F.R. 202), is to prevent discrimination on a prohibited basis in the availability of credit in both consumer and commercial lending. Regulation B requires that creditors notify credit applicants of the action taken on their applications and the reasons for any adverse credit decisions. The act also requires that creditors collect certain government monitoring information about the applicants. The law applies to all persons who are creditors, including banks, thrifts, credit unions, federal land banks, investment companies, and finance companies.

Banking Industry Concerns

Most of the bankers' concerns regarding ECOA focused on the amount of recordkeeping, public disclosure, and notification required by the law and its implementing regulation. Bankers also expressed concern about what they regarded as inconsistency in examination and enforcement.

Overlap of Regulations B and C

Both Regulations B and C require lenders to collect information in connection with certain loan applications. Because Regulation C applies to a wider variety of loans than Regulation B, a different form must be prepared for each regulation. Bankers say this causes a great deal of confusion as to which form to prepare.

Redundant Recordkeeping

ECOA, FHA, and HMDA each require similar, but slightly different, monitoring information to be collected by banks when making loans. Bankers say this results in a confusing situation, which could be remedied by standardizing the information to be collected for each law.

Examination Inconsistency

Bankers contend that the inconsistency of examination results is unfair to bankers and examiners alike and arises from a lack of clarity on how to

satisfactorily meet the intent of the notification requirements under Regulation B.

Board Liability

Bankers say that Regulation B places excessive liability upon the bank board of directors.

Inconsistent Discrimination Categories

ECOA and FHA do not agree on discriminatory categories. For example, ECOA includes categories not included in FHA, such as marital status, age, and income from public assistance, while FHA adds familial status and handicap to the ECOA list. Lenders say this is confusing.

Other Interested Parties' Concerns

Consumer groups expressed broad concern regarding what they believe is the poor enforcement of ECOA.

Regulatory Agency Initiatives

Interagency Initiatives

A number of interagency efforts have already been completed or are underway to improve fair lending detection techniques, enforcement, and education. For example: (1) on May 27, 1993, the agencies issued a joint statement to financial institutions that reaffirms their commitment to the enforcement of the fair lending laws and provides the industry with guidance and suggestions on fair lending matters; (2) the agencies are working on a revised supervisory enforcement policy for dealing with violations of ECOA and FHA; and (3) the agencies are developing uniform fair lending examination procedures and training programs in an effort to strengthen existing discrimination detection programs.

In addition, the four agencies planned to undertake new initiatives during the summer of 1993 to (1) develop a new training program in fair lending for examiners, (2) sponsor regional fair lending seminars for top-level industry executives, (3) explore alternative discrimination detection methods, (4) implement internal processes for making referrals to the Department of Justice for violations of ECOA, and (5) refine their consumer complaint systems. These initiatives were announced in a Joint Policy Statement released on June 10, 1993.

Study of Fair Lending Laws and Regulations

In 1992, FFIEC contracted with the consulting firm Arthur Andersen to study issues related to fair lending laws and regulations. Currently, the parties are working toward a final report that is expected by late 1993.

Related GAO Studies

In February 1993, we were requested to examine the implementation and enforcement of the Community Reinvestment Act and other fair lending laws, including ECOA. This comprehensive study is currently in progress.

Consumer Protection: Home Mortgage Disclosure Act

Background

The Home Mortgage Disclosure Act of 1975 (HMDA), as implemented by the Federal Reserve Board's Regulation C (12 C.F.R. 203), is intended to provide the public with information so that they can determine whether financial institutions are serving the housing needs of their communities. Additionally, information provided under Regulation C is used to assist regulatory agencies in identifying possible discriminatory lending patterns and enforcing antidiscrimination statutes.

Under HMDA, depository institutions with total assets over $10 million that have a home or branch office within a metropolitan statisitcal area (MSA) must compile and disclose data about the applications they receive and the home purchase and home improvement loans they originate or purchase, itemized by MSA and census tract by calendar year. Most recently, HMDA was amended by the Housing and Community Development Act of 1992, which further requires that an institution maintain a loan/application register (HMDA-LAR) on which it must enter data for each application received or loan originated or purchased. Among other things, the new law also requires that each institution make available a modified HMDA-LAR and a FFIEC-prepared disclosure statement regarding the HMDA-LAR information.

Banking Industry Comments

The primary complaint among small banks and thrifts about HMDA concerned the time and expense associated with the collection and reporting of HMDA information. Small institutions frequently expressed frustration in light of what they saw as the irrelevance of the few loans that they make. Another frequent complaint concerned the redundancy of the information that banks must submit in order to satisfy the requirements of different fair lending laws. In general, such complaints argued that the information required for various laws was similar, with

only minor differences that required reporting in different formats resulting in wasted effort and confusion.

Large institutions overwhelmingly regarded the redundancy of reporting information for both HMDA and OCC's Fair Housing Home Loan Data System (FHHLDS) as the greatest concern.

Recordkeeping and Reporting

Bankers contend that they must keep track of a multitude of factors, such as race, sex, age, and familial status, for HMDA and that the required information continues to expand. Banks view this as a time-consuming record-keeping and reporting exercise.

Irrelevance of Small Bank Data

Small banks make a relatively low number of rural mortgages in a given year. Consequently, many small bankers are not convinced that the information is important or that it is being fully utilized.

Redundancy and Confusion

Bankers maintain that there are three separate sets of rules and regulations to monitor lenders' compliance with nondiscrimination requirements in consumer lending. They are confused by this. They say that the type of information to be collected in connection with a loan application and the manner in which the information is treated vary widely depending on which regulation(s) apply.

Redundancy of HMDA and FHHLDS

Bankers say that the data mandated to be collected under OCC's FHHLDS is for the most part identical to the information required to be collected for HMDA. OCC's regulation required four additional elements that are not included in the HMDA data. Bankers contend that the data validation and verification of the accuracy of the logs maintained for these two separate requirements is a particularly labor-intensive process.

Data Collection Expense

Bankers report that the direct and indirect costs associated with HMDA compliance are excessive, especially for computer support and operational staff. Indirectly, management supervision, oversight, and programming consume thousands of work hours annually. Bankers argue that HMDA's complexity and length make its value to the general public questionable, particularly in light of the costs involved.

Other Interested Parties' Concerns

Consumer groups argue strongly that the HMDA data is of great value and that its dissemination has had a positive effect on fair lending. These groups maintain that if it were not for HMDA's reporting requirements, banks would not be lending to minority applicants. In general, consumer groups strongly oppose any reduction in the HMDA reporting requirements.

Regulatory Agency Initiatives

Redundancy of HMDA and FHHLDS

On May 10, 1993, OCC published in the Federal Register a proposed rule that would amend its FHHLDS to enhance its ability to utilize data collected under HMDA in fair lending examinations and to reduce recordkeeping requirements on national banks that are currently required to maintain duplicative information under FHHLDS and HMDA. To relieve duplicative recordkeeping, the proposed rule would provide national banks that report under both FHHLDS and HMDA an alternative method of recordkeeping to meet the requirements of FHHLDS and avoid duplication. Comments on the proposed rule were due by July 9, 1993, and a final rule is expected soon.

Exemptions for Smaller Banks

While it would require legislative action, FRB has previously suggested that the reporting exemption for depository institutions with assets of $10 million or less could be expanded to exempt institutions at some higher level. FDIC concurs and notes that raising the compliance threshold to $25 million could reduce the burden on relatively small institutions while still ensuring the collection of sufficient information to provide statistically significant data on banks in MSAS. FDIC has drafted legislative language to raise the exemption threshold and to provide for annual adjustment of the HMDA exemption based on the consumer price index. The language is included in several bills currently before Congress.

Also, FRB has previously suggested shifting the requirements for reporting from the current asset test to a test based on the level of an institution's mortgage lending activity, such as number of applications received in a given year. FRB adopted such an approach for nondepository lenders when it implemented provisions of FDICIA. The rule went into effect January 1, 1993.

Related GAO Studies

In February 1993, we were requested to examine the implementation and enforcement of the Community Reinvestment Act and other fair lending laws, including HMDA. This comprehensive study is currently in progress.

Other Requirements: Call Reports

Background

Each federally insured depository institution is required to file periodic Reports of Condition (Call Reports). Generally, these reports are required to be submitted quarterly. Reports include detailed information on a myriad of bank financial statistics, including assets, liabilities, deposits, nonaccruing loans, and expenses. Call reports must be submitted according to a format specified by the primary regulator.

Banking Industry Comments

Because of the level of detail requested in the Call Reports, smaller institutions without computerized accounting systems maintain that the task of filing these reports is quite burdensome. Additionally, bankers claim that frequent changes to the reports require even institutions with sophisticated computer systems to invest substantial time and expense updating their systems.

Complexity of Call Reports

Bankers claim that the Call Reports, which now require almost 30 pages of information, have become unduly complicated and confusing. The reports, they say, require a level of detail and knowledge that threatens to overwhelm smaller depository institutions. Additionally, bankers say that the Office of Management and Budget (OMB) has severely underestimated the time required to complete the Call Reports.

Frequency of Changes

Bankers claim that almost every quarter, without advance notice, regulators make changes to the Call Reports. As a consequence, instructions and definitions must be reinterpreted and programming changes to computer systems must be made, all at great expense.

Monthly Thrift Financial Reports

Thrift institutions believe that the monthly thrift financial reports required by OTS are of little value since only small changes occur over such a short time horizon. They argue that these monthly filings are expensive and time-consuming.

Multiple Reports and Redundant Information

Institutions are irritated by the apparent lack of coordination among the

regulators regarding the Call Reports—each requesting the same basic information with slight variations. Additionally, they believe several areas of the report are redundant. For example, loan volume must be provided in eight different sections.

Other Interested Parties' Concerns

A banking industry consultant noted that the preparation of annual securities reports (Form 10-K) and quarterly security reports (Form 10-Q) are very labor-intensive and costly and have an especially burdensome effect on smaller publicly held institutions.

Regulatory Agency Initiatives

Standardized Reporting

FFIEC has begun to develop a proposed core financial report that would permit a uniform performance report for all banks and thrifts. Additionally, OTS is currently considering the possibility of converting to the bank Call Report.

Reports Simplification

As reported in the FFIEC study, the banking agencies are now considering providing a more detailed index for the Call Report instructions. While an instruction index has not yet been developed, the reporting agencies believe that an improved index would be helpful.

Frequency of Changes

The four banking agencies have already adopted a uniform formal policy governing the frequency of changes to Reports of Condition and the amount of advanced noticed required for such changes. Under the policy, the agencies will announce prior to the end of each year all reporting changes that will take effect in the following year. A few exceptions apply, particularly in cases where deletions or changes are required by statute or regulation. FFIEC is also considering revising and broadening its existing policy for approving changes to include other interagency reports as well.

Monthly Thrift Financial Report

Effective January 1, 1993, OTS eliminated the monthly submission of thrift financial reports. The Financial Reports are now required only on a quarterly basis. However, OTS has maintained the discretionary right to require monthly reports from weak and/or otherwise troubled thrifts.

Implementation of FDICIA

FRB, FDIC, and OCC implemented several changes to the Call Reports in the

first half of 1993, most of which were the result of provisions in FDICIA. New items that were added to the report will collect data on (1) loans to small businesses and small farms, (2) troubled loans that are guaranteed by the U.S. government, (3) deposits in "lifeline accounts" and estimates of "uninsured deposits," (4) off-balance sheet assets not otherwise reported, (5) deferred tax assets, and (6) intangibles that are "grandfathered" to count toward regulatory capital even though new rules disallow them.

Related GAO Studies

Our 1992 report, Call Report Automation, (GAO/IMTEC-92-60R, May 28, 1992), described interagency efforts to improve the efficiency of Call Report data collection and its processing and publication. The report encouraged the aggressive pursuit of the interagency initiatives discussed and the agencies' increased utilization of available technologies to raise reporting efficiency.

Other Requirements: Bank Holding Company Reports

Background

The Bank Holding Company Act and its implementing regulation, FRB Regulation Y (12 C.F.R. Part 225), includes requirements that all bank holding companies register with the Federal Reserve Board and furnish the Board with annual reports of holding company operations each fiscal year and such additional information as the Board may require. FRB has required bank holding companies to file quarterly and annual reports (Y-9 and Y-6, respectively) on holding company activities and financial conditions.

Banking Industry Comments

Banker concerns regarding the filing of Bank Holding Company Reports were similar to those expressed about the Call Reports; i.e., the reports are time-consuming and redundant.

Redundant Reporting

Bankers believe that Bank Holding Company Reports request almost the same information as do the Call Reports and suggest that the agencies develop a more streamlined approach to eliminate the numerous and largely duplicative reports. Also, bankers claim that a considerable amount

of expense could be saved if the Y-9 and Y-6 reporting requirements followed GAAP and were consistent with SEC reporting formats.

Other Interested Parties' Concerns

None known.

Regulatory Agency Initiatives

Consistency with GAAP

In response to industry complaints, FFIEC studied the accounting treatments used in form FR Y-9c and found that it is already filed on a GAAP basis. Furthermore, in its December 1992 study on regulatory burden, FFIEC noted that the report is already generally consistent with information that is required by SEC.

Related GAO Studies

None.

Other Requirements: Bank Secrecy Act

Background

The Bank Secrecy Act (BSA), as amended, requires financial institutions to report certain currency and financial transactions and to maintain records for possible use in criminal and tax proceedings. BSA is implemented by Treasury Department regulation (31 C.F.R. 103). The basic purpose of BSA is to deter money laundering and other forms of white collar and organized crime by providing a paper trail to assist law enforcement agencies. The Currency Transaction Report (CTR) and the Currency and Monetary Instrument Report (CMIR) are the two principal reports that financial institutions are required to file.

Banking Industry Concerns

The general concern bankers have regarding the Bank Secrecy Act is that the level of recordkeeping and reporting required under the law is excessive. Furthermore, bankers contend that while their efforts benefit law enforcement agencies, the reports themselves serve no banking purpose; yet, bankers receive no compensation and are assessed severe penalties for violations.

The Filing of CTRs

Bank and thrift officers maintain that financial institutions incur

considerable expense to comply with the reporting and recordkeeping requirements of BSA. Expenses that have been associated with BSA compliance include payroll, training and materials costs, forms and documentation time, compliance monitoring, reduced cashier productivity, and educating customers regarding the legal reporting requirements.

Excessive Penalties for Noncompliance

Bankers contend that the civil penalties and possible criminal liability associated with a failure to properly report the necessary transactions place such a huge burden on a bank that extreme controls must be in place to ensure compliance. This increases the already excessive costs associated with meeting the requirements of the law.

Low Exemption Threshold

Bankers say that the $10,000 threshold for CTRs and the $3,000 threshold for the purchase of monetary instruments is too low. They argue that these thresholds have been in place since 1980 without adjustment for inflation. The result has been that an ever-increasing number of CTRs and CMIRs are being filed every year.

Costs Exceed Benefits

Literally millions of currency transaction reports are filed annually by the banking industry, and some bankers believe that much of this information has never been utilized. Consequently, bankers question whether the level of recordkeeping and reporting presently being undertaken serves as a realistic, cost-effective control over money laundering and criminal activity.

Maintenance of Exemption Lists

Bankers claim that the exemption process is so complex and time-consuming that it is less troublesome and expensive to just file the CTR. They suggest that a simpler exemption process would serve as an incentive for banks to avail themselves of the opportunity to use an exempt list.

Other Interested Parties' Concerns

None known.

Regulatory Agency Initiatives

Treasury Study

The Treasury Department is currently undertaking a comprehensive

review of BSA regulations and reporting forms to insure that BSA-related benefits outweigh the costs to society and financial institutions. As part of this review, the current reporting threshold of $10,000 will be closely considered, as will the exemption process and enforcement procedures.

Related GAO Studies

In an October 1992 report, Money Laundering: State Efforts To Fight It Are Increasing But More Federal Help Is Needed (GAO/GGD-93-1, Oct. 15, 1992), we reported that federal law enforcement agencies have found BSA reports extremely useful in identifying, investigating, and prosecuting money laundering operations or any other criminal activity generating large amounts of cash. However, we also testified that CTRS are not being used to their fullest extent by law enforcement agencies because the large volume of reports being filed has made meaningful analysis difficult; see Money Laundering: The Use of Bank Secrecy Act Reports By Law Enforcement Could Be Increased (GAO/T-GGD-93-31, May 26, 1993). Moreover, we found that access to the data, particularly at the state level, is limited and cumbersome. We also determined that federal resources to enforce CTR provisions at nonbank institutions may be insufficient to ensure compliance. We are examining these issues in more detail in ongoing assignments.

Other Requirements: IRS Reports

Background

IRS requires that financial institutions report a variety of different types of information to assist the agency in its monitoring of transactions and collection of appropriate tax. For example, all payers of interest are required to file forms 1099-INT or 1099-OID to report the payment of interest of $10 or more to any person or nominee during a calendar year. Another example of such a requirement is the filing of IRS Form 1098 to assist IRS in verifying the accuracy of claimed mortgage interest deductions.

Banking Industry Concerns

In general, complaints about IRS reporting requirements stemmed from the filing of IRS Form 1099. Bankers were annoyed that they are required to submit these forms at considerable expense, with no compensation. A significant number of complaints were also submitted regarding the

B-Notice Backup Withholding Program. Concern was also expressed about the number of changes to the regulation and the excessive penalties for noncompliance. The collection of Taxpayer Identification Numbers (TINS) also spurred some comment.

Form 1099

From the moment a customer requests to open a deposit account, regulations require that the financial institution obtain the correct name and TIN to use for the purpose of filing a 1099 information return at year end. Bankers argue that these requirements have caused more paperwork and additional costs that must be passed on to consumers.

Backup Withholding

Bankers believe that backup withholding regulations are an ongoing problem. Essentially, bankers say they are acting as tax collectors but receive no compensation. They add that policing accounts for IRS causes a public relations nightmare. Additionally, bankers say the regulations hold banks liable for incorrect TINS. Thus, much time and money must be spent collecting and verifying TINS. Finally, bankers complain that frequent last-minute changes to the B-Notice Backup Withholding Program are confusing, frustrating, and expensive for the financial industry.

Other Interested Parties' Concerns

None known.

Regulatory Agency Initiatives

The IRS reporting requirements fall outside the jurisdiction of the bank regulatory agencies. Hence, no initiatives have been taken.

Related GAO Studies

None.

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