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**BANKING BY THE NUMBERS; 70.2% ARE STATE-CHARTERED**

By far, state-chartered banks continue to out-populate their national and federally-chartered brethren, according to second quarter statistics released Aug. 24 by the FDIC. The agency’s Quarterly Banking Profile showed there were 6,230 state-chartered commercial and savings institutions as of June 30, 2006, compared to 1,780 national banks and 768 federal savings institutions. However, national banks and federal thrifts continue to hold the lion’s share of assets, with a 69.7 percent asset share, compared to 30.3 percent held by state-chartered institutions. Interestingly, the total number of state-chartered institutions stood equal to the numbers from June 30, 2005, while the total number of nationally- and federally-chartered institutions declined by 90.

State commercial banks had an average return on assets of 1.43 compared to 1.37 for national banks. State savings institutions had an ROA of 0.84, while federal savings banks had an ROA of 1.16. Net income for state-chartered commercial banks was more than $21.9 billion, up from $19.9 billion in June 2005 and $19.8 billion in June 2004. The net interest margin for state commercial banks was 3.88 in 2006, up from 3.81 in 2005 and 3.36 in 2004. For these institutions, the ratio of noncurrent loans and leases to total loans and leases was 0.59 in 2006, 0.65 in 2005 and 0.85 in 2004.

**CSBS: BASEL II AND CRE ‘GUIDANCE’ POSE SYSTEMIC IMPACT**

Testifying on behalf of the Conference of State Bank Supervisors (CSBS) on Sept. 14, Massachusetts Commissioner of Banks Steven L. Antonakes told the House Financial Services’ Financial Institutions Subcommittee that proposed new capital rules for large banks and proposed federal ‘guidance’ on commercial real estate lending could do particular harm to community banks by altering the competitive landscape.

“It is our responsibility as regulators to ensure that regulatory proposals are prudent and do not create a competitive imbalance,” he said at a hearing on two pending federal banking proposals, (1) a new capital framework that would purportedly align regulatory capital requirements more closely with the risk profiles of the largest banks, and (2) proposed “guidance” on commercial real estate lending.

Antonakes said that capital plays a pivotal role in ensuring safety and soundness within the banking system and should not be undercut by proposed new capital rules known as Basel II or the New Capital Accord, published in June 2004 by the Basel Committee on Banking Supervision. He noted that at least 10 states charter banks that are potential core Basel II banks or are likely to opt-in to the Basel II framework.

The House Financial Services subcommittee convened the hearing to hear the views of bank regulators on proposals on Basel Capital and commercial real estate. Antonakes testified alongside federal regulators, including Federal Reserve Gov. Susan Schmidt-Bies, FDIC Chairman Sheila Bair, Comptroller of the Currency
John Dugan, Office of Thrift Supervision Director John Reich, and SEC Acting Director of Market Regulation Robert Colby. The regulators’ panel was followed by a panel of bankers and industry analysts.

“All regulators must be cognizant that these proposals could alter the competitive landscape and lead to the shifting of risk among business lines within the system,” Antonakes said.

On federal banking regulators’ proposed commercial real estate loan guidance, Antonakes told the committee that CSBS was concerned about the impact of the guidance.

“As regulators, we must not be overly prescriptive in how risk is managed. In our opinion, the benefits of the guidance do not outweigh the potential negative impact on competition and our communities,” Antonakes said.

He said CSBS is particularly concerned with the thresholds that would be used to determine if an institution has a high CRE concentration in its portfolio. “We do not believe the federal agencies have justified these particular thresholds,” he said.

He reiterated CSBS’s desire to have a seat at the table alongside the federal regulators when rules that affect state-chartered financial institutions are considered. Antonakes is a member of the CSBS Board and is chairman of the Federal Financial Institutions Examination Council (FFIEC) State Liaison Committee.

“Despite the fact that state-chartered institutions will be directly impacted by changes to the capital rules, there is the view from some of the agencies that since these rules are federal regulations, there is no part for the states to play in their development or implementation,” he said. “We believe the exclusion of state regulators from this process is fundamentally wrong,” he added.

CSBS JOINS STATE/LOCAL GROUPS FILING AMICUS BRIEF IN PREEMPTION CASE

The Conference of State Bank Supervisors joined with the National Conference of State Legislatures, National Governors Association and a number of other state and local government organizations filing an amicus curiae brief with the Supreme Court in a case involving the federal preemption of state consumer protection laws. The brief was filed Sept. 1 in support of the petitioner, Linda A. Watters, Commissioner, Michigan Office of Insurance and Financial Services. The Supreme Court is expected to hear the case later this fall.

The case at issue, Watters v. Wachovia Bank, N.A. and Wachovia Mortgage Company, was brought in response to earlier district court and appeals court rulings that upheld preemptive regulations issued by the Office of the Comptroller of the Currency which divest the states of all power to regulate state-chartered, non-bank operating subsidiaries of national banks.

“In practical effect, the court created a presumption in favor of the OCC’s authority to adopt rules preempting state law – a presumption that could not be overcome without an unambiguous statement of congressional intent to forbid the OCC’s regulations,” the brief states.

The brief asserted that the Sixth Circuit Court of Appeals erred in failing to apply a presumption against preemption and in holding that the OCC’s preemptive regulations were entitled to deference under the Chevron doctrine, based on the following points:

(1) The Sixth Circuit should have required the OCC to demonstrate that its preemptive rules were consistent with congressional intent because “the critical question in any pre-emption analysis is always whether Congress intended that federal regulation supersede state law.”

(2) The Sixth Circuit should have applied a presumption against preemption, because (i) the Supreme Court has affirmed that federally chartered banks are subject to state law, and (ii) the Supreme Court has repeatedly upheld the States’ authority to regulate domestic corporations, and to require foreign corporations to comply with state laws designed to assure responsibility and fair dealing.

“This Court should now hold that Chevron does not apply to a federal agency’s regulation that claims to preempt state law,” the brief stated.
"Preemption is ‘an extraordinary power’ in a federalist system. Accordingly, the judiciary should undertake a de novo review of every preemptive rule to ensure that the federal-state balance is not altered without a deliberate decision by Congress,” the brief states. The brief added that even if Chevron applies to this case, the OCC’s regulations do not qualify for deference unless they were “promulgated pursuant to authority Congress has delegated to the OCC.”

"None of the statutes cited by the OCC and the Sixth Circuit empowered the OCC to preempt the states’ authority to regulate state-chartered corporations that are operating subsidiaries of national banks. Without such delegated authority, the OCC is not entitled to Chevron deference,” the brief states. The OCC’s rules reference three statutes that refer only to national banks and do not mention operating subsidiaries.

"Operating subsidiaries cannot be treated as “national banks,” a term that is expressly defined in 12 U.S.C. §§ 221 and 221a(a). Operating subsidiaries are chartered as non-bank corporations under state law, and they do not meet statutory criteria that national banks must satisfy in order to obtain federal charters under the National Bank Act,” the brief said, concluding that “Congress has established a clear distinction between national banks, on one hand, and state-chartered, non-bank operating subsidiaries, on the other.”

Other organizations joining CSBS, NCSL and NGA in the joint brief were the Council of State Governments, National League of Cities, National Association of Counties, International City/County Management Association and U.S. Conference of Mayors.

All amicus curiae briefs in support of the petitioner may be found on the CSBS Web site at http://www.csbs.org/Content/NavigationMenu/LegislativeAffairs/LegalIssues/Wachovia_V_Watters_S.htm

**CSBS SUGGESTS BANKS HAVE CHOICE OF BASEL APPROACHES**

The Conference of State Bank Supervisors (CSBS) has gone on record in support of giving financial institutions a choice in approaches for implementing Basel II in the United States. In a letter sent to the principals of the four federal bank regulatory agencies on July 13, CSBS suggested that including the Standardized Approach to Basel II “is an option worthy of discussion” as the agencies finalize a rule on the implementation of Basel II. CSBS recognizes the need for enhanced risk sensitivity for complex and internationally active institutions and generally supports Basel IA for banks not following Basel II’s Advanced Approach. In September 2005, CSBS asked federal bank regulators to “go slow” on Basel II to ensure smaller banks aren’t left at a competitive disadvantage to large banks from a capital standpoint. CSBS’s most recent letter may be found online at http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/CommentLetters/CommentLettersMain.htm

**CSBS PROVIDES VIEWPOINTS ON HOEPA, HOME EQUITY LENDING MARKET**

The Conference of State Bank Supervisors has sent a comment letter to the Federal Reserve Board as a follow-up to a recent series of public hearings on the home equity lending market and the effectiveness of existing regulatory and legislative provisions in protecting the interests of consumers.

CSBS President and CEO Neil Milner noted that the bulk of mortgage regulation falls to the state supervisory agencies, with some 440,000 state licensees comprising 100,000 companies, 60,000 branches and 280,000 individuals that engage in residential mortgage lending. He recounted the role the states played in two historic predatory lending cases involving Ameriquest Mortgage Company in 2006 and Household International in 2002 that involved settlements of $325 million and $484 million respectively.

Milner’s letter also referenced the CSBS/American Association of Residential Mortgage Regulators’ initiative to develop a nationwide licensing system by January 2008. The web-based system will provide uniform applications for residential mortgage lenders, brokers and loan officers, as well as a central repository of licensing information and publicly adjudicated enforcement actions. CSBS has contracted with the National Association of Securities Dealers (NASD) to develop and host the system.

CSBS, in its letter, also commented on federal banking regulators’ regulatory preemption of state consumer protection laws, saying that such preemptions are a hindrance to state supervisory agencies in that they bar the states from licensing, examining and otherwise regulating state-chartered corporations that are subsidiaries of national banks.
The letter also found fault with current disclosures. Milner said, “More often than not, consumers do not, or cannot, read and understand the expansive disclosure forms.” CSBS recommended changes to simplify the disclosures.

To read the comment letter in its entirety, go to the CSBS Web site at http://www.csbs.org/Content/NavigationMenu/RegulatoryAffairs/CommentLetters/CSBSHomeEquityLendingResponse.pdf

CSBS SUGGESTS IDEAS TO MAKE MSBs MORE BANKABLE

In recent testimony before the House Financial Services’ Subcommittee on Financial Institutions and Consumer Credit, New York State Superintendent of Banks Diana L. Taylor said that finding a solution to the diminution of banks willing to provide banking services to “money services businesses” (MSBs) will require effort from all parties involved: the MSBs, the banking industry, state and federal banking regulators, FinCEN and the IRS.

Representing the Conference of State Bank Supervisors (CSBS), Taylor told the panel that most states license MSBs, and 31 states examine MSBs for compliance with federal BSA and anti-money laundering regulations using federal guidelines as the foundation of their examination programs.

“It is better for the safety and soundness of the entire industry if MSB accounts are spread out across a diversity of banks,” she said, adding that “our solution must create incentives that ultimately serve to protect consumers, the banks and the MSBs.”

Taylor outlined seven recommendations which should be considered as the basis of a solution. They include:

- Revisit the FinCEN definition of an MSB. Taylor said the current definition captures not only businesses that consider money services their primary function, but also those for which money services are incidental, such as grocery stores that provide check cashing services for customers.
- Further clarification of standards. Taylor suggested regulators develop simplified, standardized requirements for MSBs that serve a lower-risk client base, and additional guidance on due diligence when maintaining accounts for foreign providers of money services and identifying entities that may be operating covertly as MSBs.
- Continue to improve federal-state coordination. To date, 39 states have signed memoranda of understanding with FinCEN, and 35 states have similar MOUs in place with the IRS, setting forth procedures for sharing Bank Secrecy Act information. Taylor suggested additional training and a renewed commitment from FinCEN and the IRS to deliver on the promises of the MOUs.
- Create incentives to encourage banks to serve the MSB industry. Regulators should consider offering CRA credit to banks that provide services to MSBs since a significant segment of their customers are low-income, minorities and new immigrants.
- Seek out incentives for banks to offer MSB-type services in underbanked communities. Taylor cited New York’s Banking Development District program which incents banks to open branches in underserved areas including access to below-market, municipal deposits.
- Continue to require better risk management systems for MSBs. MSBs must continue to improve their risk management systems and continue to focus on BSA/AML compliance.
- Continue to improve state supervision of these entities. States should strive for high-quality, consistent supervision and educational opportunities for state MSB examiners, such as the CSBS “Boot Camp for BSA Professionals.”

Taylor’s testimony may be found at http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=482

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