Mr. Chairman, Ranking member Sarbanes, and members of the Committee, my name is Terry Jorde. I am Vice Chairman of the Independent Community Bankers of America (ICBA)[1] and President and CEO of CountryBank USA, a community bank with $37 million-in-assets located in Cando, North Dakota. Cando is a small town of only 1,300 people, but we have three banks and a motto that "You Can Do Better in Cando." Our bank is full service and progressive, offering our customers a full range of insurance and investment services, residential mortgages, check imaging, and fully transactional Internet banking.

I would like to compliment this Committee on exercising its oversight role by calling this hearing on the effect the Gramm-Leach-Bliley Act has had on the financial industry, the nation, and – most importantly – on our communities. We conclude that the Act has had a number of effects, many positive, and some negative:

- The Federal Home Loan Bank reform provisions have been especially helpful to community banks and could be further improved by the passage of Senator Enzi's amendment to this Committee's GSE reform legislation. It clarified the FHLBank's mission to provide community financial institutions with funding for agricultural and small business loans.
- GLB closed the unitary thrift loophole – which allowed any commercial firm to purchase a thrift institution – but Congress now needs to close the industrial loan company loophole to maintain the separation of banking and commerce;
- GLB contributed to increased financial concentration;
- Community banks have made limited use of the Act's new financial holding company structure, most likely to engage in insurance agency activities;
- The notice requirements under the privacy provisions should be streamlined, especially for the majority of community banks that do not share information with outside parties.

FHLBank System

The Federal Home Loan Bank reforms provided the Act's most significant benefits to community banks. Frankly, during the time the bill was being

[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to protecting the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

considered, ICBA concluded that these provisions and the closing of the unitary thrift loophole offset the bill's problematic aspects.

From our perspective, the FHLBank reforms included these significant benefits:

- Permitted any "community financial institution" (now – with indexing – any FDIC-insured institution with less than $550 million in total assets) to become a member. Previously, an institution had to have at least 10 percent of total assets in "residential mortgage assets" to qualify. Changing this was particularly important to many agricultural banks that found the 10 percent test difficult to meet in their markets.
- Allowed community financial institutions to use small business, small farm, and small agri-business loans as collateral for advances.
- Equalized membership requirements for commercial banks and thrifts. This was a win-win for community banks of all charter types, since it made membership for federal thrifts voluntary and eliminated second-class membership status for commercial banks.
- Eliminated an emerging problem by repealing the 30 percent ceiling on FHLBank System advances to institutions that did not meet the qualified thrift lender test.

As a result of these reforms, community banks of all charter types have greatly increased their involvement in the System. Approximately 76 percent of ICBA members are now also members of the System, compared to 17 percent immediately after passage of GLB.

ICBA members are increasing their use of the FHLBanks' advances to fund local loans. I am sure my experience is typical of many new members. My bank was a member before GLB, but not an active advance user. For the first time in years, we are borrowing from our FHLBank because our deposits are down and loan demand has increased. Because of these liquidity pressures, the FHLBank System is more important than ever for our members.

While FHLBank access has provided community financial institutions like CountryBank needed liquidity, it has also helped us better serve our customers. FHLBanks provide many different types of advances that help bankers better meet the needs of our customers who are seeking longer term fixed rate loans for residential mortgages, commercial and agricultural real estate mortgages and other types of loans that our deposit base does not permit without unduly exposing the bank to interest rate risk.

My bank belongs to the Federal Home Loan Bank of Des Moines that has been a champion in accepting small business and agricultural assets as collateral for advances. Some FHLBanks have been slow to accept the new collateral types permitted by the Act and have place severe constraints on pledging small business, small agri-business and small farm loans, such as limiting the types of loans or severely haircutting values. Thus, some community financial institutions have not been able to use this collateral to obtain advances as Congress envisioned. While any institution needs to be cautious about moving into a new type of business, the FHLBanks have had sufficient time since the Act's passage to develop the expertise and the policies and procedures to more readily accept these new collateral types. As the economy strengthens and loan demand increases, many community financial institutions will need the ability to pledge this collateral.

ICBA is pleased that this committee addressed this issue by adopting an amendment by Senator Enzi to the GSE reform bill, S. 1508. That amendment clarified that the mission of the FHLBanks includes providing liquidity and funds to community financial institutions for agriculture and small business lending. We are hopeful that your endorsement of this will stimulate the FHLBanks to use the authority provided in GLB. ICBA will continue to support Senator Enzi's effort as this legislation moves through the process.

Maintaining the Separation of Banking and Commerce

GLB reaffirmed the nation's long-standing policy maintaining the separation between banking and commerce by closing the unitary thrift loophole that permitted any commercial firm to acquire a single thrift institution. By maintaining the separation of banking and commerce, Congress helped ensure that our financial system would avoid the conflicts of interest and threats to safety and soundness that would arise if commercial firms – such as retailers and manufacturers – were permitted to own their own banks.

While GLB grandfathered the few existing commercial/unitary thrift combinations, it effectively cut off Wal-Mart's application to acquire an Oklahoma thrift. This prevented Wal-Mart from engaging in dangerous self-dealing between its huge retail operation and a federally insured thrift institution. And, since many banks already have branches in thousands of Wal-Mart stores, customers will continue to have convenient access to banking services. However, the banks will maintain their legal independence from Wal-Mart and will be able to lend on an arm's length basis to all businesses in their communities.

Congress also successfully addressed the banking and commerce issue before GLB. In 1987, the Competitive Equality Banking Act closed the nonbank bank loophole that permitted commercial firms to establish banks. In 1972 Congress closed a loophole that would have permitted any commercial firm to own a single bank.

All of these loopholes existed for many years before they were closed. However, Congress acted as soon as it became clear that they could be exploited in a major way. Policy makers now must face the same issue with industrial loan companies. Several years ago, Wal-Mart attempted to buy a California ILC.

Fortunately, the California legislature quickly acted to block that attempt by closing the ILC banking and commerce loophole in its state. Unfortunately, the loophole remains in place in several other states and has been exploited most enthusiastically in Utah. ICBA joins with the Federal Reserve in urging Congress to reassert its authority and close the ILC loophole for the entire nation by bringing the ILCs under the Bank Holding Company Act. This would prevent additional commercial/ILC affiliations and extend effective holding company regulation to the parents of ILCs.

In its regulatory relief bill, H.R. 1375, the House took steps to address the ILC loophole by adopting the Gillmor/Frank amendment that would prevent newly formed ILCs with commercial affiliations from using the bill's new de novo interstate branching authority or the interstate banking and branching powers provided by the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.[2] Unfortunately, the House did not include similar restrictions in the business checking provisions of H.R. 1375. As a result, ILCs – including those owned by commercial firms – would be granted completely new authority to offer business checking accounts, plus be permitted to pay interest on those accounts. This would make ILCs the functional equivalent of full service banks and negate the original rationale—a limited charter—for excluding them from the BHCA.

While the Gillmor/Frank language was a positive first step, ICBA strongly urges Congress to take the next step and close the ILC loophole completely.

Increased Concentration

As Congress considered the financial modernization legislation that ultimately became GLB, ICBA repeatedly warned that it would likely lead to increased financial concentration. That has certainly proven to be the case. GLB and the Riegle-Neal Act have together led to the creation of truly huge financial conglomerates. We now have <u>three</u> one trillion dollar banks in the United States. This is certain to decrease competition and increase systemic risk.

While it is too late to turn back the clock on these developments, ICBA recommends that Congress take steps to improve the competitive landscape so that consumers and businesses continue to have robust financial services choices. In this regard, ICBA has particular concern about the competitive position of community banks in this environment. Just last month, ICBA submitted testimony that highlighted the detrimental effects than increasing regulatory burden is having on community banks' ability to compete. We again strongly urge you to reduce this burden to improve our ability to serve our customers and communities. This burden falls disproportionately on community banks that cannot spread their costs across a large asset and personnel base. Unless Congress and the regulators can lift it soon in material ways, economic

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[2] Without the Gillmor/Frank amendment, Wal-Mart could buy or charter an ILC and establish a nationwide network by setting up branches of the ILC in each one of its stores.

development and small businesses will suffer. Therefore, we urge you to follow up on our recommendations and those the financial regulatory agencies develop under the EGRPRA regulatory review.[3]

In addition, we hope that Congress will complete action on deposit insurance reform legislation this year. Deposit insurance provides the bedrock for community bank competitiveness. Since community banks are not too-big-to-fail, our depositors look to deposit insurance to protect their transaction and savings accounts. While we continue to favor immediate increases in coverage – especially for retirement funds – ICBA hopes that at least Congress can pass legislation that will provide a robust indexing system, along with other key reforms such as eliminating the 23-basis-point premium cliff and ending the free ride for rapidly growing institutions.

I would also like to draw your attention to another aspect of increased concentration, the fact that the largest institutions appear to be too big to regulate and too big to punish for their transgressions. Community bankers from around the country are increasingly concerned about what they perceive as a regulatory double standard. In case after case, they note that regulators and courts impose only nominal fines for megabanks' misdeeds and regulators go on to approve their mergers. For example, Citigroup agreed to pay investors $2.7 billion for its part in WorldCom's bankruptcy. J.P. Morgan paid $135 million for its part in the Enron scandal. This proved to be less than a speed bump for its acquisition of Bank One; the case was barely alluded to in the 63-page approval decision. UBS was fined $100 million for providing U.S. currency to Cuba, Libya, Iran, and Yugoslavia. While it was also ordered out of this line of business, it had not been particularly profitable or significant to the institution.

While some of the fines and settlements may seem large to the average person, they are tiny when applied to these companies. Commenting on Citi's WorldCom settlement, an analyst wrote that, "Citi's earning power and existing capital levels allow it to take such a charge without any material adverse impact to capital levels and [with] no impact on dividend policy."[4]

A relatively large community bank like Riggs ($6 billion) in Washington, D.C., suffered more serious consequences when it failed to file Suspicious Activity Reports on certain embassy transactions. Regulators forced significant management changes and the bank is exiting its signature line of business, handling the banking needs of the diplomatic community. The $25 million fine

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[3] The agencies are in the midst of reviewing 129 banking regulations to identify provisions that are outdated, unnecessary or unduly burdensome, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.
[4] (Susan Roth, Credit Suisse First Boston, quoted in "For Citi, $5B Is Price of 'Moving On'; *American Banker,* 5/11/04)

assessed against Riggs was more than its annual earnings for each of the last four years. Analysts believe Riggs may even lose its independence.

The vast majority of community banks undergo even harsher treatment. State and federal regulators (properly) hold management strictly accountable for everything that happens in the bank – from its culture to the actions and deeds (and misdeeds) of its staff and alliance partners. If they cross the line, both the bank and management are punished. There are no exceptions.

ICBA urges Congress to direct the agencies to review their policies, comparing the fines and other punishments that they apply to the largest institutions they regulate with those they mete out to the rank and file. It is important to eliminate the perception that large institutions are above the law and can commit serious offenses without facing serious consequences.

In the face of these concerns, this is certainly not the time for Congress to take further steps, such as lifting the deposit caps in the Riegle-Neal legislation, that would further increase concentration. ICBA will vigorously oppose any such proposals.

Additional Financial Services

GLB did not provide community banks with substantial new opportunities to provide financial services to their customers. In the years prior to enactment, state action, plus court and regulatory interpretations allowed virtually all banks to offer retail financial services – primarily insurance and securities – as agents. One exception to this general rule are the provisions of GLB that permit financial holding companies and financial subsidiaries of national banks to sell insurance even if they are not headquartered in towns of less than 5,000 in population or in states that granted insurance agency powers to state chartered banks. A number of community banks have formed FHCs or financial subsidiaries, apparently for the purpose of engaging in insurance sales. However, only the largest financial institutions were interested in affiliating with underwriting companies. Indeed, it was the apparently illegal merger between Citibank and Travelers Insurance that provided the final impetus to the legislation.

While community banks did not seek the new financial affiliation authority under GLB, a significant number of ICBA member community banks offer retail insurance and securities services. Just under half of the banks under $1 billion in assets earned fee income from insurance activities in 2003. That same year, nearly 23 percent of those banks earned income from mutual fund and annuity activity.[5]

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[5] Michael White's Bank Insurance & Investment Fee Income Report, 2003 Year-end Edition, pp. 13 & 109.

My own bank is active in insurance sales and investment brokerage, though we did not need GLB to enter these fields. Insurance sales are particularly important for our bank and we are having good success. We have just purchased our third agency. In fact, thirty percent of our bank's employees are dedicated to insurance sales.

Real estate brokerage is another retail service community banks would like the opportunity to offer to our customers. Therefore, ICBA is disappointed that Congress has repeatedly used the appropriations process to block the Treasury from finalizing the proposed regulation to allow financial holding companies and financial subsidiaries of national banks to engage in real estate brokerage and management. We believe that GLB provides the Treasury and the Federal Reserve full authority to permit these activities. More importantly, these new powers will allow FHCs and financial subsidiaries to better serve customers by increasing choice and decreasing costs. And, it will allow community banks to diversify their sources of income by engaging in a low-risk agency activity analogous to securities and insurance brokerage.

The financial market is rapidly changing and evolving, and it is important for community banks to have the means and opportunity to serve all of their customers' financial needs. Many other entities already offer one-stop shopping for real estate brokerage, mortgage lending, and real estate settlement services. It flies in the face of the GLB Act's fundamental purpose to continue blocking the proposed Treasury/Federal Reserve regulation.

While GLB did not greatly increase retail sales opportunities for community banks, it did make substantial changes in how these sales are conducted today.

Prior to GLB, banks were specifically excluded from the definition of "broker" contained in the Securities Exchange Act of 1934. As a result, banks could engage in securities sales activities and did not have to be concerned about registering as a broker with the SEC. With the enactment of GLB, banks are excluded from the definition of 'broker" only to the extent that their securities sales activities fall into one or more of the eleven statutory functional exceptions. Each of these exceptions permits a bank to act as an agent with respect to specified securities products or in transactions that meet specific statutory conditions. In particular, Section 3(a)(4) of the Exchange Act provides conditional exceptions from the definition of broker for banks that engage in third party brokerage arrangements; trust and fiduciary activities; permissible securities transactions; certain stock purchase plans; sweep accounts; affiliate transactions; private securities offerings; safekeeping and custody activities; municipal securities; and de minimis transactions.

In 2001, the Commission adopted interim final rules designed to provide banks with guidance regarding the GLB by defining certain key terms used in the new statutory exceptions. These interim final rules were suspended after the trade associations and members of the banking industry expressed serious concerns about the complexity and regulatory burden of the new rules and the negative impact they would have on banks' ability to engage in traditional banking activities such as trust, fiduciary and custody activities.

On June 17, 2004, after discussions with representatives of the industry, the SEC published new proposed rules (with comments due in August). These new rules, which are 228 pages long, are designed to define and clarify a number of the statutory exceptions from the definition of "broker" in GLB.

Although ICBA is pleased that the SEC has modified its original proposal made in 2001 – particularly with respect to the definition of what is considered a "nominal" fee under the network exemption and raising the small bank threshold to $500 million under the custody exception – ICBA still is concerned about the overall complexity of the proposed rules. The regulatory burden on community banks is already significant and these rules will just add to that burden by requiring community banks to adopt compliance programs to ensure that they comply with one of the complex exceptions under the regulations. The SEC should make an effort to simplify the proposed rules, particularly with regard to the trust and fiduciary activity exemption.

The banking agencies have long since finalized the consumer protection regulations regarding the retail sale of insurance required under GLB. Like so many consumer disclosures, these regulations – which closely follow the legislative language – require far more information than consumers are prepared to absorb as they complete a financial transaction. Even more troubling, the disclosures are often irrelevant. For example, we must give all new insurance customers a disclosure that informs them that the insurance product they are inquiring about is not a deposit, not guaranteed by the bank, not insured by the FDIC, and may go down in value. This disclosure must be given even if the insurance product has no investment risk. In fact, none of the products that my agency sells have investment risk. I have seen the dumbfound look on my customers' faces when they have been told that their auto policy or their crop insurance is not a deposit and may go down in value, followed by their look of concern when we inform them that their insurance is not guaranteed. If the customer inquires about insurance over the telephone, we must make these disclosures orally and then follow up with written disclosures. And we need for them to sign the disclosure document and retain it in our file. The end result is a waste of time, paper, and postage and puts us at a competitive disadvantage to other insurance agencies in my community that are not housed within a bank office. ICBA urges Congress to ask the agencies to recommend specific changes in GLB to streamline and simplify these disclosures, while maintaining adequate consumer protection.

Increased financial conglomeration of the kind permitted under GLB has had a mixed competitive effect on community banks. Some report that insurance companies like State Farm (which bought a thrift while GLB was moving through Congress) present stiff competition by offering extremely attractive rates on deposits. Others report an opposite effect; some new financial conglomerates turn their attention away from traditional banking, opening up competitive opportunities for community banks. Still others report little direct effect at this time.

Privacy

GLB requires financial institutions to provide annual notices regarding their privacy policies to each of their customers. Many community bankers view the annual privacy notice as ineffective and unnecessary. They have become another example of the disclosure blizzard that has done little more than confuse and burden consumers with pages of incomprehensible legalese.

Most community banks do not share their customers' financial information with outside marketing companies and the like. They share information with vendors like check printers and data processors that use it strictly to help the bank provide essential services. Therefore, ICBA recommends that Congress amend GLB to allow these institutions to provide a short statement to that effect printed on the customer's bank statement.

In addition, community banks – and doubtless many other financial institutions – maintain consistent privacy policies from year to year. These institutions should have the option not to deliver the annual notice unless they have changed their privacy policy. Not only would this relieve them of a costly paperwork burden, it would make it more likely consumers would pay attention to the notices. The current requirement that banks furnish all customers with an annual privacy notice actually has a very serious unintended consequence: it encourages customers to disregard the information that is provided, making them increasingly less likely to pay heed to notices.

These notices are particularly pointless for my bank and our customers, since North Dakota has such restrictive privacy laws that the federal requirements are a moot point. Yet we are required to mail thousands of privacy notices to our customers every year just to tell them that we will not break the law. It is this type of unnecessary burden that is driving community banks to sell out, often times leaving the very consumer that these laws are meant to protect with fewer choices for financial services.

Conclusion

I would again like to compliment the Committee on holding this oversight hearing on the Gramm-Leach-Bliley Act. Most of the benefits we anticipated have been borne out, especially with regard to the FHLBank System (although more must be done to implement the community financial institution provisions regarding use of advances for agriculture and small business lending). The Act successfully closed the unitary thrift loophole, but a new one – the ILC loophole – is emerging as an important threat. The Act has led to increased concentration, though has provided some limited new opportunities for community banks to offer insurance products. The impact of the securities push-out provisions on community banks will depend on the final rule expected to be issued by the SEC later this year. Finally, Congress should streamline the privacy notice provisions and will need to continue its oversight efforts if states seek to impose their own privacy restrictions.

Thank you again for this opportunity to testify.