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January 31, 2008

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

RE: Part 363 – Annual Independent Audits and Reporting Requirements

Mr. Feldman:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking, *Annual Independent Audits and Reporting Requirements* (the proposal). ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

The proposal addresses a number of topics, including: (1) requiring management and the independent public accountant to identify the internal control framework used to evaluate internal control over financial reporting and disclose all identified material weaknesses; (2) extending the time period for a non-public institution to file its Part 363 Annual Report by 30 days and replacing the 30-day extensions of the filing deadline that may be granted if an institution (public or non-public) is confronted with extraordinary circumstances beyond its reasonable control with a late filing notification requirement that would have general applicability; (3) providing relief from the annual reporting requirements for institutions that are merged out of existence before the filing deadline; (4) providing relief from reporting on internal control over financial reporting for businesses acquired during the fiscal year; (5) requiring management's assessment of compliance with designated safety and soundness laws and regulations to state management's conclusion regarding compliance and disclose any noncompliance with such laws and regulations; (6) clarifying the independence standards with which independent public accountants must comply and enhance the enforceability of compliance with these standards; (7) specifying that the duties of the audit committee include the appointment, compensation, and oversight of the independent public accountant; (8) requiring audit committees to ensure that audit engagement letters do not contain unsafe and unsound limitation of liability provisions and requiring institutions to file copies of these letters; (9) requiring certain communications by independent public accountants to audit committees and establishing retention requirements for audit

working papers; (10) requiring boards of directors to adopt written criteria for evaluating an audit committee member's independence and providing expanded guidance for boards of directors to use in determining independence; (11) requiring the total assets of a holding company's insured depository institution subsidiaries to comprise 75 percent or more of the holding company's consolidated total assets in order for an institution to comply with part 363 at the holding company level; and (12) providing illustrative management reports to assist institutions in complying with the annual reporting requirements.

We continue to have significant concerns about regulatory burdens relating to Part 363 (as well as Section 404 of the Sarbanes Oxley Act of 2002) on banking institutions. Although many of the changes appear to be sensible accommodations or minor adjustments to requirements under the current rules of 12 CFR Parts 308 and 363, they can still impose costly and unnecessary burdens on some banking institutions, especially non-public institutions. We urge the FDIC to continue to work with industry to help lighten the load of regulation on all banking institutions, including non-public banking institutions.

Below are our comments on some specific changes and opportunities for regulatory burden relief.

Independence of the External Auditor
We are concerned that the past and proposed rules related to auditor independence could cause problems in practice for banking institutions in smaller communities. Prior to this proposal, banks were required to utilize auditors that were independent under the rules of the SEC and the AICPA. This definition, along with the proposed addition of a third set of independence rules—those of the PCAOB—could be problematic for some community banks, because: (1) the banks may not have ready access to multiple audit firms that satisfy all three sets of independence rules and have experience in auditing banking institutions, and (2) it creates a third set of standards that may need to be reviewed on a regular basis by the banking institution in order to determine whether its auditor meets the independence test in a situation where a single set of rules may be acceptable. In order to address this issue, the FDIC should describe in the rules the FDIC's ability to ease the rules in cases where these restrictions can cause problems or impose significant costs or regulatory burdens. Some relief could also be supplied by requiring that the auditor meet an either/or test. For example, the auditors meet at least one of the independence definitions. Public banks are already expected to use firms that satisfy the SEC/PCAOB independence rules by the SEC. Nonpublic banks would then be relieved from having to monitor all changes in the three sets of definitions.

Independence and Responsibility of the Audit Committee
FDIC Regulation 363.5 and its accompanying Appendix A Guidelines and Interpretations 27 through 35 provide the regulatory requirements and guidelines for the audit committee of a bank board of directors. Among other things, the proposal amends the regulation and Appendix sections to specify in more detail the composition and duties of the audit committee, as well as what constitutes "independent of management." We take this opportunity to comment not only on the proposed amendments, but also on existing aspects of the Appendix sections.

We commend the FDIC for revising the guidelines in a number of places. In particular, we support the change to (b)(1) so that a bank need only look back three years to consider whether a member is disqualified for serving as a consultant, advisor, promoter, underwriter, legal counsel, or trustee of the institution or its affiliate. This amendment provides more flexibility for finding suitable independent directors, especially for institutions located in less populated places. We also support the creation of a one-year transitional period, under proposed Appendix A section 35, for banks whose assets recently exceeded $1 billion or $3 billion to adjust their audit committees to the requirements of 363.5(a)(2) and 363.5(b).

Under amended Appendix A section 27, an audit committee should keep written criteria for assessing existing and potential audit committee members, as well as minutes that document the results and basis for the assessment. We question the need to dictate the nature and extent of the minutes kept by the audit committee. Banks must carefully balance legal and regulatory considerations to satisfy the banking examiners in terms of recordkeeping, yet protect the institution from unnecessary legal exposure and public disclosure of personal information about directors. As an alternative, we suggest that bank audit committees be allowed to survey their existing and potential members for the "independent of management" criteria. This survey would be available for examiner inspection, but kept out of the official documentation of the board.

Amended Appendix A section 28 incorporates many of the existing interpretations and adds a great many more to the definition of "independent of management." We are concerned about amended section 28(a) that has been carried over from existing section 29. Under this subsection, a director holding more than 10% of voting stock would not be considered independent. We question the need for shareholders of closely-held companies, such as family-owned institutions, that have more than $1 billion in assets to be prohibited from sitting on the audit committee. These companies frequently have very few shareholders, yet these shareholders have a great loyalty and interest in serving the institution and could, by virtue of their training and experience, add value to the audit functions of the board. We would support further flexibility for institutions in these circumstances.

Under amended section 28(b)(4), we recommend that the FDIC raise the compensation limitations from $60,000 to $100,000. Such an amendment would align the requirement with NASDAQ Rule 4200 and avoid confusion over inconsistent thresholds. We also question the meaning of "financial services" in the limitation on "indirect compensation." Do "financial services" include computing services and check printing? In addition, we question the need for the "indirect compensation" limitation given all of the other independence requirements, including section 28(b)(6), the interlocking directors limitation. All of these new limitations should address any concerns of the FDIC about potential conflicts of interest with outside entities.

Amended section 28(b)(7) would prohibit, for purposes of independence, any director's employer to receive or pay more than $200,000 or 5% of the gross revenues of the employer. We strongly recommend that the FDIC carve out from

the definition of "payment" loans and other services extended to directors in the ordinary course of business of the bank. Such a carve-out would align the guidelines with the New York Stock Exchange and NASDAQ listing requirements. In addition, the $200,000 or 5% of gross revenues test should be measured against the *recipient* of the payment, and not always against the outside employer. Under our recommended changes, interest payments made on loans would be subject to the quantitative test, but not payments for the loan principal or the initial loan itself. Lastly, we urge the FDIC to include a carve-out from the definition of "payment" for payments arising solely from investments in the bank's securities (e.g., dividend or interest payments) or payments made under non-discretionary charitable contribution matching programs.

Extension of Filing Deadlines for Nonpublic Banks
We commend the FDIC's proposal to extend the filing deadline for nonpublic banks' Part 363 Annual Reports. In many cases, these nonpublic institutions are utilizing the same auditors as their public counterparts, and because of the timing pressures for public institutions, it can be difficult for nonpublic institutions to receive timely services. The additional 30 days will help to ensure that auditors are able to devote sufficient resources to the nonpublic engagements and will provide nonpublic banking institutions with the additional time needed to comply with the filing requirements.

Filing Engagement Letters
The proposed rules would require that banks file their signed audit engagement letters with the appropriate regulator within 15 days of signing. We understand that the purpose is to allow regulators to review for possible language that would limit auditor liability. If the proposed rules are also going to require that the audit committee monitor for this language, then we recommend that the submission of the engagement letters not be required for these reasons: (1) this imposes a deadline that is no longer necessary, (2) it unnecessarily adds to paperwork and compliance burdens with little or no additional benefit, since the audit committee will be responsible for the appointment and oversight of the audit firm, and (3) in the relatively rare instances where the FDIC might not be satisfied with the language, even with the monitoring by the audit committee, then it could be raised on exam.

Illustrative Management Reports
The proposal provides examples of management reports to facilitate the preparation of the reports by management. The proposal indicates that the exact language in the examples will not be required, and it is important that the FDIC make this clear in the final rule to avoid misinterpretation by public accounting firms.

Specific Questions from Proposal
The proposal also includes two specific questions on the application of the new rules, which we have addressed below:

1. As proposed, the rule would require management's assessment of compliance with designated safety and soundness laws and regulations to include a clear statement as to management's conclusion regarding compliance and disclose any noncompliance with such laws and regulations. The designated

safety and soundness laws and regulations relate to loans to insiders and dividend restrictions. Management's assessment of compliance is included in the management report within the Part 363 Annual Report, which is available for public inspection. Should the disclosure of instances of noncompliance with these designated laws and regulations be made available for public inspection or should the FDIC designate such disclosure as privileged and confidential and not available to the public?

The proposal retains the existing requirement that management of insured depository institutions annually assess and report on their institution's compliance with designated safety and soundness laws and regulations. However, the proposal elaborates on this obligation, requiring: "The assessment must state management's conclusion as to whether the insured depository institution has complied with the designated safety and soundness laws and regulations during the fiscal year and disclose any noncompliance with these laws and regulations." In light of this proposed new requirement, the FDIC has requested comment on whether such management assessment should be made available for public inspection or designated as privileged and confidential.

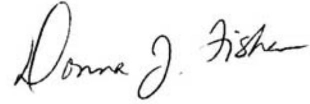
The disclosure of instances of noncompliance with these designated laws and regulations should not be made public. The FDIC has the ability to address any instances of noncompliance more appropriately through prudential oversight via exam and discussion between regulators and banks. Public availability of detailed information may result in unintended consequences, particularly if the exceptions are based on minor oversights. Furthermore, if such information were discovered during a safety and soundness examination, it would be considered a confidential and nonpublic part of the examination report. For these reasons, the FDIC should exercise its right to designate these disclosures as privileged and confidential, and the proposal should be expressly modified to provide this protection.

2. As proposed, the rule would require the total assets of a holding company's insured depository institution subsidiaries to comprise 75 percent or more of the holding company's consolidated total assets as of the beginning of its fiscal year in order for an institution to comply with part 363 at the holding company level. The holding company could be the institution's top-tier or any mid-tier holding company that meets the 75 percent threshold. Considering the costs and benefits of a threshold, is 75 percent or more of consolidated total assets an appropriate threshold? If not, what would be an appropriate threshold to use for compliance with part 363 at a holding company level?

It appears that this part of the proposal attempts to ensure that in order to comply at the holding company level rather than at the individual bank level, a sufficient portion of the total assets of the holding company must consist of insured institutions' assets. The goal appears to be reasonable; however, we are not certain as to whether the proposed percentage (75%) is appropriate. There may be factors that should be considered in individual cases prior to coming to this conclusion. Rather than select an arbitrary figure such as 75%, we recommend that the FDIC lower the threshold and require consultation with the FDIC prior to reporting at the holding company level if the percentage is below the threshold. This recommendation presumes that a fairly small percentage of banking institutions would fail the threshold test and would not result in significant burdens to the FDIC or the industry.

Thank you for you consideration of our comments, and please contact Charles Gilman, at 202-663-4986, to discuss. Please contact Phoebe Papageorgiou, at 202-663-5053, with questions on independent directors of audit committees.

Sincerely,



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