Statement of William A. Loving, Jr.

on behalf of the
Independent Community Bankers of America

before the

Advisory Committee on Smaller Public Companies

of the

Securities and Exchange Commission

New York, June 17, 2005

Statement of William (Bill) A. Loving, Jr., Executive Vice President and Chief Executive Officer of Pendleton County Bank on behalf of the Independent Community Bankers of America

Good morning. My name is Bill Loving, and I am Executive Vice President and Chief Executive Officer of Pendleton County Bank in Franklin, West Virginia. I am representing the Independent Community Bankers of America, a trade association with approximately 5,000 community banks and bank holding companies many of which are publicly held companies. I appreciate the opportunity to address you today concerning ways to scale securities regulations for smaller public companies to assure that the costs and burdens of the regulations are commensurate with the benefits to investors and the public.

Community Banks like Mine Should Not be Subject to the Exchange Act and Sarbox

Pendleton County Bank was chartered in 1925 in Marlinton, West Virginia and moved to Franklin in 1937 after the failure of that town's two banks during the Great Depression and after the Franklin community requested the move. Since 1937, Pendleton County Bank has grown to its present size of $165 million due to the strong support it has received from its surrounding community. Pendleton County Bank is a wholly owned subsidiary of Allegheny Bancshares, Inc. whose stock is not listed on any exchange.

Like many publicly held community banks, Allegheny Bancshares together with its subsidiary, Pendleton County Bank, is a good example of a publicly held company that should not be subject to the reporting requirements of Section 12 of the Securities and Exchange Act and to all the regulatory burdens of Sarbanes-Oxley Act of 2002 (Sarbox). Allegheny Bancshares has 653 registered shareholders the majority of which reside in or are related to residents of Pendleton County. With 53 employees and three branches, it is a severe strain for our bank (or bank holding company) to comply with all the reporting and disclosure requirements of the Exchange Act. This will particularly be true next year when our bank becomes subject to the internal control attestation requirements of Section 404 of Sarbox. Our accountant has estimated that our external audit costs could rise as much as 50% because of the new Sarbox requirements.

Already, we have spent about $40,000 in consultancy and outside vendor costs, $10,000 in training and education, and have incurred approximately 160 internal staff hours to

comply with Sarbox. We anticipate an additional 1600 staff hours to get ready for next year's Section 404 requirements. The costs of the testing alone will be approximately $50,000, not including internal staffing costs and additional external audit costs. Additionally, due to the complexity of the new law, we have added one (1) additional senior management employee to coordinate and oversee the project. This is far too much time and money for our community bank to afford. However, based on ICBA's recent survey of community banks concerning the costs of complying with Section 404, our costs are lower than what many other community banks have experienced. ICBA's survey indicated that the average community bank will spend more than $200,000 and devote over 2,000 internal staff hours to comply with Section 404.

Our bank has considered going private to avoid these costs. However, considering the small community where our bank is located--Franklin, West Virginia has a population of less than 1,000 and Pendleton County's population is only 8,000-- it would be a significant loss both to our community and to the bank's reputation if our bank were to go private and repurchase most of its stock or participate in a reverse stock split—a process that forces out shareholders below a certain level of ownership. Many of our local residents, who have taken pride in their ownership of the bank, would cease to own a share of stock in one of the few publicly held companies in the county. Not only would this be costly to our bank, it would be a devastating blow to the reputation and image of the community and to many of the stockholders/customers of the bank who have supported the bank since its establishment.

Update the Registration Threshold Under the Exchange Act

In my opinion, the best way to scale the securities regulations so that the costs and burdens are commensurate with the benefits to investors and the public is to update and increase the registration threshold under the Exchange Act so that smaller companies like Pendleton County Bank are not subject to the burdensome reporting and disclosure requirements of that law. Generally, domestic companies that have over $10 million in assets and over 500 shareholders must register as public companies with the SEC pursuant to Section 12 of the Securities and Exchange Act.[1] Once registered, a public company is subject to all the reporting requirements under that law including the new reporting requirements of Sarbox. This standard has not changed since 1964 except that the asset level was increased by a factor of ten, or from $1 million to $10 million in 1996. The Commission noted in 1996 that the "increase in the asset threshold is not inconsistent with the public interest or the protection of investors…" and that it intended to update the 500 shareholder requirement at a later date.

Certainly, this standard is due for a change. A community bank like Pendleton County Bank with assets of $165 million might have been considered a medium sized bank in 1964. But that is not the case anymore. If you divide total banking assets in the United States by the total number of commercial banks and thrifts, the average size bank in the United States today is about seven times the size of Pendleton County Bank or about $1.1 billion in assets which places Pendleton well into the small bank category.

[1] 15 U.S.C. Section 78a

Furthermore, just in terms of inflation, the dollar today is worth over six times what it was worth in 1964. Stated another way, the market value of what 500 shareholders would hold in 1964 would be equivalent to what 3,000 shareholders would hold in 2005. **ICBA recommends that the 500-shareholder requirement under Section 12 of the Exchange Act be increased to 3,000 to reflect the increased size of companies and the increased value of the dollar. ICBA also recommends that Sections 12(g)(4) and 15(d) of the Exchange Act be updated so that the threshold for de-registration is increased from 300 shareholders to 1800 shareholders.**

Exempting community banks like Pendleton County Bank from the Exchange Act would substantially reduce the regulatory costs of those banks without adversely impacting the investor or the public. Our bank's stock is very thinly traded and has few institutional holders. Furthermore, our shareholder base has grown to over 500 shareholders not because of mergers or other public offerings of our stock but because successive generations of our original shareholders have distributed their stock holdings among their descendants. To stay current, our shareholders do not need the kind of instantaneous access to information that an institutional investor may need for a Fortune 500 company. For instance, our stockholders don't need us to file a Form 8-K within four days of the event and immediately disclose when, for instance, a bank director resigns from the Board or our bank changes its bylaws as Sarbox now requires. Not only are they burdensome, many of the new Sarbox disclosure requirements are unnecessary for smaller companies like Pendleton County Bank and provide few benefits to investors.

Furthermore, banks as regulated entities are subject to disclosure requirements under federal and state banking laws including the filing of lengthy Call Reports (e.g., Reports of Condition and Income) on a quarterly basis with their federal supervisory banking agency. With the completion of the Call Report Modernization Project at the end of this year, the public will be able to access this Call Report data concerning banks almost instantaneously after the reports are filed with the banking agencies. Although the Call Report is a financial snapshot of the bank and is not consolidated with the holding company, in many instances this data is all that is needed by a community bank investor. Many community banks operate like Pendleton County Bank and have holding companies where the majority of the assets are held at the subsidiary level and the holding company has few, if any, assets other than the stock of its subsidiary.

Community Banks With Less Than $1 Billion in Assets Should be Exempt from Section 404

The regulatory burden of the securities laws could also be reduced for smaller companies if community banks and bank holding companies with less than $1 billion in assets were exempted from the Section 404 requirements of Sarbox. Banks have been subject to the internal control attestation requirements of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) since 1991[2]. Those requirements exempt banks with assets

[2] FDICIA amended Section 36 of the Federal Deposit Insurance Act (12 U.S.C. 1831m). All insured depository institutions that have assets of $500 million or more, whether or not they are public companies, are subject to the provisions of Section 36 of the Federal Deposit Insurance Act and the FDIC's

of less than $500 million because federal banking regulators recognize that internal control reporting and attestation requirements for community banks would be unduly burdensome, particularly since these banks are subject to the full scope of banking laws and regulations, are required to have an adequate internal control structure in place, and, most importantly, are subject to regular safety and soundness examinations. The FDIC is currently considering raising the FDICIA threshold so that banks with assets of less than $1 billion would be exempt from the internal control attestation requirements of Section 36 of the Federal Deposit Insurance Act. New rules under FDICIA may be issued as early as this summer. We encourage the Advisory Committee to consider a similar exemption for community banks from Section 404 of Sarbox.

ICBA's recent survey of publicly held community banks (which was discussed in more detail in ICBA's initial comment letter filed with the Advisory Committee) indicate that Section 404 is a major financial burden to community banks and that the average community bank will be spending more than $200,000 and devoting over 2,000 internal staff hours to comply with Section 404. Community banks are convinced that the costs of Section 404 compliance significantly outweigh any benefits to their companies or their internal control processes. Furthermore, time devoted to Section 404 compliance is diverting management from its duties of running a bank. We urge the Committee to review the costs and time involved with implementing Section 404 for smaller companies and to make recommendations to reduce those costs.

Scale Auditing Standard No. 2 to the Complexity of the Company

ICBA commended the Public Company Accounting Oversight Board for its recent issuance of additional guidance for auditors on how to implement the PCAOB's Auditing Standard No. 2, "*An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*." In ICBA's view, the guidance was a "good step" towards reducing unnecessary costs of internal control audits that are required under Section 404 of Sarbox. The guidance incorporated a number of recommendations that ICBA had previously made such as encouraging auditors to tailor audit plans to the risks facing individual clients, using the work already performed by others in their audits, and engaging in more communication with their clients.

However, ICBA also recommends that application of AS2 be tiered to a company's size and complexity so that community banks are not subject to the same type of internal control testing and auditing as large institutions. AS2 is still too much of a one-size-fits-all standard. Smaller companies should not have to comply with the same standard of complex internal controls that are used for larger companies. The complexity of AS2 together with the market domination of the Big Four accounting firms has also driven up the costs of internal control audits for smaller companies. As the Big Four

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implementing regulations and guidelines (12 CFR Part 363). Section 36 and Part 363 require an annual management report, and impose annual auditing and attestation, and audit committee requirements on covered depository institutions. Part 363 allows the holding company of a covered insured depository institution to fulfill these requirements for the institution. In addition, the FDIC's implementing guidelines reference and incorporate the SEC's requirements and interpretations concerning auditor independence.

accounting firms drop their smaller companies as clients, smaller companies are having a more difficult time finding audit firms that have the expertise to understand and apply the complex standard. We believe that a less complex AS2 for smaller companies would eventually result in lower audit costs and reduce some of the internal costs associated with complying with Section 404.

Revise the Definition of an Accelerated Filer

For many of ICBA's members that qualify as "accelerated filers," filing on an accelerated basis presents an undue burden. The complexity of today's accounting standards, the volume of disclosure requirements, and the new Section 404 requirements create an immense amount of work for the staffs of smaller public companies and particularly for community banks. Completing all the work that needs to be done to file a Form 10-K within the standard time frame of 90 days after year-end and for filing a form 10-Q within 45 days after quarter-end is very difficult. Compressing this work into shorter periods increases costs to smaller public companies by (a) forcing them to increase their accounting staffs and (b) limiting the time that management can devote to their business during the periods before the periodic reports are due. For publicly held community banks and bank holding companies that are "accelerated filers", the work is even more substantial since they have to file lengthy Call Report data with bank regulators within 30 days of the end of a quarter.

ICBA recommends that the SEC raise significantly the $75 million public float threshold in Exchange Act Rule 12b-2 that subjects an issuer to accelerated filing requirements. In connection with the *Securities Offering Reform* proposal[3], the SEC 's Office of Economic Analysis performed a study in which it identified issuers with wide market following. The study indicated that the market capitalization level at which issuers become widely followed is $700 million and that companies with market capitalization of $700 million or more account for about 95% of U.S. equity market capitalization. This study supports increasing the $75 million market capitalization threshold to a level close to $700 million. At the current level of $75 million, the costs of meeting the accelerated filing deadlines is burdensome and exceeds any benefit to investors.

ICBA also recommends that the SEC not proceed with the further acceleration of filing deadlines as currently scheduled for accelerated filers but retain the filing deadlines in effect this past year (e.g., 75 days for annual reports and 40 days for quarterly reports). The 60-day deadline for 2005 annual reports and 35 days for quarterly reports will place undue stress on internal accounting departments of small companies with few corresponding benefits to investors.

[3] Release No. 33-8501

Revise the Definition of "Small Business Issuer" under Regulation S-B

To qualify as a "small business issuer" under SEC Regulation S-B, a company must have revenues and a public float of less than $25 million. **ICBA recommends that the thresholds for qualifying as a "small business issuer" under Regulation S-B be increased.** These thresholds were set when Regulation S-B was adopted in 1992. Given the explosive growth of the stock market, the current size of companies, and the inflation that has occurred since that time, it would be appropriate for the SEC to raise these thresholds.

ICBA also recommends that the SEC analyze the effectiveness of Regulation S-B for smaller public companies. While Regulation S-B does reduce disclosures for smaller companies, there is still not a significant enough difference between Regulation S-B and Regulation S-K. We recommend that the Regulation be revised so that it would more substantially streamline the disclosure process for smaller companies.

Conclusion

In conclusion, I appreciate the opportunity to present to the Advisory Committee ICBA's recommendations for scaling the securities regulations so that the costs and burdens of the regulations are commensurate with the benefits to investors and the public. As has been discussed, ICBA's recommendations include:

- Updating and increasing the registration threshold under the Exchange Act to 3,000 so that smaller companies like Pendleton County Bank are not subject to the burdensome reporting and disclosure requirements of that law;
- Establishing an exemption level of at least $1 billion for community banks with respect to the internal control attestation requirements of Section 404;
- Scaling the application of AS2 to the complexity and size of a company;
- Revising the definition of "accelerated filer" in Exchange Act Rule 12b-2 by substantially raising the $75 million market cap threshold;
- Revising the definition of "small business issuer"; and
- Analyzing the effectiveness of Regulation S-B with the objective of revising it so that it more substantially streamlines the disclosure process for smaller companies**.**

As Executive Vice President and Chief Executive Officer of a community bank subject to the disclosure requirements of the Exchange Act and Sarbox, I am concerned about the regulatory burden that is facing community banking. The time and effort taken by regulatory compliance diverts resources away from customer service. Even more significant, the crushing weight of regulatory burden is causing many community bankers to seriously consider selling or merging with larger institutions, taking the community bank out of the community. I urge the Advisory Committee to recommend to the SEC ways to relieve community banks like Pendleton County Bank from the regulatory burden of Sarbox and other securities laws and regulations. Thank you again for this opportunity to testify.