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Statement of

John E. Bowman, Chief Counsel  
Office of Thrift Supervision

concerning

**Regulatory Burden Relief**

before the

Committee on Banking, Housing, and Urban Affairs  
United States Senate

June 22, 2004

Office of Thrift Supervision  
Department of the Treasury

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**I. Introduction**

Good morning, Mr. Chairman, Ranking Member Sarbanes, and members of the Committee. Thank you for the opportunity to discuss the regulatory burden relief initiatives of the Office of Thrift Supervision (OTS). It is always important to remove unnecessary regulatory obstacles that hinder profitability, innovation, and competition in our financial services industry. I particularly want to thank Senator Crapo for his leadership in this area. We look forward to working with the Senator and his staff on legislation to address the issues we discuss today.

Our highest priority items for regulatory burden relief legislation are:

- Removing the continuing disparate treatment of thrifts under the federal securities laws by providing thrifts the same exemptions as banks with respect to the investment adviser and broker-dealer activities that each conducts on otherwise equal terms and substantially similar authority.
- Increasing commercial lending limits for federal thrifts to enhance their ability to diversify and to provide small and medium-sized businesses greater choice and flexibility in meeting their credit needs.
- Amending the International Lending Supervision Act of 1983 (ILSA) to support equal representation for OTS on the Basel Committee and to extend ILSA to thrifts to promote consistency in supervising the foreign activities of insured institutions.

I will explain each of these in more detail and describe several other initiatives that we are recommending for enactment.

## II. Revising the Federal Securities Laws to Treat Thrifts and Banks Equally

OTS's most important regulatory burden reduction legislative priority is revising the federal securities laws so that thrifts and banks are treated equally with respect to their investment adviser and broker-dealer activities. As described more fully below, this involves exempting thrifts from the investment adviser and broker-dealer registration requirements to the same extent as banks are exempt under the Investment Advisers Act (IAA) and the Securities Exchange Act of 1934 (1934 Act).

Although the SEC has issued several proposals purportedly to address the inequitable treatment of thrifts, the application of the federal securities laws remains anything but charter neutral. Significant disparities remain under the IAA, with thrifts subject to an entirely duplicative SEC oversight regime. Equally significant, in a proposal released to the public last week,<sup>1</sup> the SEC indicated that it would roll back an interim rule that had extended equal treatment to thrifts vis-à-vis banks for purposes of the broker-dealer exemption. Clearly, this is not heading in the direction of charter neutrality between banks and thrifts with respect to the application of the federal securities laws.

Underscoring the case for charter neutrality is the fact that banks and thrifts provide the same investment adviser, trust and custody, third party brokerage, and other related investment and securities services in the same manner and under equivalent statutory authorities. With respect to the oversight and regulation of these activities, OTS examines investment and securities activities of thrifts the same way as the Office of the Comptroller of the Currency (OCC) and the other federal banking agencies examine the same bank activities—with thrift and bank customers equally well-protected.

To avoid the regulatory burden and substantial costs of this duplicative regulatory structure, some previously OTS-regulated thrifts have converted to banks (or to state chartered trust companies) to take advantage of the bank registration exemption. In addition, some institutions have avoided opting for a thrift charter in the first place because of the SEC registration requirements. The different purposes of the various banking charters make our financial services industry the most flexible and successful in the world. While OTS strongly supports charter choice, that decision should be based solely on the merits of the charter—by choosing a charter that fits a particular business strategy—not on

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1. SEC Proposed Rule: Regulation B, Release No. 34-49879, approved by the Commission on June 2, 2004, and released to the public on June 17, 2004.

unrelated and extraneous factors such as registration requirements and avoiding duplicative regulation under the federal securities laws.

The existing inequity under the federal securities laws undermines our collective efforts to maintain a strong and competitive banking system. Eliminating the unnecessary costs associated with the IAA and 1934 Act registration requirements would free up significant resources for thrifts in local communities. It would also avoid the regulatory burden and substantial costs associated with a duplicative regulatory structure that has already dictated some institutions' charter choice—an issue recognized by Chairman Donaldson in the context of the discussion on the SEC's IAA proposal.<sup>2</sup>

### **A. Investment Adviser Registration**

Prior to enactment of the Gramm-Leach-Bliley Act (GLB Act) in 1999, banks—but not thrifts—enjoyed a blanket exemption under the IAA. While the GLB Act slightly narrowed the bank exemption, banks may still provide investment management and advisory services to all types of accounts without registering as an investment adviser. The one exception is that a bank (or a department of the bank) must register when it advises a registered investment company, such as a mutual fund.

On May 7, 2004, the SEC issued a proposal providing a narrow exemption from IAA registration to thrifts that limit their investment management and advisory services to a limited range of accounts. Under the proposal, thrift fiduciary accounts are segregated into two categories. Thrifts that provide services to accounts that include only traditional trust, estate, and guardianship accounts will be exempt from registration. Thrifts providing services to accounts that include investment management agency accounts and other accounts that the SEC has defined as not being for a fiduciary purpose will be required to register as an investment adviser.

The practical effect of this approach is that it provides an extremely limited exemption that is beneficial to few thrifts. This fact was made clear to the SEC Commissioners at a meeting on April 28 when the SEC staff advised the Commissioners that none of the thrifts currently registered under the IAA—there are 47 thrifts currently registered—would be able to take advantage of the

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2. Comment of SEC Chairman William Donaldson, at the April 28, 2004, SEC meeting discussing SEC Proposed Rule: Certain Thrift Institutions Deemed Not To Be Investment Advisers, Release Nos. 34-49639 (May 3, 2004).

proposed exemption since all provide advisory services for both account categories.

While the SEC applies the federal securities laws in two different manners depending on the business operations of a thrift, there is no distinction between these two categories of accounts under the HOLA and OTS regulations applicable to thrifts. The accounts in both categories are fiduciary accounts that receive the same protections under the HOLA and OTS regulations and are subject to similar examination scrutiny. There is no logical basis why thrifts, unlike banks, need duplicative regulatory oversight by the SEC of account activities that OTS already supervises and examines. This is far from functional regulation, but rather over-regulation that accomplishes nothing in the way of a legitimate policy objective.

Thrifts registering as investment advisers have indicated to OTS that registration costs are substantial. IAA costs include registration fees, licensing fees for personnel, and audit requirements, as well as the many hours management must devote to issues raised by duplicative SEC supervision, examinations and oversight. Costs related to legal advice for IAA registration are also a factor. An informal survey of most of our largest IAA-registered thrifts shows aggregate annual costs ranging from \$75,000 to \$518,200.

Limiting the types of accounts for which a thrift may provide investment management and advisory services to avoid IAA registration has the likely effect of negating any meaningful exemption. Generally, institutions will not opt to enter the trust and asset management business line and then decide to forego the most profitable aspects of the business activity. In fact, from a safety and soundness standpoint, we would have to question the rationale behind such an approach. Thrifts providing investment management and advisory services should be encouraged to do so to the fullest extent practicable and without concern for arbitrary triggers that could significantly increase their compliance costs and supervision. This is particularly important from a regulatory burden reduction perspective when you consider that a bank competitor will incur none of the regulatory costs and burdens as a thrift for engaging in exactly the same activities.

In addressing this issue, it is important to recall that in July 2000 an amendment was offered by Senator Bayh to extend the IAA exemption to thrifts so that thrifts and banks could compete equally in the provision of investment management and advisory services. As the Senator and others on the Committee may recall, the SEC represented to the Committee that legislation was not needed to resolve this problem since the SEC would be able to resolve the issue by

regulation.<sup>3</sup> Four years later the issue remains unresolved with virtually no likelihood of this changing given that the SEC's recent proposal will provide no relief to existing IAA-registered thrifts. This fact, alone, underscores why nothing short of a legislative solution is adequate to resolve this issue going forward.

While OTS will submit a comment letter to the SEC on why the proposed IAA rule is flawed, after much discussion for several years between OTS and the SEC staff, we have made virtually no headway toward a mutually satisfactory solution. We have no reason to believe that a comment letter outlining all of the discussions that we have already had with the SEC staff will sway the SEC's position on this issue. This further underscores the need for legislation such as the provision set forth at section 201 of H.R. 1375, the regulatory burden reduction bill passed by the House in March of this year.

## **B. Broker-Dealer Registration**

Banks—but not thrifts—enjoyed a blanket exemption from broker-dealer registration requirements under the 1934 Act before changes were made by the GLB Act. The GLB Act removed the blanket exemption and permitted banks to engage only in specified activities without having to register as a broker-dealer. All other broker-dealer activities must be “pushed out” to a registered broker-dealer. The SEC issued interim broker-dealer rules on May 11, 2001, to implement the new “push-out” requirements. As part of the broker-dealer “push out” rules, the SEC exercised its authority to include thrifts within the bank exemption. This treated thrifts the same as banks for the first time for purposes of broker-dealer registration. In the interim broker-dealer rule, the SEC recognized it would be wrong to continue disparate, anomalous treatment between thrifts and banks.

The SEC postponed the effective date of the interim rule several times. It published proposed amendments to the interim dealer rule on October 20, 2002 and the final dealer rule on February 24, 2003. The final dealer rule gives thrifts the same exemptions as banks. On June 2, 2004, the SEC approved a new proposed rule governing when a bank or thrift must register as a broker, with comments due by August 1. Based on our preliminary view of the text of the broker rule, which became available June 17, 2004, it appears that the SEC has proposed rolling back the parity it had extended to thrifts in an interim rule that

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3. During deliberations on the Competitive Markets Supervision Act before the Senate Banking Committee in July 2000, Senator Bayh proposed an amendment to extend the IAA exemption to thrifts. As noted in Senator Bayh's statement and subsequent letter to the SEC ([attached](#)), the amendment was withdrawn pending the SEC's offer to resolve the issue by regulation.

granted a blanket exemption from SEC registration requirements to both banks and thrifts until November 12, 2004.

Unlike the SEC's interim broker rule, the new proposal would no longer treat thrifts the same as banks in all respects. Although thrifts would be treated the same as banks for purposes of the 11 statutory activities they may engage in without registering as a broker with the SEC, as provided by the GLB Act, three non-statutory exemptions provided banks would not be extended to thrifts. The SEC describes the three non-statutory exemptions as targeted exemptions that recognize the existing business practices of some banks. We understand that the SEC staff does not believe thrifts are engaged in the exempted securities activities and will only extend relief for thrifts to the securities activities they are currently performing. Based on the information available to us, it appears that thrifts currently engage in some, if not all, of the securities activities covered by the three additional exemptions. Moreover, since the exemptions apply to all banks—whether or not they are currently engaged in one of the exempted activities—this approach is not logical, and OTS will strongly urge the SEC to remove this new disparity.

As was the case in the SEC's investment adviser proposal, in issuing its proposed broker rule, the SEC passed on the opportunity to provide equivalent treatment to thrifts. In both instances, the SEC has proposed to treat thrifts differently than banks in fundamentally important respects. Both of these very recent actions, occurring within the last two months, demonstrate the immediate need for legislative relief to provide equal treatment of banks and thrifts under the federal securities laws.

### **III. Enhancing Small Business and Consumer Lending by Federal Thrifts**

Another OTS legislative priority is enhancing the ability of federal thrifts to meet the small business and other commercial lending needs of their communities by providing businesses greater choice and flexibility for their credit needs. HOLA now caps the aggregate amount of loans for commercial purposes at 20 percent of a thrift's assets. Commercial loans in excess of 10 percent of assets must be in small business loans. OTS supports provisions in H.R. 1375 that remove the current limit on small business lending and that increase the cap on other commercial lending from 10 percent to 20 percent of assets.

There are several reasons why we have concluded that these changes make sense from a policy perspective. First, this will give thrifts greater flexibility to promote safety and soundness through diversification. Additional flexibility, particularly in small business lending, would provide opportunities to counter the

undulations of a cyclical mortgage market. This would enable thrift managers to continue to meet their ongoing customers' mortgage and consumer lending needs, while providing additional resources to manage their institutions safely and soundly. In addition, some thrifts are at or near the current statutory limits and must curtail otherwise safe and sound business lending programs.

This proposal would increase competition for, and the availability of, small business and other commercial loans now and in the future as thrifts develop this line of business. This will be particularly welcome to smaller businesses that have experienced difficulty in obtaining relatively small loans from large commercial banks that set minimum loan amounts as part of their business strategy—a problem that may increase with industry consolidation. Finally, the proposal will also assist businesses that prefer borrowing from entities like thrifts that meet the needs of borrowers with personal service.

In addition to the legislative proposals that OTS has already submitted to the Committee, we are considering submitting an additional item that would eliminate anomalies that exist under HOLA relating to thrift lending authority. Currently, consumer loans are subject to a 35 percent of assets limitation, while there is no limit on loans a thrift may make through credit card accounts, even though the borrower may use the loan for the same purposes. Ironically, consumer loans subject to the 35 percent cap are typically secured loans, whereas credit card loans—subject to no limit—are not secured.

In addition, for purposes of computing qualified thrift investments, a thrift may count 100 percent of its credit card loans, but other consumer loans only count to the extent that these and other categories of loans do not exceed 20 percent of the thrift's "portfolio assets." This restriction is arbitrary, unduly complex, and unique to the thrift industry. It bears no relationship to the relative risks presented by the loans and, in our experience, the existing limit is irrelevant to the safe and sound operation of an institution. Removing this artificial limit would enable thrifts to perform more effectively as the retail institutions their customers need and expect, without impairing safety and soundness.

#### **IV. Amending ILSA to Support Consistency and Equal Representation**

OTS has identified two proposals that we believe will promote greater consistency among U.S. regulators in supervising the foreign activities of insured depository institutions.



### **A. Applying ILSA to Savings Associations**

OTS recommends making federal and state thrifts (and their subsidiaries and affiliates) subject to ILSA on the same basis as other banking institutions. This will eliminate regulatory burden by promoting the uniform supervision of insured depository institutions. OTS is already covered by ILSA along with the other federal banking agencies (FBAs), but thrifts are not. In enacting ILSA, Congress sought to assure that the economic health and stability of the United States and other nations would not be adversely affected by imprudent lending practices or inadequate supervision. A depository institution subject to ILSA must, among other things:

- Establish special reserves necessary to reflect risks of foreign activities; and
- Submit to the appropriate FBA quarterly reports on its foreign country exposure.

The legislative history of ILSA is silent on the international lending activities of thrifts because thrifts were not active in international finance in 1983. While thrifts maintain a predominantly domestic focus—providing credit for housing and other consumer needs within the United States—some thrifts have significant foreign activities. These include investing in foreign currency-denominated CDs, offering foreign currency exchange services, and making loans on the security of foreign real estate or loans to foreign borrowers. In addition, numerous thrift holding companies have international operations (including several foreign-based holding companies) that provide opportunities for expanded international operations by the subsidiary thrift.

While OTS has broad supervisory powers under HOLA to oversee all activities of thrifts, their subsidiaries, and their affiliates, making thrifts subject to ILSA will enhance OTS's ability to carry out its responsibilities under ILSA and promote consistency among the federal regulators in supervising the foreign activities of insured depository institutions.

### **B. OTS Representation on the Basel Committee**

Amending ILSA to support equal representation for OTS on the Basel Committee will enable OTS to share its expertise with respect to residential and consumer lending and interest rate risk. This is an important issue for the United States banking system. OTS is one of the preeminent regulators of residential

mortgage lenders. Giving OTS a recognized voice on Basel will help assure that international bank supervision policies do not inadvertently harm residential lending or impose unintended burdens on thrifts. OTS is particularly skilled at assessing interest rate risk, and this experience will be a valuable addition for all depository institutions. OTS's experience and perspective in regulating diverse holding company structures is another important factor for including it on the Committee.

## **V. Other OTS Proposals**

OTS also recommends enactment of other important regulatory burden relief initiatives. We appreciate the opportunity to work with the Committee's staff on these and other provisions that will be of significant benefit to the thrift industry.

### **A. Enhancing Examination Flexibility**

Current law requires the FBAs to conduct a full-scale, on-site examination for the depository institutions under their jurisdiction at least every 12 months. There is an exception for small institutions that have total assets of less than \$250 million and are well-capitalized and well-managed and meet other criteria. Examinations of these small institutions are required at least every 18 months.

When originally enacted in 1991, the small institution examination exception was available to institutions with assets less than \$100 million (assuming the other statutory criteria were satisfied). This statutory threshold was raised to \$250 million in 1994 for institutions in outstanding condition and meeting the other statutory criteria. In 1996, the FBAs were authorized to extend the \$250 million threshold to institutions in good condition. Given the fact that the current threshold has been in place for more than eight years, OTS recommends considering whether the \$250 million cap should once again be raised. If so, we believe consideration of a \$500 million cap for well-capitalized, well-managed institutions is appropriate.

A large majority of thrifts are well-run institutions that do not require full-fledged annual on-site examinations to assure their safety and soundness. This is also true for the majority of banks. This proposal will reduce regulatory burden on low-risk, small institutions and permit the FBAs to more effectively focus their resources on the highest risk institutions.

## **B. Modernizing Thrift Community Development Investment Authority**

OTS supports updating HOLA to give thrifts the same authority as national banks and state member banks to make investments to promote the public welfare. This proposal enhances the ability of thrifts to contribute to the growth and stability of their communities.

Due to changes made to HUD's Community Development Block Grant (CDBG) program more than 20 years ago, thrift investment opportunities that meet the technical requirements of the statute are rare. OTS has found it cumbersome to promote the spirit and intent of Congress's determination to allow thrifts to make such community development investments. Currently, using its administrative authority, OTS may issue a "no action" letter when a thrift seeks to make a community development investment that satisfies the intent of the existing provision, but does not clearly fall within the wording of the statute or the "safe harbor" criteria issued by OTS for these investments. The no-action process, however, takes time and lacks certainty.

The proposal closely tracks the existing authority for banks. Under the proposal, thrifts may make investments primarily designed to promote the public welfare, directly or indirectly by investing in an entity primarily engaged in making public welfare investments. There is an aggregate limit on investments of 5 percent of a thrift's capital and surplus, or up to 10 percent on an exception basis.

## **C. Eliminating Geographic and Ownership Limits on Thrift Service Companies**

OTS strongly supports legislation authorizing federal thrifts to invest in service companies without regard to the current geographic and ownership restrictions. Current law permits a federal thrift to invest in a service company only if (i) the service company is chartered in the thrift's home state, and (ii) the service company's stock is available for purchase only by thrifts chartered by that state and other federal thrifts having their home offices in that states.

HOLA imposed these restrictions before interstate branching and before technological advances such as Internet and telephone banking, and they no longer serve a useful purpose. This restriction needlessly complicates the ability of thrifts, which often operate in more than one state, to join with thrifts and banks to

obtain services at lower costs due to economies of scale or to engage in other approved activities.

Today, a thrift seeking to make investments through service companies must create an additional corporate layer—known as a second-tier service company—to invest in enterprises located outside the thrift’s home state or with a bank. Requiring second-tier service companies serves no rational business purpose, results in unnecessary expense and red tape for federal thrifts and banks, and discourages otherwise worthwhile investments. While this proposal simplifies the ability of banks and thrifts to invest together in service companies, it does not expand the powers of thrifts or banks. The activities of the service company must be permitted by whatever rules govern the activities of the thrift or bank.

#### **D. Authorizing Federal Thrifts to Merge and Consolidate with Their Nondepository Affiliates**

OTS favors giving federal thrifts the authority to merge with one or more of their nondepository institution affiliates, equivalent to authority enacted for national banks at the end of 2000.<sup>4</sup> The Bank Merger Act will still apply, and the new authority does not give thrifts the power to engage in new activities.

Under current law, a federal thrift may merge only with another depository institution. This proposal reduces regulatory burden on thrifts by permitting mergers with nondepository affiliates where appropriate for sound business reasons and if otherwise permitted by law. Today, if a thrift wants to acquire the business of an affiliate, it must engage in a series of transactions, such as merging the affiliate into a subsidiary and liquidating the subsidiary into the thrift. Structuring a transaction in this way can be costly. Under the OTS proposal, thrifts may merge with affiliates and continue to have the authority to merge with other depository institutions, but may not merge with other kinds of entities.

#### **E. Streamlining Agency Action under the Bank Merger Act**

OTS supports streamlining Bank Merger Act application requirements by eliminating the requirement that each federal banking agency request a competitive factors report from the other three banking agencies and the Attorney General. This means five agencies must consider the competitive effects of every proposed bank or thrift merger. The vast majority of proposed mergers do not raise anti-competitive issues, and these multiple reports, even for those few that do raise issues, are not

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4. Section 6 of the National Bank Consolidation and Merger Act (12 U.S.C. § 215a-3).

necessary. The proposal decreases the number to two, with the Attorney General continuing to be required to consider the competitive factors involved in each merger transaction and the FDIC, as the insurer, receiving notice even where it is not the lead banking agency for the particular merger. This will streamline the review of merger applications while assuring appropriate consideration of all anti-competitive issues.

## **VI. Other Proposals**

OTS also supports several proposals that others have offered for your consideration.

### **A. Clarification of Citizenship of Federal Thrifts for Federal Court Jurisdiction**

A federal thrift may sue or be sued in federal court if the claim exceeds \$75,000 and the parties are citizens of different states. This is known as diversity jurisdiction. OTS supports an amendment to clarify that, for purposes of determining diversity jurisdiction, a federal thrift is a citizen only of the state where it has its home office.

Some courts have determined that if a thrift that is organized as a stock corporation conducts a substantial amount of business in more than one state, it is not a citizen of any state and, therefore, it may not sue or be sued in federal court under diversity jurisdiction. This proposal would avoid this result. It would also avoid a potential similar problem with respect to mutual thrifts. The general rule for an unincorporated association is that it is a citizen of every state of which any of its members is a citizen. If a court were to apply this general rule to mutual thrifts, those operating regionally or nationally with depositors across the country would find it difficult or impossible to establish diversity jurisdiction. This proposal will establish a uniform rule governing federal jurisdiction when a thrift is involved and, accordingly, reduce confusion and uncertainty.

## **B. Removal of Qualified Thrift Lender Requirements with Respect to Out-of-State Branches of Federal Thrifts**

OTS also supports removing the requirement that federal thrifts meet the QTL test on a state-by-state basis. This requirement is a superfluous regulatory burden because interstate thrifts may easily structure their activities to assure compliance with the state-by-state requirement. The QTL test should, of course, continue to apply to the institution as a whole.

## **VII. Agency Continuity -- Creation of Statutory OTS Deputy Directors**

OTS urges Congress to authorize the Treasury Secretary to appoint up to four Deputy Directors for OTS to assure agency continuity. This would remove any question about a Deputy Director's authority to perform the functions of the Director during a planned or sudden vacancy in the office of the Director or during the absence or disability of the Director. Especially at this time of national emergency, we should take every possible step to assure the stability of the financial system and the regulatory oversight agencies. For example, uncertainty about the authority of an acting OTS Director should not be allowed to impair our participation in the Financial and Banking Information Infrastructure Committee, the entity charged with coordinating federal and state financial regulatory efforts to improve the reliability and security of the U.S. financial system.

The new authority would be based closely on long-standing authority for appointing Deputy Comptrollers in the Office of the Comptroller of the Currency (OCC).<sup>5</sup> Consistent with the existing OCC legislation, the HOLA amendment would require the Treasury Secretary to make the OTS appointments so each Deputy Director would qualify as an "inferior officer" under the Appointments Clause of the Constitution.

The safety and soundness of the banking system depends on regular, uninterrupted oversight by the federal banking agencies. The reality of the appointments process is that there can be a delay of many months before a sub-cabinet level position is filled, and these delays have grown significantly over the last 20 years. An event resulting in numerous vacancies in the Executive Branch would, of course, exacerbate this problem. In light of these growing, and potentially even greater, delays, it is especially important to establish a statutory chain of command within OTS that will avoid the possibility of gaps in authority

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5. 12 U.S.C. § 4.

to regulate and supervise thrifts, eliminate uncertainty for the thrifts OTS regulates, and avoid future litigation over whether the acts of OTS staff are valid.

OTS is the only financial services sector regulator that could be readily exposed to this vacancy problem. During a vacancy, OTS succession now occurs through the process of the Vacancies Act, which does not ensure an immediate succession when the OTS Director departs and limits the period an acting Director may serve. The organic statutes of the other financial regulators minimize or avoid vacancy problems by providing for automatic and immediate succession or by vesting authority in the remaining members of a board or commission.

### **VIII. Conclusion**

OTS is committed to reducing regulatory burden wherever it has the ability to do so, consistent with safety and soundness and compliance with law. We support proposed legislation that advances this objective. I want to thank you, Mr. Chairman, and the others who have shown leadership on this issue. We look forward to working with the Committee to shape the best possible regulatory burden relief legislation.