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Statement
of

Carolyn J. Buck, Chief Counsel
Office of Thrift Supervision

concerning

Reducing Regulatory Burden

before the

Subcommittee on Financial Institutions and Consumer Credit
U. S. House of Representatives

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I. Introduction

Mr. Chairman, Ranking Member Sanders, and members of the Subcommittee, good morning and thank you for the opportunity to discuss the regulatory burden reduction initiatives currently being considered by the Subcommittee. We commend Congresswoman Capito for introducing H.R. 1375, the "Financial Services Regulatory Relief Act of 2003," and for her continuing efforts in support of regulatory burden relief. It is always important to remove unnecessary regulatory obstacles that hinder profitability, innovation, and competition in our financial services industry.

Relieving institutions from these burdens meshes well with three responsibilities that OTS Director James E. Gilleran has emphasized for OTS:

- Protecting taxpayers by minimizing risks to the insurance fund. Relief from superfluous regulatory burden enhances the safety and soundness of institutions by avoiding the distraction of complying with needless red tape.

- Keeping the financial institution system healthy. Reducing regulatory burden and enhancing supervision are both important in assuring the continued health of the financial services system.

- Protecting consumers by fully utilizing the consumer laws that we enforce.

II. Support for Other Pending Congressional Initiatives

The House is already hard at work on several fronts to provide regulatory relief.

A. Deposit Insurance Reform

We congratulate the Committee on reporting out H.R. 522, the "Federal Deposit Insurance Reform Act of 2003." Merger of the Bank Insurance Fund and the Savings Association Insurance Fund is a central feature of the bill. It is long past time to merge the funds, and there is no longer any controversy about this important reform. We strongly support merger because it will promote efficiency in administering the funds and, more importantly, result in a more stable insurance system. The bill also gives the Federal Deposit Insurance Corporation (FDIC) Board flexibility to set the designated reserve ratio within a target range and decide when to increase or decrease assessments to assure the continued stability of the insurance fund. This will assure a safer and more stable insurance system. Providing certainty about the process for determining the amount of deposit insurance assessments and eliminating the procyclicality of the current system—which imposes higher assessments when institutions are least able to afford them—are very important regulatory burden reduction initiatives.

B. Business Checking

We also congratulate the Committee on reporting out H.R. 785, the "Business Checking Freedom Act of 2003." OTS supports enactment of legislation to permit depository institutions to pay interest on business transaction accounts. We agree that the current limitations no longer serve a public purpose and are ineffective. The prohibition is circumvented daily by sweep accounts and similar vehicles. Permitting insured depositories to offer interest directly on demand deposit accounts will help smaller institutions compete with other financial providers, such as money market mutual funds, resulting in greater market and institutional efficiencies. For competitive and fairness reasons, it is time to modernize this provision.

III. Removing Disparate Treatment of Thrifts under the Federal Securities Laws (§ 201)

OTS is particularly pleased that H.R. 1375 would eliminate disparate treatment of thrifts under the federal securities laws. This reform is, by far, the most significant regulatory burden reduction provision for thrifts in the bill. The proposal removes the investment adviser and broker-dealer registration requirements that continue to apply to thrifts under the Investment Advisers Act (IAA) and the Securities Exchange Act of 1934. Despite the fact that banks and thrifts may engage in substantially similar activities, subject to substantially

similar supervision, thrifts do not enjoy the same exemption as banks from these securities laws.

Thrifts and banks provide investment adviser, trust and custody, third party brokerage, and other related services in the same manner and under equivalent statutory authority. OTS examines securities-related thrift activities the same way as the OCC and other banking agencies examine comparable bank activities. Notwithstanding bank-equivalent activities, authority, and supervision, thrifts have been subject to different requirements under the SEC's interpretation of the securities laws. There is no logical basis to structure the regulatory oversight of these activities differently for thrifts and banks. Removing the disparity will reduce regulatory burden by eliminating duplicative paperwork and providing cost savings for thrifts. It will also remove a disincentive for institutions to select the most appropriate charter.

Different purposes of the various banking charters make our financial services industry the most flexible and successful in the world, but disparities unrelated to those purposes only cause unnecessary costs for institutions and consumers. While OTS strongly supports each institution having a choice of charters, that decision should be based on which charter is the best fit for its business. The proposed amendments to the federal securities laws remove distinctions that have caused some depository institutions to make a charter choice to avoid SEC regulation and reduce costs, even though the thrift charter is otherwise a better fit for their businesses.

The details of the current situation are complex, but I will briefly summarize the key points.

Banks—but not thrifts—enjoyed a blanket exemption from broker-dealer registration requirements under the Securities Exchange Act before changes made by the Gramm-Leach-Bliley Act (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, and on October 30, 2002, published proposed amendments to the interim dealer rule. As part of the broker-dealer "push out" rules, the SEC exercised its authority to include thrifts within the bank exemption. This gave thrifts parity with banks for the first time for purposes of broker-dealer registration.[1] In the broker-dealer

[1] The SEC rule does not, however, address other problems under the Securities Exchange Act, such as the need to exempt thrift collective trust funds from registration to the same extent as bank collective trust funds.

changes, the SEC recognized it would be wrong to continue disparate, anomalous treatment between thrifts and banks.

The SEC postponed the effective dates of the interim rules several times. It published the final dealer rule on February 24, 2003, and it continues to develop the final broker rule. In the meantime, banks and thrifts both continue to have a blanket exemption from the definition of broker (the current extension expires May 12, 2003).

Under SEC interpretation, banks—but not thrifts—are exempt from investment adviser registration requirements under the IAA. In 1999, the GLB Act narrowed the bank exemption and now requires a bank to register when it advises a registered investment company, such as a mutual fund. The SEC division responsible for investment adviser registration has been reluctant to recommend to the Commission that it provide the same equal treatment of banks and thrifts as the SEC has already adopted for broker-dealers.

Detailed Explanation

Treating thrifts and banks the same under both the IAA and the Securities Exchange Act makes sense for the following reasons:

- The statutory authorities for thrifts and banks to engage in trust services are essentially the same. In 1980, Congress gave thrifts the authority to offer trust services closely based on parallel national bank authority. The Senate report for the Depository Institutions Deregulation and Monetary Control Act of 1980 explained that the Home Owners' Loan Act (HOLA) amendment gives thrifts "the ability to offer trust services on the same basis as national banks."[2] Consistent with this legislative history, these amendments further promote uniformity in the way thrifts and banks provide trust services.

- OTS examines securities-related thrift activities the same way as the OCC and the other banking agencies examine comparable bank activities, not only to assure safe and sound operations, but also to protect customers. OTS has formalized its policies with new regulations and guidance. On December 12, 2002, OTS issued a final rule establishing recordkeeping and confirmation requirements for thrifts that effect securities transactions. The rule assures that thrift customers receive the same protections and disclosures as bank customers; these protections and disclosures are

[2] S. Rep. No. 96-368, at 13 (1979), reprinted in 1980 U.S.C.C.A.N. 236, 248.

equivalent to those that protect customers of broker-dealers and investment advisers registered with the SEC. In August 2001, OTS issued an entirely revised trust and asset management handbook that assists examiners in planning and conducting examinations of trust and asset management products and services to assure they are provided consistent with applicable law and customer protection requirements.

- To the extent thrifts are subject to different rules and must register with the SEC, they are placed at a competitive disadvantage to banks due to the additional paperwork and costs related to IAA registration. The cost to new and small institutions is particularly significant and can greatly affect profitability. The competitive disadvantage in dual compliance has caused some thrifts recently to convert to a bank or state trust company charter to obtain the benefit of the registration exemption under the Investment Advisers Act. This allows them to avoid SEC regulation with a one-time conversion cost. It is sound public policy to treat the bank and thrift charters the same where similarly situated. This promotes a level playing field among depository institutions in the marketplace.

- Some have objected to this change based on concerns that it would give thrifts a competitive advantage over registered investment advisers. The stronger argument supports comparable regulatory treatment of depository institutions that already have the same powers and that are subject to equivalent, frequent oversight by the appropriate federal banking agency. Most importantly, the amendment will have a relatively minor impact on the investment adviser industry because banks are already exempt and, if this proposal does not become law, the trend of thrifts to convert to a bank charter could intensify.

- OTS agrees with the SEC analysis set forth in its preamble to the May 2001 interim broker-dealer "push-out" rule. The logic of the SEC argument in the context of the broker-dealer rule applies equally for purposes of extending to thrifts the same investment adviser registration exemption that applies to banks. The SEC explained the basis for its decision to exempt thrifts from broker-dealer registration to the same extent as banks, as follows:

  "Now that the general exception for banks has been replaced, and the differences between banks and savings associations have narrowed; it seems reasonable to afford savings associations and savings banks the same type of exemptions. Moreover, insured savings associations are subject to a similar regulatory structure and examination standards as banks. We find

> that extending the exemption for banks to savings associations and savings banks is necessary or appropriate in the public interest and is consistent with the protection of investors." 66 Fed. Reg. 27788 (May 18, 2001).

In an effort to resolve, administratively, the issue of how to extend the bank exemption to thrifts under the IAA, OTS has communicated with the SEC for a number of years. The SEC has, on occasion, expressed a commitment to achieve a mutually satisfactory resolution. We understand that in 2000 an amendment to a bill under consideration by a Senate committee was withdrawn after SEC staff informally advised that the issue of extending the IAA exemption to thrifts might be handled by regulation. However, the SEC has demonstrated no sense of urgency in resolving this matter. To avoid further delay, we urge Congress to act now to remove the disparity and to make the changes necessary to eliminate the numerous incidental differences that remain. Legislation would also have the beneficial effect of avoiding the need for a series of SEC administrative exemptions—another potential regulatory burden.

IV. Streamlining for Thrift Institutions—OTS Proposals

H.R. 1375 includes other important regulatory burden relief initiatives that OTS has proposed. We appreciate the opportunity to work with the Committee's staff on these provisions that will be of significant benefit to the thrift industry as a whole.

A. Modernizing Thrift Community Development Investment Authority (§ 202)

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 proposed amendment closely tracks the existing authority for banks. Under the amendment, 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.

B. Eliminating Geographic Limits on Thrift Service Companies (§ 503)

OTS strongly supports legislation authorizing federal thrifts to invest in service companies without regard to geographic restrictions. Current law permits a federal thrift to invest only in service companies chartered in the thrift's home state. HOLA imposed this geographic restriction before interstate branching and before technological advances such as Internet and telephone banking, and it no longer serves a useful purpose. This restriction needlessly complicates the ability of thrifts, which often operate in more than one state, to join together to obtain services at lower costs due to economies of scale.

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. Requiring the formation of second-tier service companies serves no rational business purpose, results in unnecessary expense and red tape for federal thrifts, and discourages otherwise worthwhile investments.

C. Authorizing Federal Thrifts to Merge and Consolidate with Their Non-thrift Affiliates (§ 203)

OTS favors giving federal thrifts the authority to merge with one or more of their non-thrift affiliates, equivalent to authority for national banks enacted at the end of 2000.[3] The new authority does not affect the applicability of the Bank Merger Act or 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 certain mergers, where appropriate for sound business reasons and if otherwise permitted by law. Today, if a thrift wants to acquire the business of a non-

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

depository institution 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 this amendment, 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.

D. Repealing the Statutory Dividend Notice Requirement for Thrifts in Savings and Loan Holding Companies (§ 204)

The proposed legislation repeals the requirement in section 10(f) of HOLA that any thrift owned by a savings and loan holding company must notify OTS 30 days before paying a dividend. Under the proposed amendment, the Director could continue to require prior notice, where appropriate, and establish reasonable conditions on the payment of dividends.

The current dividend notice requirement does not depend on a thrift's capital condition or relative risk to the insurance fund. No similar limitation on thrift owners applies to thrifts controlled by individuals, thrifts controlled by bank holding companies, or banks. There is no basis for disparate treatment based on the form of ownership of thrifts.

Federal statutes and regulations assure that thrifts held by holding companies may only pay dividends in appropriate circumstances, and this amendment confirms this authority. All thrifts are subject to the prompt corrective action—PCA—provisions that generally prohibit an insured depository institution from paying a dividend if doing so would make it undercapitalized. In addition, based on OTS's general regulatory authority, OTS has a capital distributions regulation[4] that governs when a thrift must file an application or give notice if it decides to pay a dividend. In 1999, as part of OTS's ongoing regulatory burden reduction effort, OTS amended its regulations to exempt adequately capitalized, highly rated thrifts from providing advance notice of dividends under certain circumstances. The rule conformed OTS's dividend requirement more closely to those of the other federal banking agencies. This proposal will permit OTS to extend to thrifts owned by savings and loan holding companies the same regulatory relief that is available to all other thrifts.

V. Streamlining for Thrift Institutions—Other Proposals

[4] 12 CFR Part 563, Subpart E.

OTS would like to comment briefly on several other provisions of H.R. 1375.

A. Clarification of Citizenship of Federal Thrifts for Federal Court Jurisdiction (§ 213)

OTS supports the amendment to clarify citizenship of federal thrifts for purposes of determining federal court diversity jurisdiction. Not all courts agree that a federal thrift should be treated as a citizen only of its home state, consistent with the rule for national banks. The amendment would permit a thrift involved in an interstate dispute to remove the matter to federal court based on diversity jurisdiction. This change 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 (§ 211)

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 would, of course, continue to apply to the institution as a whole.

VI. Streamlining for Depository Institutions

A. Enhancing Examination Flexibility (§ 601)

OTS strongly supports the proposal to give additional flexibility to permit the federal banking agencies to adjust the examination cycle for depository institutions. The Federal Deposit Insurance Act (FDIA) currently requires annual examinations for all but the smallest institutions. Small institutions that have assets less than $250 million and are well-capitalized and well-managed may be examined every 18 months. A large majority of thrifts are well-run institutions that do not require full-fledged annual examinations to assure their safety and soundness. This is also true for the majority of banks. This amendment will reduce risk to the insurance fund by permitting the banking agencies to focus supervisory attention on the institutions that are, or are at the greatest risk of becoming, troubled.

B. Enhancing Authority to Enforce Agreements (§ 405)

OTS welcomes the amendment to clarify provisions of the FDIA that some courts have interpreted to limit the ability of banking agencies to require an institution-affiliated party (IAP) to transfer capital to an institution. In particular, the amendment clarifies that limits in sections 8(b)(6)(A)(i) and (ii) and section 38(e)(2)(E) of the FDIA do not apply when a federal banking agency seeks to enforce certain conditions imposed on, and agreements with, IAPs that pre-date the enforcement action. These amendments will enhance the safety and soundness of insured depository institutions and protect the insurance fund from unnecessary losses.

Neither of these two sections should apply when a banking agency seeks to require an IAP to meet its prior obligations. Agencies must be able to count on financial commitments an IAP made to support a depository institution in its application for a charter or in any other agreement. It is illogical to reduce or eliminate an IAP's prior commitment at the very time the institution most needs it. The sections in question make sense only in the context of an agency seeking to impose additional requirements to resolve problems at a troubled depository institution.

C. Streamlining Agency Action under the Bank Merger Act (§ 607 & § 609)

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 necessary. The amendment 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.

OTS also supports amending the Bank Merger Act to shorten the post-approval waiting period before a transaction subject to the Act may be consummated. After approval, except in the case of emergencies, mergers are subject to a 30-day waiting period to give the Attorney General time to initiate legal action where the Attorney General determines the merger would have a significantly adverse effect on competition. The lead banking agency and the

Attorney General may agree to shorten the waiting period to 15 days. This proposal shortens the statutory minimum from 15 to five days. Permitting a merger to go forward sooner will reduce burden on the affected depository institutions.

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[5] for appointing Deputy Comptrollers in the Office of the Comptroller of the Currency (OCC). 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 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

[5] 12 U.S.C. 4

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 burden wherever it has the ability to do so consistent with safety and soundness and compliance with law. The proposed legislation advances this objective. We especially appreciate inclusion of the amendments to remove disparate treatment of thrifts under the federal securities laws. I want to thank you, Mr. Chairman, and the others who have shown leadership on this issue. We look forward to working with the Subcommittee to shape the best possible regulatory burden reduction legislation.