Statement of

John M. Reich, Director
Office of Thrift Supervision

concerning

Regulatory Burden Relief

before the

Senate Committee on Banking, Housing and Urban Affairs

March 1, 2006

Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W.
Washington, DC 20552
202-906-6288

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I. Introduction

Good morning, Mr. Chairman, Ranking Member Sarbanes, and members of the Committee. Thank you for the opportunity to address the issue of regulatory burden relief.

Mr. Chairman, I wish to commend you, Ranking Senator Sarbanes and the other distinguished Members of this Committee for your efforts to develop legislation to remove unnecessary regulatory burden from the banking industry. I especially want to recognize the tremendous efforts of Senator Crapo and his staff, who have taken the lead in crafting this important legislation.

Since most of our regulations are mandated by statute, I believe it is critical that the agencies work hard not only on the regulatory front, but also on the legislative front, to alert Congress to unnecessary regulatory burden. In fact, the
Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), which I will discuss today, requires us to identify and address unnecessary regulatory burdens that require legislative action.

Removing unnecessary regulatory obstacles that prevent institutions from efficiently and effectively serving their customers, stifle innovation, distort competition in our financial services industry, and impede job creation and economic growth in the general economy, is an important personal goal of mine and a continuing objective of the Office of Thrift Supervision (OTS).

Although we have accomplished much in recent years to streamline and eliminate some of the burdens faced by depository institutions, there remain many other areas for improvement. We are fully committed to work with you, Mr. Chairman, Senator Crapo, Senator Sarbanes, and the Members of the Committee to address these issues.

In my statement, I will discuss the ongoing interagency regulatory burden relief process, pursuant to EGRPRA, which I have led since 2003. I will also highlight the most pressing industry needs for regulatory relief, and provide you with an overview of various legislative proposals important to the banking industry. Finally, I will conclude my remarks with a discussion of the legislative priorities of OTS. The most important of these include the following:
• Removing the duplicative oversight and disparate treatment of savings associations under the federal securities laws by providing the same exemptions available to banks with respect to investment adviser and broker-dealer activities that each conducts on otherwise equal terms and under substantially similar authority.

• Updating commercial lending limits for federal savings associations to enhance their ability to diversify and to provide small and medium-sized businesses greater choice and flexibility in meeting their credit needs.

• Eliminating the existing arbitrary limits on thrift consumer lending activities.

• Clarifying the citizenship status of federal savings associations for federal court diversity jurisdiction.

• Establishing statutory succession authority within the Home Owners’ Loan Act (HOLA) for the position of the OTS Director.

I will explain each of these items in more detail at the end of my testimony, and describe several other initiatives that we are recommending for enactment. First, I will summarize our efforts under the EGRPRA Program.
A. The EGRPRA Program

EGRPRA, enacted in 1996, requires the Federal Financial Institutions Examination Council (FFIEC) and each of its member agencies to review their regulations at least once every ten years, in an effort to eliminate any regulatory requirements that are outdated, unnecessary or unduly burdensome. For the past three years, I have been leading the interagency effort and I am pleased to report that we are making progress.

Pursuant to EGRPRA, the agencies are required to categorize their regulations by type (such as "safety and soundness" or "consumer protection" rules) and then publish each category for public comment. The interagency task force divided the agencies' regulations (131 rules in all) into 12 categories and agreed to publish one or more categories for public comment every six months, with 90-day comment periods, for the remainder of the review period (which ends in September, 2006).

The agencies have already jointly published six separate requests for comment in the Federal Register. Those six requests for comments have covered more than 120 regulations. In response to these requests, the agencies received more than 1000 comment letters containing hundreds of recommendations for change from bankers, consumer and community groups, trade associations and
other interested parties. Each of the recommendations is being carefully reviewed and analyzed by the agency staffs. Based on these reviews, the appropriate agency or agencies is expected to bring forward, and request public comment on, proposals to change specific regulations.

Industry, consumer and public insight into these issues is critical to the success of our effort. The regulatory agencies have tried to make it as easy as possible for all interested parties to be informed about the EGRPRA project and to let us know what are the most critical regulatory burden issues. The EGRPRA website, which can be found at www.egrpra.gov, provides an overview of the EGRPRA review process, a description of the agencies' action plan, information about our banker and consumer outreach sessions and a summary of the top regulatory burden issues cited by bankers and consumer groups.

The EGRPRA website also provides direct links to the text of each regulation and comments can be sent to the website. Comments submitted through the website are automatically transmitted to all of the financial institution regulatory agencies. Comments are then posted on the website for everyone to review. The website has proven to be a popular source for information about the project, with thousands of hits being reported every month.
While written comments are important to the agencies' efforts to reduce regulatory burden, it is also important to have face-to-face meetings with bankers and consumer group representatives so they have an opportunity to directly communicate their views on the issues. Over the past three years, the agencies sponsored a total of ten banker outreach meetings in different cities around the country to heighten industry awareness of the EGRPRA project. The meetings provided an opportunity for the agencies to listen to bankers' regulatory burden concerns, explore comments and suggestions, and identify possible solutions. Banker outreach meetings were held in Orlando, St. Louis, Denver, San Francisco, New York, Nashville, Seattle, Chicago, Phoenix and New Orleans. More than 500 bankers (mostly CEOs) and representatives from the national and state trade associations participated in these meetings along with representatives from OTS, the Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), the Conference of State Banking Supervisors (CSBS), and the state regulatory agencies. The banker outreach meetings have been extremely useful and productive in identifying regulatory burden concerns. Summaries of the issues raised during the meetings are posted on the EGRPRA website.

We also held three outreach meetings for consumer and community groups. The first meeting was on February 20, 2004, in Arlington, Virginia, the second on
June 24, 2004 in San Francisco and the third on September 23, 2004 in Chicago. Representatives from a number of consumer and community groups participated in the meetings along with representatives from the FDIC, FRB, OCC, OTS, CSBS, and the National Credit Union Administration (NCUA). The meetings provided a useful perspective on the effectiveness of many existing regulations.

At the June 9, 2005 regulatory burden hearing before this Committee, Senator Sarbanes, among others, expressed concern that the banking agencies had not obtained sufficient input from consumer and community groups in connection with the EGRPRA process. The Senator also suggested that we hold several joint meetings with bankers and consumer/community groups. We followed this suggestion and found the opportunity to meet with a number of community and national consumer leaders enormously helpful.

In response to these suggestions, the agencies hosted a meeting on July 20, 2005, in Washington, D.C., with representatives of various national consumer and community organizations to solicit their views on the proposals to reduce regulatory burden. The agencies also sponsored three joint banker and consumer/community group focus group meetings on August 25, 2005 in Washington, D.C., on September 1, 2005 in Los Angeles, and on September 8, 2005 in Kansas City. We subsequently received a document outlining the views of
the consumer and community organizations on the items on the EGRPRA Legislative Matrix.

As a result of these efforts, a growing number of legislative items and issues have gained support. It is my sincere hope that all of this effort has not been wasted. I urge you carefully to consider all of the suggestions that you hear today, as well as the various items and proposals set forth by each of the agencies in our written statements.

B. Most Pressing Industry Needs

Before discussing some of the industry's legislative proposals, it is important to note that there are two areas not detailed in this statement that many of our institutions have identified as unduly burdensome—the Bank Secrecy Act (BSA) requirements and the rules under the Sarbanes Oxley (SOX) Act.

Virtually all institutions raise these two issues as regulatory relief priorities; however, the impact of these statutory provisions is often most acute for smaller, community-based institutions that do not have the resources and wherewithal to implement the type of cost-effective, global programs required to address the monitoring of activities under these laws. While these laws are also problematic for larger institutions, smaller institutions are significantly more burdened, by virtue of their size, to develop and implement cost-effective solutions to address
BSA and SOX requirements. This, in turn, imposes greater competitive stresses on smaller institutions relative to their larger competitors.

An item of particular significance is a provision in H.R. 3505, the regulatory relief bill passed by the House last October, to except from filing certain currency transaction reports (CTRs) of so-called “seasoned customers.” Eligible customers would include corporations and organizations that have maintained a depository account at an institution for at least 12 months, and have engaged through that account in activities that have triggered multiple CTR filings. It is our understanding that the Financial Crimes Enforcement Network (FinCEN) supports this amendment.

OTS is fully supportive of efforts to provide meaningful BSA relief to the institutions we regulate consistent with the requirements of the BSA and the needs of law enforcement. We will support any burden reduction proposal to streamline existing BSA requirements, provided it is supported by FinCEN, not opposed by law enforcement, and it provides meaningful relief that outweighs any diminished utility to the BSA.

Similarly, we are also open to working with the other federal banking agencies (FBAs), and the Members of this Committee to identify ways to provide relief to all institutions, but particularly to smaller institutions, under the SOX Act.
II. Industry Legislative Proposals

EGRPRA requires input from the industry and other interested parties. As described above, we have made tremendous efforts to get input through the public notice and comment process as well as through outreach meetings held around the country. As a result, we have received many promising ideas for true regulatory burden reduction.

As you will recall, in June of 2004, I testified, along with 17 other witnesses, before this Committee. At the end of the hearing, Senator Crapo asked me, as the leader of the interagency EGRPRA task force, to review the testimony presented at the hearing and extract the various regulatory burden reduction proposals. The result was a matrix with a total of 136 burden reduction proposals.

Thereafter, I convened a meeting of banking industry representatives from the American Bankers Association, America's Community Bankers, the Independent Community Bankers of America, and the Financial Services Roundtable, who together reviewed the matrix of 136 proposals in an effort to determine which of these proposals they could all support as industry consensus items. This process yielded a list of 78 banking industry consensus items.
Subsequently, each federal banking agency reviewed the 136 items, with particular emphasis on the 78 industry consensus items, and provided comment. Review of the agencies positions show that 59 items are supported by at least two agencies, and that 21 items are opposed by at least one agency. This means that there are 115 of 136 items that the agencies either support or do not oppose.

After hearing what the industry viewed as outdated or unnecessary regulatory burdens and numerous interagency discussions analyzing the merits of the industry requests, we next turned to the consumer/community groups for their input. As previously described, the agencies first met with these groups to solicit their input on the matrix items, and then inter-agency meetings were held jointly with the consumer/community groups and bankers in Washington, D.C., Los Angeles and Kansas City. The meetings helped to develop greater consensus and understanding among the parties on the legislative proposals to reduce regulatory burden, and provided an opportunity to work through the matrix to hear the insights and concerns of all parties. The meetings were very thoughtful and interactive and we value the perspective that the consumer and community leaders provided on these issues.

Recently, the agencies and various industry groups identified 50 more items that they believe should be under consideration in any regulatory relief legislation.
The industry and the consumer groups have also provided comment on these items, and I believe that the agencies are nearing final review of these items as well.

For your convenience, we have grouped the 186 matrix items into the following categories of significant regulatory relief priorities promoted by the industry that meet the objectives of the EGRPRA project. These priorities are grouped as follows:

- Bank Secrecy Act amendments (Matrix items 106, 176 and 180)
- Privacy Notices (Matrix items 63, 108, 134, 174 and 177)
- Small Institution Examination Flexibility (Matrix items 42, 68, 112 and 169)
- Interest on Business Checking Accounts (Matrix item 3)
- Federal Court Diversity Jurisdiction (Matrix items 28, 58 and 184)
- Cross Marketing Provision (Matrix items 139, 171 and 187)
- Anti-Tying amendment (Matrix items 136 and 185)
- Streamline Call Reports (Matrix item 109)
- Parity for Savings Associations under the Securities Acts (Matrix item 52)
• Removal of Limitations of Consumer Loans and Small Business Loans (Matrix items 82 and 53)

• Streamline Depository Institution Merger Applications (Matrix items 5, 6, 61 and 69)

• Increase Limits for Thrifts on Commercial Real Estate Loans (Matrix item 87)

• Insider Lending/Regulation O (Matrix items 4, 93 and 111)

• Eliminate Prior Written Consent to Establish Branches by Well-Managed, Well-Capitalized, Highly-Rated Institutions (Matrix items 62 and 118)

Based on the feedback that I have received from the many people who have participated in the EGRPRA process, including various meetings with lawmakers, industry participants, and community leaders, I believe that there is real momentum behind the effort to reduce regulatory burden in our country, and particularly in industries, such as financial services, that directly impact American consumers. I was gratified to see the House Financial Services Committee address some of these burden issues and pass H.R. 3505, the Financial Services Regulatory Relief Act, with unanimous bipartisan support last year. H.R. 3505 includes a number of significant regulatory relief provisions to reduce regulatory burden.
III. OTS Legislative Priorities

All of OTS’s top legislative priorities are included in H.R. 3505, although two of the provisions offer only a partial fix. Section 201 of H.R. 3505 provides relief to savings associations under the federal securities laws. Section 212 of H.R. 3505 updates the commercial and small business lending authority of savings associations. In addition, section 622 establishes statutory succession authority for the position of the OTS Director. Sections 213 of H.R. 3505, however, provides only partial relief to savings associations (for auto loans) with respect to the existing consumer lending limits imposed on thrifts. Similarly, section 208 falls short of a complete fix by providing that a federal savings association is a citizen of both its home state and the state of its principal place of business (rather than just its home state) for purposes of federal court diversity jurisdiction.

A. Eliminating Duplicative Regulatory Burdens for Savings Associations under the Federal Securities Laws

OTS’s most important regulatory burden reduction legislative priority is revising the federal securities laws so that savings associations are relieved of a duplicative burden imposed on them with respect to their investment adviser and broker-dealer activities. This is easily accomplished by revising the federal securities laws so that savings associations and banks are treated equally. As
described more fully below, this involves exempting savings associations from the
investment adviser and broker-dealer registration requirements to the same extent
that banks are exempt under the Investment Advisers Act (IAA) and the Securities

Although the Securities and Exchange Commission (SEC) has issued
several proposals purportedly to address the duplicative burden imposed on
savings associations, the application of the federal securities laws in these two
areas remains a needless additional burden with no additional supervisory benefit
for savings associations. Significant disparities remain under the IAA, with
savings associations subject to an entirely duplicative SEC oversight regime.
Equally significant, it remains uncertain how the SEC will ultimately treat savings
associations for purposes of the broker-dealer exemption. In the SEC’s last
iteration on this issue, it indicated that it would roll back an interim rule that had
extended equal treatment to savings associations vis-à-vis banks for purposes of
the broker-dealer exemption.1 While these issues remain in flux, there has been
nothing to indicate that we are heading in the direction of reducing needless
duplicative oversight for savings associations under the federal securities laws.

1. SEC Proposed Rule: Regulation B, Release No. 34-49879, approved by the Commission on
June 2, 2004, released to the public on June 17, 2004, and published in the Federal Register on
Underscor[ing the case for eliminating these duplicative requirements is the fact that banks and savings associations 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 savings associations the same way as the OCC and the other federal banking agencies examine the same bank activities—with savings association and bank customers equally well-protected.

To avoid the regulatory burden and substantial costs of this duplicative regulatory structure, some OTS-regulated savings associations 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 unrelated and extraneous factors such as SEC registration requirements and avoiding duplicative regulation under the federal securities laws. Institutions should be able to expand and diversify their product lines to meet customer
demands within the boundaries of their existing charter authorities and without additional, redundant regulatory burdens, such as those imposed by the IAA and 1934 Act registration requirements.

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—as set forth in section 201 of H.R. 3505—would free up significant resources for savings associations 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 former SEC Chairman Donaldson in the context of the discussion on the SEC’s IAA proposal.²

1. Investment Adviser Registration

Prior to enactment of the Gramm-Leach-Bliley Act (GLB Act) in 1999, banks—but not savings associations—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

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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 3, 2004, the SEC issued a proposal providing a narrow exemption from IAA registration to savings associations that limit their investment management and advisory services to a limited range of accounts. Under the proposal, savings association fiduciary accounts are segregated into two categories. Savings associations that provide services to accounts that include only traditional trust, estate, and guardianship accounts would be exempt from registration. Savings associations 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 would continue to be required to register as an investment adviser.³

The practical effect of this approach is that it provides an extremely limited exemption that does not provide meaningful regulatory relief for savings associations. This fact was made clear to the SEC Commissioners at a meeting in May 2004 when the SEC staff advised the Commissioners that none of the savings

³ A more detailed description and comparison of bank and savings association activities, and applicability of the IAA to each, is set forth in an attachment to this statement.
associations currently registered under the IAA—there are 47 savings associations currently registered (and 3 registered operating subsidiaries)—would be able to take advantage of the proposed exemption since all provide investment management and advisory services for both account categories.

While the SEC wants to apply the federal securities laws in two different manners depending on the business operations of a savings association, there is no distinction between these two categories of accounts under the HOLA and OTS regulations applicable to savings associations. 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 savings associations, 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.

Savings associations registered 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 last year of most of our largest IAA-registered
savings associations indicated aggregate annual institution costs ranging from $75,000 to $518,200.

Limiting the types of accounts for which a savings association may provide investment management and advisory services to avoid IAA registration, as the SEC has proposed, 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. Savings associations providing investment management and advisory services should be encouraged to provide competitive products and services 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 savings association for engaging in exactly the same activities.

Ironically, many of these same themes were cited as the basis for the SEC’s recent rule exempting certain broker-dealers from the IAA registration
requirements. Minimizing duplicative regulation, changes reflecting developments and advances in industry practices, underlying Congressional intent to carve out certain types of entities from IAA registration because of parallel federal oversight, and ensuring and maintaining consistent consumer protections are all reasons supporting the SEC's exemption for broker-dealers under the IAA. These same reasons support an IAA exemption for savings associations.

Duplicative registration and oversight without any additional supervisory or regulatory benefit is, as we all recognize, regulatory burden in its truest form. For the same reasons that SEC registered broker-dealers should not be subject to registration under the IAA, OTS-licensed savings associations should not be subject to IAA registration.

In addressing this issue, it is important to recall that in July 2000 an amendment was offered by Senator Bayh (on regulatory burden reduction legislation then pending before the Senate Banking Committee (SBC)) to extend the IAA exemption to savings associations so that savings associations and banks could compete equally in the provision of investment management and advisory services. During consideration of the amendment, the SEC represented to the SBC

that legislation was not needed to resolve this problem since the SEC would be able to resolve the issue by regulation. More than five years later the issue remains unresolved with virtually no likelihood of this changing given that the SEC's May 2004 proposal offers no relief to existing IAA-registered savings associations. This fact, alone, underscores why nothing short of a legislative solution is adequate to resolve this issue going forward.

While OTS submitted a comment letter to the SEC discussing why the proposed IAA rule is flawed, we are not optimistic that it will change anything given the history of this issue. After much discussion for several years between OTS and the SEC staff and SEC Commissioners, including the three past Chairmen, we have not made any 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 section 201 of H.R. 3505.

5. 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 savings associations. 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.
2. Broker-Dealer Registration

A similar duplicative burden exists for savings associations under the broker-dealer provisions of the 1934 Act. Extending the current bank broker-dealer exemption to savings associations would eliminate this duplicative burden. Banks—but not savings associations—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 savings associations within the bank exemption. This treated savings associations 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 savings associations and banks.

The SEC postponed the effective date of the interim rule several times. It released proposed amendments to the interim dealer rule on October 31, 2002, and the final dealer rule on February 14, 2003. The final dealer rule gives savings
associations the same exemptions as banks. On June 30, 2004, the SEC published in the Federal Register a new proposed rule (Regulation B) governing when a bank or savings association must register as a broker. Originally scheduled to go into effect on September 30, 2005, the SEC recently extended the effective date for Regulation B until September 30, 2006 in order to afford time to fully consider the comments received from the industry and other interested parties. 

Unlike the SEC’s Regulation B, savings associations are not treated the same as banks in all respects. Although savings associations 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 savings associations. 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 savings associations are engaged in the exempted securities activities and will only extend relief for savings associations to the securities activities they are currently performing. A separate analysis conducted by OTS, however, indicates that savings associations currently

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engage in all of the securities activities covered by the three additional exemptions. This information was forwarded to the SEC staff pursuant to their request. 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. OTS has strongly urged the SEC to remove this new disparity and the additional duplicative burden it imposes on savings associations.

As was the case in the SEC’s investment adviser proposal, in issuing its proposed broker rule, the SEC passed on the opportunity to streamline its overlapping oversight of savings association broker-dealer activities by providing the equivalent treatment to savings associations as banks receive. In both instances, the SEC has proposed to treat savings associations differently than banks in fundamentally important respects. Both of these actions impose duplicative regulatory burdens and demonstrate the continuing, immediate need for legislation to provide relief to savings associations under the federal securities laws.

B. Eliminating Obstacles to Small Business Lending by Federal Savings Associations

Another OTS legislative priority is reducing statutory limitations on the ability of federal savings associations 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 savings association's assets. Commercial loans in excess of 10 percent of assets must be in small business loans. OTS supports legislative provisions—such as that set forth in section 212 of H.R. 3505—that remove the current limit on small business lending and increase the cap on other commercial lending from 10 percent to 20 percent of assets.

In addition to being good for small business job creation and the economy, there are several reasons these changes make sense for savings associations. First, this will give savings associations greater flexibility to promote safety and soundness through diversification. Additional flexibility, particularly in small business lending, will provide opportunities to counter the undulations of a cyclical mortgage market. This will enable savings association 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 savings associations are at or near the current statutory limits and must curtail otherwise safe and sound business lending programs. Finally, this proposal will enable savings associations that have a retail lending focus to be able
to achieve the economies of scale necessary to engage in this activity safely and profitably.

Small business lending is an integral component of job growth and employment in the United States.\(^7\) This proposal would increase competition for, and the availability of, small business and other commercial loans now and in the future as savings associations 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.\(^8\) Finally, the proposal will also assist businesses that prefer borrowing from entities like savings associations that meet the needs of borrowers with personal service.

\(^7\) There are currently 23 million small businesses in the United States, representing 99.7 percent of U.S. employers. These firms employ more than half of all private sector employees, accounting for 44 percent of the U.S. private sector payroll. Small businesses generate between 60 to 80 percent of all net new jobs annually, and are responsible for over 50 percent of the U.S. private gross domestic product. U.S. Small Business Administration, Frequently Asked Questions (March 2004).

\(^8\) See “The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks.” Small Business Administration Office of Advocacy (March 2005).
C. Removing Disparate Standards in Savings Association Consumer Lending Authority

Another important regulatory burden legislative proposal for OTS is eliminating an anomaly that exists under HOLA relating to the current consumer lending authority for savings associations. Currently, consumer loans are subject to a 35 percent of assets limitation, while there is no limit on loans a savings association 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 savings association investment limit—are not secured. Removing the 35 percent cap on consumer lending will permit savings associations to engage in secured lending activities to the same extent that they may make unsecured credit card loans. Our hope is that this will increase savings association secured lending activities relative to unsecured credit card lending, thereby improving the overall safety and soundness of savings association loan portfolios, as well as providing burden relief.

Currently, section 208 of H.R. 3505 removes the 35 percent cap for auto loans made by savings association. For the reasons stated above, we believe eliminating the 35 percent cap for all types of consumer loans, including auto
loans, makes good policy sense and we urge that the Committee consider an amendment that accomplishes this objective.

A related amendment would address a similar anomaly that exists with how savings associations compute so-called “qualified thrift investments” (QTI) under the qualified thrift lender (QTL) test. Currently, a savings association may count 100 percent of its credit card loans as QTI, but other consumer loans count as QTI only to the extent that these and other categories of loans do not exceed 20 percent of the savings association’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 savings associations to perform more effectively as the retail institutions their customers need and expect, without impairing safety and soundness.

D. Clarification of Citizenship of Federal Savings Associations for Federal Diversity Jurisdiction

Pursuant to federal diversity jurisdiction, a federal savings association may sue or be sued in federal court if the claim exceeds $75,000 and the parties are citizens of different states. Section 213 of H.R. 3505 provides that, for purposes of
determining diversity jurisdiction, a federal savings association is a citizen of its home state and, if different, the state in which its principal place of business is located. While OTS supports section 213, our preference would be to modify the provision consistent with the Supreme Court’s recent decision holding that a national bank is a citizen of only its home state.

Some courts have determined that if a savings association 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. A provision similar to section 213 of H.R. 3505 would avoid this result, and also avoid a potential similar problem with respect to mutual savings associations. 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 savings associations, those operating regionally or nationally with depositors across the country would find it difficult or impossible to establish diversity jurisdiction. A uniform rule governing federal jurisdiction when a savings association is involved would reduce confusion and uncertainty.
E. Agency Continuity – Creating Statutory Succession Authority and Modernizing Appointment Authority for the OTS Director

OTS urges Congress to authorize the Treasury Secretary to appoint one or more individuals within OTS to serve as OTS Acting Director in order to assure agency continuity. Section 622 of H.R. 3505 would accomplish this by revising the current procedure of relying on the Vacancies Act to fill any vacancy that occurs during or after the term of an OTS Director or Acting Director. This would eliminate potential concerns and time constraints imposed by the Vacancies Act process under which OTS currently operates.

We believe that this revision is important given our continuing focus on the stability of the financial system and the regulatory oversight agencies in the event of a national emergency. For example, existing uncertainty about succession authority for an OTS Acting Director could impair the ability of OTS to act effectively and decisively in a crisis if an existing OTS Director or an Acting Director suddenly was incapacitated as a result of an event arising from a national emergency.
The OCC has long-standing authority for appointing Deputy Comptrollers, and both the FDIC and Federal Reserve Board have succession authority built into their operative authorizing statutes. One approach to ensure OTS continuity would be to amend HOLA to permit the Treasury Secretary to make the OTS appointments so each potential OTS Acting 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 FBAs. 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 greater, delays, it is important to promote stability and continuity within OTS by establishing a statutory chain of command within OTS. Implementing these suggested changes will avoid the possibility of gaps in authority to regulate and supervise savings associations, eliminate uncertainty for the savings associations OTS regulates, and avoid potential litigation over whether the acts of OTS staff are valid.

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The vacancy issue is of particular concern to OTS because we are the only financial services sector regulator that could be readily exposed to a vacancy problem. During a vacancy, OTS succession now occurs through the process of the Vacancies Act, which has inherent uncertainty regarding 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.

VI. Other Regulatory Burden Reduction Proposals

OTS also recommends enactment of other important regulatory burden relief initiatives. We appreciate the opportunity to work with the Committee on these and other provisions that will benefit the thrift industry. Before addressing these items, however, we want to draw the Committee’s attention to a proposal that has been circulated among some Members of the Committee regarding legislation to amend the law applicable to mutual holding companies (MHCs).

A. Proposed Mutual Holding Company Amendments

Within the last several months, we have been asked to opine on several occasions regarding a proposal to amend the statutory and regulatory requirements applicable to mutual holding companies (MHCs). In particular, a request has been
made to alter the corporate governance rules for these types of entities in order to permit the minority shareholders of a savings association to override the interests of a controlling, majority MHC shareholder (all MHCs are structured in this manner).

By way of background, a MHC structure is a statutory creation that permits a mutual savings association to remain community-based by avoiding a full-scale mutual-to-stock conversion. As we described in a recent letter to Senator Crapo, “part of the rationale supporting the MHC structure is that it allows for an infusion of capital into the institution without subjecting the institution to the types of shareholder pressures that may compromise and/or eventually eliminate the institution as a separate community banking organization.” We believe that this is an important objective that should be preserved.

As part of the process, the MHC is initially the sole shareholder at the outset of a MHC reorganization (owning 100 percent of the outstanding shares of the underlying institution); pursuant to statute and OTS regulations, the MHC is required to remain the majority and controlling shareholder throughout its existence. When an MHC subsequently decides to sell a minority interest to members of the public (including to the existing depositors of the institution), it does so under strict rules and procedures set forth by both the Securities Exchange Commission and OTS. This ensures that minority investors in a depository
institution controlled by a MHC acquire their minority interest with full notice and disclosure that the MHC is, and will continue to be, the controlling shareholder of the underlying depository institution.

The proposal that we have been asked to review would provide the minority shareholders in a MHC structure greater control over the underlying depository institution than a majority and controlling MHC. In our view, this is inconsistent with U.S. corporate governance standards, and would undermine the interests of the underlying institution’s depositors. Again, as stated in the letter to Senator Crapo, “[t]he interests of a former [mutual savings bank’s] mutual depositors, as represented by the MHC in an MHC structure, are paramount in connection with a MHC reorganization. The minority shareholders of an institution in an MHC structure are aware of this at the outset of the transaction, and they purchase shares of the converted institution with this knowledge. Any attempt to provide minority shareholders with greater rights and interests than the majority MHC undermines the basic principles of sound corporate governance and corporate ownership rights, as well as the objective of the mutual-to-stock conversion rules.”

It is our view that any proposal that overrides the controlling interest of a majority MHC shareholder in favor of the institution’s minority shareholders is inconsistent with good corporate governance and prevailing U.S. rules related to the rights of minority shareholders vis-à-vis majority shareholders in public
companies. More fundamentally, we are concerned that the proposal poses significant safety and soundness risks in the operation of MHCs, and also risks the retention and future use of the MHC structure.

B. Eliminating Duplicative Oversight of Savings Association

Subsidiaries by OTS and the FDIC

Under current law, savings associations are required to provide notice to both the FDIC and the OTS before acquiring a subsidiary or conducting any new activity through a subsidiary. This duplicative notification is burdensome and unnecessary. OTS supports streamlining the subsidiary notification process by eliminating the FDIC notification requirement for savings associations that wish to acquire a subsidiary or engage in any new activity through a subsidiary. The FDIC would still be able to determine by regulation or order that any specific activity poses a serious threat the Deposit Insurance Fund; and savings associations would still be required to provide notice to OTS when engaging in a new activity or acquiring a new subsidiary.

This proposal would place discretion within OTS, the primary federal regulator of savings associations, to determine permissible activities conducted by savings association subsidiaries. There appears to be no sound policy rationale for having a duplicative oversight procedure for determining what activities are
permissible for a savings association subsidiary. In this regard, we note that no similar procedure exists for determining the activities permissible for a national bank subsidiary.

The proposal is set forth in Matrix Item # 95, which it is my understanding is supported by the industry, and not opposed by any consumer groups. We urge inclusion of this provision in any regulatory relief bill considered by the Committee.

C. Authorizing Federal Savings Associations to Merge and Consolidate with Non-Depository Affiliates

OTS favors an amendment, such as that set forth at section 203 of H.R. 3505, providing federal savings associations the authority to merge with one or more of their non-depository institution affiliates, equivalent to authority enacted for national banks at the end of 2000.\(^{10}\) The Bank Merger Act would still apply, and the new authority does not give savings associations the power to engage in new activities.

Under current law, a federal savings association may only merge with another depository institution. This proposal reduces regulatory burden on savings

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\(^{10}\) Section 6 of the National Bank Consolidation and Merger Act (12 U.S.C. § 215a-3).
associations by permitting mergers with non-depository affiliates where appropriate for sound business reasons and if otherwise permitted by law. Today, if a savings association 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 savings association. Structuring a transaction in this way can be costly and unduly burdensome. We support permitting savings associations to merge with affiliates, along with the existing authority to merge with other depository institutions.

D. Amending the International Lending Supervision Act (ILSA) to Support Consistency and Equal Representation

Two amendments to ILSA that we previously proposed would promote greater consistency among U.S. regulators in supervising the foreign activities of insured depository institutions and should be added to any regulatory relief legislation considered by the Committee.

1. Applying ILSA to Savings Associations

OTS recommends making federal and state savings associations (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 FBAs, but savings associations 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 savings associations because these institutions were not active in international finance in 1983. While savings associations maintain a domestic focus—providing credit for housing and other consumer needs within the United States—some savings associations 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 savings and loan holding companies (SLHCs) have international operations (including several foreign-based holding companies) that provide opportunities for expanded international operations by the subsidiary savings association.
While OTS has broad supervisory powers under HOLA to oversee all activities of savings associations, their subsidiaries, and their affiliates, making savings associations 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.

2. OTS Representation on the Basel Committee on Bank Supervision

Amending ILSA to support equal representation for OTS on the Basel Committee will enable OTS to share its expertise with respect to consolidated supervision of diverse, internationally active holding companies, one-to-four family and multifamily residential lending, consumer lending, and interest rate risk management. SLHCs operate in more than 130 countries, control over $6 trillion in assets, and their savings association subsidiaries originate almost one in every four residential mortgage loans in the United States. At $2.6 trillion in one-to-four family residential mortgage loan originations in 2004, this market stands as the largest credit market in the world, currently with over $9 trillion in outstanding loans.11

11. See Mortgage Bankers Association Mortgage Finance Forecast (June 6, 2005).
OTS currently participates in numerous Basel Committee working groups and subcommittees. Giving OTS a recognized voice on Basel will help assure that international bank supervision policies do not inadvertently harm savings associations or the numerous internationally active SLHCs.

E. 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 support an amendment, such as that set forth in section 607 of H.R. 3505 to
increase the small institution threshold to $1 billion for well-capitalized, well-managed institutions.

This provision would reduce regulatory burden on low-risk, small institutions and permit the FBAs to more effectively focus their resources on the highest risk institutions.

F. Removal of Qualified Thrift Lender Requirements with Respect to Out-of-State Branches of Federal Savings Associations

OTS also supports an amendment, such as that at section 211 of H.R. 3505, removing the requirement that federal savings associations meet the QTL test on a state-by-state basis. This requirement is a superfluous regulatory burden because interstate savings associations may currently structure their activities to assure compliance with the state-by-state requirement. Thus, there is no meaningful purpose for maintaining this requirement. The QTL test should, of course, continue to apply to the institution as a whole.

G. Authority for a Savings and Loan Holding Company to Own a Separate Credit Card Savings Association

Another unnecessary and burdensome statutory provision is a limitation imposed on existing SLHCs that limits their activities (to those permissible for a
multiple SLHC) for the acquisition or chartering of a limited purpose credit card savings association, but permits acquiring or chartering (without any activities limitations) of a substantially similar limited purpose credit card bank. This restriction arises out of the fact that a SLHC generally cannot own more than one savings association (unless acquired in a supervisory transaction), without being subject to the activities restrictions imposed on SLHCs owning multiple savings associations. Under the HOLA, a SLHC cannot charter or acquire a limited purpose credit card savings association, but can charter or acquire a limited purpose credit card bank without triggering the multiple SLHC restrictions or being treated as a BHC under BHC Act.

From a regulatory burden perspective, it makes no sense to subject a SLHC structure to an additional bank regulator, i.e., supervising the limited purpose credit card bank, simply because of a statutory activities limitation that provides the SLHC cannot own an otherwise permissible limited purpose credit card savings association that it can own if the entity is a bank. This result is illogical and excessive regulatory burden with no additional supervisory or regulatory benefit attached. We support an amendment, such as section 216 of H.R. 3505, providing that a limited purpose credit card savings association is not deemed a savings association, or is excluded from consideration, in applying the activities restrictions imposed on multiple SLHCs under the HOLA.
H. Modernizing the Community Development Investment Authority of Savings Associations

OTS supports updating HOLA to give savings associations the same authority as national banks and state member banks to make investments to promote the public welfare. A provision, such as section 202 of H.R. 3505, would enhance the ability of savings associations 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, investment opportunities that meet the technical requirements of savings associations' current statutory community development authority are rare. As a result, OTS has found it cumbersome to promote the spirit and intent of Congress's determination to allow savings associations to make such community development investments. Currently, using its administrative authority, OTS may issue a "no action" letter when a savings association 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, lacks certainty, and is clearly burdensome.
We favor a provision such as section 202 of H.R. 3505 because it closely tracks the existing authority for banks. Under this provision, savings associations 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 savings association’s capital and surplus, or up to 15 percent on an exception basis.

I. Eliminating Geographic and Ownership Limits on Thrift Service Companies

OTS supports legislation authorizing federal savings associations to invest in service companies without regard to the current geographic and ownership restrictions. Current law permits a federal savings association to invest in a service company only if (i) the service company is chartered in the savings association’s home state, and (ii) the service company’s stock is available for purchase only by savings associations chartered by that state and other federal savings associations 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 savings associations, which often operate in more than one state, to join with
savings associations and banks to obtain services at lower costs due to economies of scale or to engage in other approved activities.

Today, a savings association 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 savings association’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 savings associations and banks, and discourages otherwise worthwhile investments. While this proposal simplifies the ability of banks and savings associations to invest together in service companies, it does not expand the powers of savings associations or banks. The activities of the service company must be permissible investments under the rules applicable to the savings association or bank.

Currently, section 406 of H.R. 3505 would provide authority for savings associations to invest in bank service companies, and section 503 would eliminate geographic limits on thrift service companies. We support these provisions and urge the Committee to include these in any bill considered by the Committee in order to provide for a streamlined and efficient regulatory framework.
J. Streamlining Agency Action under the Bank Merger Act

OTS supports streamlining the Bank Merger Act application requirements by eliminating the requirement that each FBA request a competitive factors report from the other three banking agencies and the Attorney General. An amendment such as that set forth at section 610 of H.R. 3505 would eliminate the need for five agencies to consider the competitive effects of every proposed bank or savings association 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 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.

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, and without undue impact on existing consumer protections. We support proposed legislation that advances this objective and urge action by this Committee to
reduce regulatory burden on the industry at the earliest possible date. I want to thank you, Mr. Chairman, Senator Sarbanes, Senator Crapo, and the other Members of the Committee who have shown leadership on this issue. We look forward to working with the Committee to shape the best possible regulatory burden relief legislation.
# SEC Proposed Relief

## Investment Advisor Registration

<table>
<thead>
<tr>
<th>Type of Account or Service Provided</th>
<th>National or State Charter Banks and Trust Companies</th>
<th>SEC Proposal for Savings Associations</th>
</tr>
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</table>
| Accounts without Investment Management or Advice Responsibilities  
   - Trust Accounts  
   - Court Accounts  
   - Agency/Custodial Accounts | These accounts do not trigger investment advisor registration | These accounts do not trigger investment advisor registration |
| Trust Accounts  
   (with investment management or advice responsibilities)  
   - Personal Trust  
   - Employee Benefit Trust  
   - Charitable Trust | Do not have to register because of existing exemption | NO CHANGE  
   These accounts will still trigger investment advisor registration |
| Court Accounts  
   (with investment management or advice responsibilities)  
   - Executor  
   - Administrator  
   - Guardian  
   - Conservator | Do not have to register because of existing exemption | NO CHANGE  
   These accounts will still trigger investment advisor registration |
| Agency Accounts  
   (with investment management or advice responsibilities)  
   - Individuals  
   - Personal Trusts  
   - Employee Benefit Plans and Trusts  
   - Corporate Entities  
   - Charities  
   - Mutual Funds  
   - Hedge Funds  
   - Common Trust Funds  
   - Collective Investment Funds | Do not have to register because of existing exemption  
   (unless providing investment advice to a mutual fund, in which case the department or division of the bank or trust company providing the advice must register as an investment adviser) | NO CHANGE  
   These accounts will still trigger investment advisor registration |
One of the bills that is before us today is the Competitive Market Supervision Act. This bill, which I have co-sponsored, does two important things for the people of the United States. First, the bill reduces securities fees for a large number of Americans. These fees, while relatively small, put an unnecessary burden on all investors, including those with retirement funds or pension funds. Second, the bill would provide for pay parity for Securities and Exchange Commission professional employees, by permitting the SEC to bring their pay in line with that of employees of other financial regulatory agencies. The SEC is charged with ensuring that investors receive the highest level consumer protections. This bill would help the SEC to attract – and retain – the best minds to fulfill its obligations to the American people.

On a separate issue, I have become aware of disparate treatment between savings associations and banks under the Investment Advisors Act. This Act exempts banks from its scope but does not exempt savings associations. This differing treatment puts savings associations at a competitive disadvantage, without reason. A similar disparity used to exist under a related law, the Investment Company Act of 1940; however, last year the Gramm-Leach-Bliley Act corrected the discordant treatment.

In the past few months, my staff has had discussions with the Securities and Exchange Commission and industry representatives. The SEC has determined that it has the statutory authority to exempt individual institutions and groups of institutions – including savings associations – from the scope of the Investment Advisors Act. Since the SEC has concluded that this parity issue may be resolved through rulemaking and has agreed to work with the industry to reach such resolution, I withhold legislative involvement. I appreciate their commitment and look forward to their resolution.
August 18, 2000

The Honorable Arthur Levitt
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Levitt:

As you are aware, on July 13, 2000, the Senate Banking Committee held a markup on S. 2107, The Competitive Market Supervision Act, among other legislation. Although I was unable to attend the markup, I submitted a written statement for the record. I thought you might be interested in seeing a copy of the statement, which I attached for you.

In my written statement, as a co-sponsor of S. 2107, I reiterated my belief of the appropriateness of the legislation and its benefits to Americans. Separately, I commented on the Securities and Exchange Committee's rulemaking initiative to exempt savings associations from the Investment Advisors Act. Savings associations should be provided a level playing field with banks, which historically have been exempt from the Act. Because SEC staff determined that this parity issue may be resolved through rulemaking and agreed to move forward with the rulemaking process, I withheld legislative action at the July 13 markup. I look forward to the SEC's timely resolution of this issue.

If I or my staff may be of assistance in this rulemaking effort or other matters, please do not hesitate to call.

Sincerely,

Evan Bayh
January 9, 2006

The Honorable Mike Crapo
239 Dirksen Building
Washington, DC 20510

Dear Senator Crapo:

This letter is in response to language on "Mutual Savings Bank Conversions" that your office has asked us to review (copy enclosed). I understand that our staff has already provided informal comments to you on this. The purpose of this letter is to formalize the previous comments, as well as to highlight the concerns of the Office of Thrift Supervision (OTS) with respect to the proposal we have reviewed.

Generally, the language we reviewed raises a number of significant issues. The description also appears confused about the relative rights and ownership interests of mutual members of a mutual holding company (MHC) and minority shareholders of a mutual savings bank (MSB) that has converted to stock form in an MHC structure. As detailed below, OTS believes the proposal would significantly disadvantage the rights and interests of the depositors of an MSB that reorganizes into an MHC structure.

First, the discussion indicates that OTS currently regulates MSBs. Please note that the OTS and FDIC both regulate MSBs and have similar rules with respect to the substantive issue raised in the proposal, i.e., enabling minority shareholders to control a savings association subsidiary of an MHC. These rules are intended to provide for the MHC structure as an alternative to an outright mutual-to-stock conversion by a mutual depository institution.

Second, part of the rationale supporting the MHC structure is that it allows for an infusion of capital into the institution without subjecting the institution to the types of shareholder pressures that may compromise and/or eventually eliminate the institution as a separate community banking organization.

Third, when minority shareholders invest in a depository institution owned in an MHC structure, they understand that they are purchasing a minority ownership interest, which OTS (and FDIC) rules clearly state and contemplate. Specifically, they understand that the MHC controls the institution and makes the business decisions regarding it.

Fourth, while many depositors of an MSB may execute "running proxies" that will continue at the MHC level, depositors always have the ability to rescind these and vote on any
matter pending at an annual meeting. Regarding the notification rules for an annual meeting by an institution in an MHC structure, the minority shareholders of the MHC’s savings association subsidiary receive the same notice as required for any stock institution.

Finally, with respect to the reference that the non-public MHC would prevail in a situation where 100 percent of the public shareholders voted against a management slate that is approved by the nonpublic MHC, please note that the largest and controlling shareholder of a converted institution in an MHC structure remains the MHC. The premise of the MHC structure is that depositors (who are members of the MHC) retain control of the institution. Moreover, to the extent that such control would pass from the MHC to the minority shareholders, a mutual-to-stock conversion would effectively occur, without compliance with existing mutual-to-stock conversion regulations.

The interests of a former MSB’s mutual depositors, as represented by the MHC in an MHC structure, are paramount in connection with an MHC reorganization. The minority shareholders of an institution in an MHC structure are aware of this at the outset of the transaction and purchase shares of the converted institution with this knowledge. Any attempt to provide minority shareholders with greater rights and interests than the majority MHC undermines the basic principles of sound corporate governance and corporate ownership rights, as well as the objectives of the mutual-to-stock conversion rules.

If you have any further questions, please feel free to contact me or Kevin Petrasic, Managing Director for External Affairs, at (202) 906-6452. Thank you.

Sincerely,

[Signature]
John E. Bowman
Chief Counsel

Enclosure