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Statement of

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Acting Director, Office of Thrift Supervision

regarding

**Systemic Regulation, Prudential Matters,
Resolution Authority and Securitization**

before the

Committee on Financial Services
United States House of Representatives

October 29, 2009

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I. Introduction

Good morning, Chairman Frank, Ranking Member Bachus and members of the Committee. Thank you for the opportunity to testify today on “Systemic Regulation, Prudential Matters, Resolution Authority and Securitization.” We appreciate the Committee’s efforts to improve the supervision of the nation’s financial institutions and to prevent a recurrence of problems affecting the housing market, the financial sector and the larger economy.

In this testimony, I will present the views of the Office of Thrift Supervision on the draft bill, the Financial Stability Improvement Act of 2009.

II. OTS Views on Financial Regulatory Reform Legislation

Financial Services Oversight Council

The OTS strongly supports the establishment of a Financial Services Oversight Council (Council) made up of the Secretary of the Treasury and all of the Federal financial regulators. Among other responsibilities, the Council would identify entities that should be designated as systemically important. The Council would also issue formal recommendations for the financial regulators to adopt material prudential standards for such firms and to set risk management standards for systemically important systems and activities regarding payment, clearing and settlement.

The draft bill provides a regime to resolve systemically important firms when the stability of the financial system is threatened. The resolution authority would supplement and be partially modeled on the existing resolution regime for insured depository institutions under the Federal Deposit Insurance Act.

OTS's view on these aspects of the draft bill is guided by our key principle that any financial reform package should create the authority to supervise and resolve all systemically important financial firms. The U.S. economy operates on the principle of healthy competition. Enterprises that are strong, industrious, well-managed and efficient succeed and prosper. Those that fall short of the mark struggle or fail; other, stronger enterprises take their places. Enterprises that become "too big to fail" subvert the system

when the government is forced to prop up failing, systemically important companies — in essence, supporting poor performance and creating a “moral hazard.”

The establishment of a strong and effective Council would create a mechanism for each of the financial regulators to provide their valuable insight and experience to the systemic risk regulator.

Supervision and Regulation of Large, Interconnected Financial Firms

As noted in the previous section, the OTS strongly supports the supervision and regulation of large, interconnected financial firms. There is a pressing need for a systemic risk regulator with broad authority to monitor and exercise supervision over any company whose actions or failure could pose unacceptable risk to financial stability. The systemic risk regulator should have the authority and the responsibility for monitoring all data about markets and companies, including, but not limited to, companies involved in banking, securities and insurance.

The continued ability of banks, thrifts and other entities in the United States to compete in today’s global financial services marketplace is critical. A systemic risk regulator should be charged with coordinating the supervision of conglomerates that have international operations. Safety and soundness standards, including capital adequacy, risk management and other factors, should be as comparable as possible for entities that have multinational businesses.

Supervision and Regulation of Federal Depository Institutions

The OTS strongly supports fixing what is broken in the nation's financial regulatory framework by addressing the problems that caused the current financial crisis and could cause the next one. As noted in previous testimony, the OTS believes that merging agencies does not fit into that category. Because the thrift charter and thrift institutions would continue to exist, the industry would be better regulated and consumers would be better served by retaining the OTS, a primary regulator that understands the operations of consumer and community lenders. For this reason, the OTS does not support the merger of the OTS and the Office of the Comptroller of the Currency (OCC), or the establishment of a single federal bank regulator that would merge the OTS, OCC and the state bank supervisory functions of the Federal Reserve Board and the Federal Deposit Insurance Corporation.

In addition, the OTS is particularly troubled by the proposed merger approach envisioned by the revised version of the draft scheduled for mark-up. The discussion draft represents a significant departure from the Administration's white paper on Financial Regulatory Reform and the original legislative language, both of which would have abolished both the OTS and the OCC, and established a new agency called the National Bank Supervisor. The discussion draft would instead preserve the OCC and create within the OCC a new Division of Thrift Supervision.

If Congress concludes that merging agencies would accomplish an important public policy goal, then we believe Congress should reorganize federal bank supervision for the 21st Century by establishing a strong new agency with a name that is recognizable to consumers and accurately reflects its mission. The Office of the Comptroller of the Currency has not had currency-related functions since the Banking Act of 1935 retired national bank currency in favor of Federal Reserve notes.

Moreover, if employees of both the OTS and the OCC had an equal opportunity to compete for positions, then the resulting agency would be more cohesive and would benefit from the most qualified and capable workforce and leadership. If this bill were to pass as currently drafted, OTS employees would be singled out and put at a significant disadvantage vis-à-vis their counterparts at other agencies. The situation would be particularly onerous for OTS employees who are not examiners and who would not work directly in the Division of Thrift Supervision. Instead of having a fair opportunity to obtain a position in the reconstituted agency based on merit and on-the-job performance, they would be folded into current divisions of the OCC.

We are concerned that OTS employees could regard this approach as unfair and punitive, and that such an approach would send the wrong signal to the OTS workforce, as well as to all federal employees. We also believe that this approach would run the danger of establishing an agency without the unity and harmony necessary for any successful enterprise.

An important way the Committee could mitigate the impact would be to include for OTS employees all of the employee protections included in the bill to establish the Consumer Financial Protection Agency (CFPA). Most important among these protections would be a five-year protection from a reduction in force. Such protections are not included in the draft bill that was available to us for review and we believe strongly that OTS employees should be accorded the same treatment as prospective CFPA employees.

As currently drafted, the draft bill would send the wrong message to all federal employees about how they would be treated in an agency consolidation. The timing of such a signal could hardly be worse, when a large percentage of federal employees are nearing retirement age and federal agencies are redoubling their efforts to attract the workforce of the future to respond to the call to federal service.

The OTS has an outstanding, highly skilled and experienced workforce. If regulatory consolidation takes place, a merger of equals into a new agency would assure better employee morale, a better work environment and a higher-quality outcome.

Congress should model its approach to agency consolidation on the recent merger of the Office of Federal Housing Enterprise Oversight and the Federal Housing Finance Board into the new Federal Housing Finance Agency.

We strongly urge the Committee to reaffirm that Congress values the service of federal employees and to ensure that the draft bill promotes a fair, even-handed approach that would result in a harmonious agency with employees hopeful about the future of the agency and their role in it.

Regulation of Savings and Loan Holding Companies

Under the Committee discussion draft, most thrift holding companies would become bank holding companies under the Bank Holding Company Act of 1956. The proposed changes would also apply to the unitary savings-and-loan holding companies that were grandfathered in the Gramm-Leach-Bliley Act of 1999. Such an entity would be required to form and register a special-purpose holding company to be governed by regulations drafted by the Federal Reserve Board.

The OTS does not support forcing thrift holding companies to be regulated by the Federal Reserve Board. This conversion would constitute an unnecessary and costly burden, especially to small thrifts that did not contribute in any way to the financial crisis.

This proposal seems to assume that thrift and bank holding companies are the same. The OTS knows this is not the case. Consumer and community lenders, particularly mutual institutions, and their holding companies are vastly different from large, complex banks and their diversified holding companies. The overwhelming majority of thrift holding companies need to be regulated by their prudential regulator not

for their systemic significance, but for the impact of their operations on the underlying insured depository institutions.

The OTS position is guided by the key principle that changes to the financial regulatory system should address real problems. This provision does not address a real problem. As is the case with the regulation of thrift institutions, OTS believes that entities became savings-and-loan holding companies based on their business models, typically of providing everyday financial services to America's consumers and communities. The OTS is not the proper regulator for systemically significant conglomerates, but the agency is indeed the proper regulator for the holding companies of community-oriented thrifts that engage in relationship banking in cities and towns across the nation.

The OTS supervises both thrifts and their holding companies on a consolidated basis. Under the draft bill, thrifts and their holding companies would be supervised by different agencies. We believe that the OTS, the prudential supervisor of thrifts, should continue to regulate their holding companies, except in the case of a thrift that is systemically significant.

Savings-and-loan holding company supervision is an integral part of OTS oversight of the thrift industry. OTS conducts holding company examinations concurrently with the examination of each thrift subsidiary, supplemented by off-site monitoring. We believe the consolidated regulation of the thrift and its holding company

has enabled us to effectively assess the risks of the entire entity, while retaining a strong focus on protecting the Deposit Insurance Fund.

The OTS has a wealth of expertise and a keen understanding of small, medium-sized thrifts, including mutual thrifts, and their holding companies. Consolidated supervision is particularly important for these entities, because separate regulation of the thrift and holding company would be especially costly, burdensome and inefficient for them. We are concerned that if the Federal Reserve became the regulator of these holding companies, it would focus most of its attention on the largest holding companies to the detriment of small and mutual savings-and-loan holding companies.

However, as mentioned earlier, the OTS believes a systemically important savings-and-loan holding company should be regulated by the systemic regulator. This is consistent with our key principle that any financial reform package should create the ability to supervise and resolve all systemically important financial firms.

Enhanced Resolution Authority

The OTS strongly supports providing a resolution regime for all systemically important firms. Given the events of recent years, it is essential that the federal government have the authority and the resources to act as a conservator or receiver, and to provide an orderly resolution of systemically important institutions, whether banks, thrifts, bank holding companies or other financial companies. The authority to resolve a distressed systemically important firm in an orderly manner would ensure that no bank or

financial firm is “too big to fail.” A lesson learned from recent events is that the failure or unwinding of systemically important companies has a far reaching impact on the economy, not just on financial services.

III. Conclusion

In conclusion, the OTS strongly supports the Committee’s goals of creating a system of financial regulation that ensures protections for consumers, while building a strong supervisory framework to prevent another financial crisis. Although we disagree with some of the details, we agree that the time for reform is now.

Thank you again, Mr. Chairman, Ranking Member Bachus, and Members of the Committee, for the opportunity to testify on behalf of the OTS.

We look forward to continuing to work with the members of this Committee and others to fashion a system of financial services regulation that better serves all Americans and helps to ensure stability for this nation’s economy.