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The Federal Reserve Begins Regulating Thrift Holding Companies

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The Federal Reserve Board took its first steps last week into the world of regulating savings and loan holding companies. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Office of Thrift Supervision, the primary regulator for savings and loan associations and their holding companies, will cease to be an independent federal agency on July 21, 2011. On that date, the OTS will become part of the Office of the Comptroller of the Currency, the current regulator of national banks, and all regulation of savings and loan associations – or "thrifts" as they are sometimes called – will be under the auspices of the OCC.

However, the Dodd-Frank Act also mandated that regulation and supervision of savings and loan holding companies (SLHCs), previously within the purview of the OTS, be transferred to the Federal Reserve Board, which regulates and supervises bank holding companies (BHCs). On April 15, 2011, the Federal Reserve issued its first pronouncement in this area by seeking comment to a proposed Supervisory Guidance by which the Federal Reserve proposes to apply certain elements of its consolidated supervisory program for BHCs to SLHCs. This is consistent with the Federal Reserve's long-standing concern about capital standards, liquidity and risk management at BHCs and with its oft-stated goal that a BHC and its nondepository subsidiaries should be a source of strength for, and not threaten the safety and soundness of, its depository banks.

While the Federal Reserve noted that in certain areas its program of consolidated supervision and regulation may well entail more encompassing reviews than those of the OTS, it does not expect these to be an "undue burden on an ongoing basis." The areas

highlighted by the Federal Reserve in announcing its proposed Supervisory Guidance are (i) a more rigorous review of internal control functions and consolidated liquidity, (ii) heightened review of the activities of nonbank subsidiaries, (iii) so-called "discovery reviews" of specific activities presently being conducted by an SLHC, and (iv) in the case of the larger SLHCs, greater continuous supervisory monitoring.

The Federal Reserve recognizes that the disparity in size among SLHCs warrants that its consolidated supervisory program be aligned based on size and complexity, along the lines currently used for community, regional or large banking organizations. Initially, the Federal Reserve will use size and complexity as the standards by which it will determine the extent of the supervisory program to be employed. Thus, as an example, a "noncomplex" SLHC of \$1 billion or less in size probably will only be subject to an off-site review if it has a satisfactory rating, while such an institution of between \$1 billion and \$10 billion in size probably will be the subject of a limited on-site examination process.

A judgment as to whether an SLHC is "complex" or "noncomplex" will depend on a number of factors, including the extent of intercompany transactions between the SLHC or any of its uninsured affiliates and the insured depository subsidiaries, the nature and scale of any nonbank activities, whether risk management processes are consolidated across the group and whether the SLHC has any outstanding public debt.

The Federal Reserve noted that a material difference currently exists between the Federal Reserve and the OTS on the question of capital adequacy. Currently, SLHCs are not subject to minimum regulatory capital ratio requirements. Rather, the OTS makes a judgment based on its assessment of the organization. Under the Dodd-Frank mandate, this will change for SLHCs and the Federal Reserve believes that, generally speaking, the same consolidated leverage and risk-based capital requirements used for BHCs should apply to SLHCs. However, the Federal Reserve is conscious of the need to address this subject in the context of the unique characteristics, risk profiles and specific activities of SLHCs. With that in mind, the Federal Reserve seeks comment on the current use of certain hybrid or unique capital instruments and how the expected new capital rules being prepared as part of the Basel III process would affect these instruments.

Finally, the Federal Reserve recognizes that the current rating system for SLHCs known as "CORE" differs in some respects from the Federal Reserve's rating system known as "RFI/C(D)." The Federal Reserve is proposing that all SLHCs be transitioned to the Federal Reserve rating system; however, it seeks comments on the burdens this transition may cause.

The Federal Reserve's April 15, 2011, Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies can be viewed [here](#).