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The Future of The Federal Thrift Charter

Author: John C. Grosvenor

The End of the OTS

Today, when the President signed the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (the "Reform Act") into law, he set in motion the beginning of the end for the Office of Thrift Supervision. The OTS, which was created in 1989 to assume the functions of the former Federal Home Loan Bank Board, is now to be abolished itself.

Under the ***Enhancing Financial Institution Safety and Soundness Act of 2010***, included as Title III of the Reform Act, Congress scheduled the OTS's last day as a functioning regulator to be July 21, 2011, unless the Secretary of the Treasury can demonstrate a genuine need to postpone that date, in which case the date of transfer of the OTS's responsibilities can be extended until as late as January 21, 2012.

Once the transfer has been accomplished, the powers and responsibilities of the OTS will be divided among other federal banking regulators:

The OCC will assume the OTS's examination powers and supervisory responsibilities over federal associations. The OCC will also receive general rulemaking authority over all federal thrifts and state savings associations.

The FDIC will assume the OTS's examination powers and supervisory responsibilities over state savings associations.

The Federal Reserve will assume the OTS's examination powers and supervisory responsibilities over savings and loan holding companies and their nondepository institution subsidiaries (other than subsidiaries of the depository institution itself). The

Newsletter Editors

Katerina Hertzog Bohannon
Partner
kbohannon@manatt.com
650.812.1364

Harold P. Reichwald
Partner
hreichwald@manatt.com
310.312.4148

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Federal Reserve will also receive rulemaking authority relating to transactions by insured thrift subsidiaries with affiliates, loans to insiders and tying arrangements.

The Bureau of Consumer Protection, a new regulator created under the ***Consumer Financial Protection Act of 2010*** included as Title X of the Reform Act. Title X provides the Bureau with independent examination and enforcement powers concerning compliance with federal consumer financial laws and regulations by savings associations having more than $10 billion in assets. The Bureau will also possess broad rulemaking authority over consumer financial protection measures.

Based upon coordination and consultation among themselves and with the OTS, the Federal Reserve, the OCC and the FDIC are required to jointly submit a comprehensive plan to Congress on or before January 21, 2011, covering the implementation of the transfer of the OTS's powers, personnel, and property. Within 60 days of receiving the plan, the Inspectors General of the Treasury, the FDIC and the Federal Reserve must jointly provide a written report to the Federal Reserve, the FDIC, the OCC and the OTS, with a copy to Congress, detailing whether the implementation plan conforms to the provisions of Title III of the Reform Act.

Further, on or before the transfer date, the Federal Reserve, the OCC and the FDIC must publish a list of OTS regulations that they will continue to enforce. The OCC and the FDIC are required to consult with one another and coordinate in identifying the list of continuing OTS regulations.

The Reform Act contains provisions intended to ensure that, on the transfer date, existing OTS orders, resolutions, determinations, agreements, regulations, interpretations, guidelines, procedures and other advisory materials will continue in effect unless and until modified, terminated, set aside or superseded by action of the assuming agency. Proposed regulations of the OTS that are not effective on the transfer date will be deemed to be proposed regulations of the OCC or the Federal Reserve, as the case may be.

The Beginning of the End for the Federal Thrift Charter as Well?

Although the Senate version of the legislation had proposed eliminating not only the OTS but the federal thrift charter as well, the Reform Act preserves the federal thrift charter but also

includes changes that may make the features of that charter less desirable and may cause many thrifts to consider the choice of converting to a bank or a state savings association charter.

For instance, although the Home Owners Loan Act ("HOLA") will continue to govern the powers and regulation of thrifts and their holding companies, each of the agencies that will assume OTS responsibilities can be expected to interpret and enforce the HOLA in a manner that will mostly rationalize and reconcile the regulatory treatment of similarly situated depository institutions. The assuming agencies are unlikely to adopt separate regulatory regimes for the different charters they may each regulate, except to the extent such differences are required under the HOLA. As a result, savings associations should expect to receive more bank-like supervision and examination from their new federal regulators.

In addition, the cultural differences between the assuming agency and the OTS may be significant, especially in light of the fact that the OTS is being abolished, at least in large part, for its perceived role in contributing to a failure of supervision that led to dramatic losses. In that regard, although OTS personnel are to be assigned new roles with the assuming agencies, because of the more stringent supervision which thrifts are likely to receive, favorable institutional relationships and specialized knowledge of the challenges of housing finance are likely to diminish with the passage of the OTS. Moreover, the perceived benefits that thrifts and their holding companies previously enjoyed by being regulated by one agency at both the holding company and the insured subsidiary levels will also soon be gone.

Further, other perceived advantages of the federal thrift charter have been the subject of legislative change. As an example, the Reform Act retains the qualified thrift lender test (the "QTL Test") but increases the risks and consequences associated with a failure to comply. Although the noncompliant thrift would no longer be required to convert to a bank under the Reform Act, it would become subject to national bank activities limitations and national bank branching restrictions. However, since the Reform Act also liberalizes opportunities for de novo branching by national banks, this latter restriction is now of less significance (See Banking Law July 1, 2010). More importantly, under the Reform Act, the noncompliant thrift would be prohibited from paying any dividend unless the dividend would be permitted for a national bank, would be "necessary" to meet the obligations of the parent holding

company, and only with the prior approval by the OCC and the FRB upon application submitted at least 30 days in advance of the proposed payment. Finally, under the Reform Act, a failure to comply with the QTL Test will be a violation of Section 5 of the HOLA, causing the thrift to be vulnerable to enforcement action.

The Reform Act also codifies the Federal Reserve's "source of strength" doctrine that historically applied to bank holding companies and directs the agency to adopt regulations on or before July 21, 2011, to make sure that any company, including a savings and loan holding company, that controls an insured depository institution must serve as a source of financial strength for that depository institution subsidiary by possessing sufficient capital to ensure that it has "the ability... to provide financial assistance to such insured depository institution in the event of the financial distress...."

Finally, federal thrifts (and national banks) have historically enjoyed the benefits of broad preemption of state laws, but under Title X of the Reform Act, state consumer protection laws will not be preempted except in cases where state law is "inconsistent" with federal measures, and then only to the extent of the inconsistency. Title X of the Reform Act also permits state attorneys general to bring civil actions to enforce the Consumer Financial Protection Act of 2010 or the regulations issued thereunder.

Alternatives for Federal Thrifts Going Forward

If the benefits of being a federal thrift have become fewer, and the burdens have become greater, then what alternatives are available going forward? It would not be wrong to suggest that, although Congress did not choose to abolish the federal thrift charter, the Reform Act certainly made it less attractive, a consequence that begs the question of whether a federal thrift is better off converting to a bank or state savings association charter.

Under the Reform Act, a thrift that converts to a bank is permitted to retain its branches and to establish additional branches within states where it operated a branch prior to becoming a bank to the same extent permitted to state-chartered banks in such states by applicable state law.

However, in order to eliminate forum shopping as a way of finding more lenient regulation, the Reform Act generally precludes

conversions between federal and state charters whenever the converting institution is subject to an enforcement order concerning a matter of significant supervisory concern. The prohibition, however, does not apply if the agency that issued the enforcement order agrees to a conversion plan that addresses the supervisory matters in a manner that is consistent with the safe and sound operation of the converting institution, and the resulting regulator agrees to implement the plan.

In light of the more stringent supervisory culture that federal thrifts can expect to see going forward from their new federal bank regulators, the increased risks associated with noncompliance under the QTL Test, the enhanced source of strength obligations to be imposed on savings and loan holding companies, the reduced federal preemption of state consumer financial protection laws, and other consequences to the federal thrift charter under the Reform Act, it would be prudent for the Board of Directors of a federal thrift and its holding company to evaluate whether a federal thrift charter remains the best choice in the future given their specific circumstances and unique needs.

For additional information on this issue, contact:

John C. Grosvenor Mr. Grosvenor's practice focuses on corporate finance, securities regulation, mergers and acquisitions, capital markets, corporate governance and regulatory issues affecting public and privately-held businesses. In addition, Mr. Grosvenor has many years of business experience as a senior executive officer in banking and telecommunications.