

# Thrift Institutions: Supervision After Dodd-Frank

August 2, 2011

Presented by:

Jeff Curry  
FTI Consulting

Dwight Smith  
Oliver Ireland

Morrison & Foerster LLP

# Topics

---

- Legal Foundations
- Preparation for Consolidated Supervision
- Consolidated Supervision Going Forward

---

# Legal Foundations

# Dodd-Frank Provisions

---

- ÿ Section 312
  - ÿ Transfer of supervisory functions and rulemaking authority
  - ÿ Transfer of all powers, authorities, rights, and duties
  - ÿ Reorganization of OCC to accommodate thrift supervision
- ÿ Section 316(b)
  - ÿ Survival of guidance
- ÿ Section 606(b)
  - ÿ Well-capitalized and well-managed status
- ÿ Section 624
  - ÿ Dividend restrictions for QTL failure
- ÿ Section 626
  - ÿ Intermediate holding companies
- ÿ Sections 1044-1046
  - ÿ Preemption, including changes specific to thrift institutions

# Dodd-Frank Provisions

---

## Survival of Home Owners' Loan Act

- ÿ Powers and activities
- ÿ Service corporations
  - ÿ Real estate brokerage generally
  - ÿ Property development
- ÿ QTL test
- ÿ Continued restrictions
  - ÿ Dividend notices
- ÿ Grandfathered unitaries

# Dodd-Frank Provisions

---

Non-thrift-specific changes that may have a substantial impact

- ÿ Capital rules (section 616(b))
- ÿ Collins Amendment (section 171)
- ÿ Source of strength (section 616(d))
- ÿ Mortgage lending
  - ÿ Risk retention
  - ÿ Title XIV restrictions
  - ÿ Disclosure requirements

# Dodd-Frank Provisions

---

Other changes that could affect results or operations

- CFPB (Title X)
- Durbin Amendment (section 1075)
- Interest-bearing transaction accounts (section 627)
- Deposit insurance assessments (section 331(b))
- Affiliate transaction amendments (section 608)
- In some circumstances, Volcker (section 619) and Lincoln (section 716) Amendments

# Agency Implementation

---

## Cross-agency items

- ÿ Joint implementation plan
- ÿ Reporting requirements
  - ÿ TFR to Call Report
  - ÿ H(b)-11 to FR Y-9
- ÿ Transitional issues
  - ÿ Continued use of TFR
  - ÿ Examination continuity

# Agency Implementation

---

## Federal Reserve Board

- ÿ Supervisory approach—“more intensive supervisory activities”
  - ÿ Capital
  - ÿ Liquidity
  - ÿ Risk Management
- ÿ Replacement of control rules
  - ÿ Rebuttal of control
- ÿ Assignments to supervisory portfolios
- ÿ Still to come:
  - ÿ Final reporting rules
  - ÿ Final control rules
  - ÿ Intermediate holding company proposal

# Agency Implementation

---

## OCC

### • Reorganization

- Deputy Comptroller for Thrift Supervision
- Associate Deputy Comptrollers
- Senior Advisor for Thrift Supervision

### • Regulatory review

- Preemption and visitorial powers

### • Assignments to supervisory programs

- Community bank supervision

### • Still to come:

- Continuing regulatory review in 2011

# Agency Implementation

---

## FDIC

- Joint notice with OCC of regulations to be enforced
- Interim TFR reporting

---

# Preparation for Consolidated Supervision

# Federal Reserve Supervision

---

- The Board supervises BHCs on a consolidated and enterprise-wide basis. The consolidated view is aimed at understanding the risks and risk management of the BHC throughout the entire company.
- The Board will apply its existing BHC supervisory framework to SLHCs. The supervisory approach will be tailored to the size, complexity and risk profile of the SHLCs and their subsidiaries.
- As with BHCs, the objective is to ensure that the SLHC and its nondepository subsidiaries are effectively supervised and can serve as a **source of strength** for, and do not threaten the soundness of, its subsidiary depository institutions.
- The Board will coordinate with banking and functional regulators of the various SLHC subsidiaries, but it will apply its own supervisory model at the holding company level.
  - The Board will review the OCC's evaluations of the thrift subsidiaries and those of the regulators of other subsidiaries, but will independently focus on the risks and risk management of all subsidiaries at the consolidated level.

## Differences from OTS Supervision

---

- The Board's SLHC supervision will likely "entail more intensive supervisory activities than under current OTS practice, at least for some SLHCs."
- Examples:
  - More rigorous reviews of internal control functions
  - More detailed reviews of consolidated liquidity measurement and analysis
  - Heightened reviews of activities of non-bank subsidiaries
  - Potential continuous supervisory monitoring of larger SLHCs
  - More intensive focus on ERM: risk management at the consolidated level
- Smaller, non-complex SLHCs will not likely experience much change in supervisory intensity.
  - Up to \$10 billion in total assets, with \$5-10 billion receiving the most supervisory scrutiny
  - Depends, in addition to size, on complexity and current examination ratings
- OTS's THC rating system ("CORE") will be migrated to the Board's rating system ("RFI/C(D)") system over 1-2 examination cycles. Both are very similar systems.
- Big difference: OTS had no minimum capital ratio requirements at the THC level. The Board is considering, but has not yet developed, consolidated leverage and risk-based capital requirements for SLHCs.

# The Major Difference from OTS: Evaluating and SLHC's Consolidated Risk Management (ERM)

## The Seven Elements of the Risk Management Process



## About the Seven Elements

---

- The SLHC needs to identify and clearly define the “enterprise” risk categories, those that reflect the risks from all business lines and subsidiary operations. (The OCC will expect this to be done at the subsidiary thrift level.)
- Then, the risk management processes for each risk category need to be dissected and analyzed—logically and consistently.
- To do this, each of the seven elements should be in place and operating effectively to evidence a sound risk management process in each risk category, and at the ERM level.
- Weaknesses or failure in any one element can undermine the effectiveness of risk management in a given risk category or in ERM.
- By ensuring effective management in each element, the company can support and confirm strong risk management in each risk category.
- If a demonstrably sound risk management capability is maintained in all risk categories, then a strong ERM capability is assured. ***This is what the FRB/Board is looking for.***
- Additionally, the SLHC should have a clear and concise “dashboard” reporting capability, so that all risks throughout the entire company can be reported up to the board and senior management on a timely, consistent basis.

# Sample Enterprise-Level “Dashboard” Risk Reporting

Risk Management Ratings									
Sample Bank's Assessment of the Quality of Risk Management									
Ratings as of June 30, 2011									
1 2 3 4 5 6 7 8 9 10									
Elements of the Risk Management Process									
Risk Category	Risk Weight	Board Involvement	Risk Policies	Senior Mgt Involvement	Decision Process	Analytics	Reporting/Monitoring	Internal Controls	Totals
Credit Risk	35.0%	2.0	3.0	2.0	3.0	3.0	3.0	2.0	2.57
Interest Rate Risk	15.0%	2.0	1.5	1.0	1.5	2.0	2.0	2.0	1.71
Liquidity Risk	10.0%	2.0	1.5	1.5	1.5	1.5	1.5	1.5	1.57
Financial Reporting Risk	5.0%	3.0	3.0	2.5	2.5	2.0	2.0	2.0	2.43
Operational Risk	5.0%	2.5	3.0	2.0	2.5	3.0	2.5	2.5	2.57
Information Tech Risk	10.0%	2.0	2.0	1.5	1.5	1.5	2.0	1.5	1.71
Human Capital Risk	5.0%	2.0	2.0	1.0	2.0	2.0	2.0	2.0	1.86
Compliance/Legal Risk	7.0%	3.0	2.5	2.0	3.0	2.0	2.5	2.5	2.50
Strategic Risk	5.0%	2.0	2.0	1.0	1.5	1.5	1.5	1.5	1.57
Reputation Risk	3.0%	2.5	2.5	2.5	2.0	3.0	2.0	2.0	2.36
<b>Totals</b>	<b>100.0%</b>	<b>2.16</b>	<b>2.38</b>	<b>1.69</b>	<b>2.27</b>	<b>2.31</b>	<b>2.34</b>	<b>1.94</b>	<b>2.15</b>
<b>Overall Rating = 2.15 ("Adequate")</b>									

Risk Category	Board Involvement	RM Policies	Senior Mgt Involvement	Decision Process	Analytics	Reporting/Monitoring	Internal Controls	Totals
Enterprise-Wide Risk Management	3.5	3.0	3.0	3.0	3.0	3.5	2.0	3.00

# The Enterprise-Level Risk Governance Framework

## The Risk Governance Structure Should be Clearly Articulated

<i>Risk Categories</i>	Credit Risk	Interest Rate Risk	Liquidity Risk	Operational Risk	Information Technology Risk	Human Capital Risk	Compliance Risk	Legal Risk	Strategic Risk	Reputation Risk	ERM
<i>Board of Directors</i>	Board Credit Committee	Finance Committee	Audit Committee *		Ethics Committee	BSA/Compliance Committee	Strategic Planning Committee		Audit Committee *		
<i>Risk Management Policies</i>	Credit Policy	Funds Management Policy	Operational Risk Policy	IT Policies	Human Capital Risk Policy	Compliance Program	Legal Policy	Strategic Risk Policy	Reputation Risk Policy	ERM Policy	Internal Audit Charter
<i>Senior Management Committees</i>	Executive Loan Committee	ALCO	Security & Cont. Plan. & Mngt. Committees	Technology Steering Committee	HR/Compensation Committee	Compliance Committee **		Management Committee		Enterprise Risk Management Committee	
<i>Senior Management Officers</i>	Chief Credit Officer	Chief Financial Officer	Senior Operations Officer	Chief Information Officer	SVP, Human Resources	Director of Regulatory Risk Mgt.	Legal Director	Chief Executive Officer		Chief Risk Officer	

\* Audit Committee sole committee composed of strictly outside directors  
 \*\* Not currently a senior management committee

— position, policy or committee that currently exists  
 - - - proposed enterprise-wide policy or function

# Components of an Effective ERM Program

---

- A Board-approved ERM Policy, to ensure integrated risk management at the enterprise level and to establish/define the Board and management focus on ERM.
- A Board-level committee that is focused on risk governance and oversight.
- A dedicated Chief Risk Officer, reporting to the CEO or to the designated risk committee of the Board.
- A Risk Management Department and staff, reporting to the Chief Risk Officer, with defined risk monitoring functions that are independent of the business lines.
- A management-level Risk Management Committee composed of senior officers representing major risk centers throughout the company.
- Comprehensive, but concise, “dashboard” risk management reporting to the Board and top management.
- An enterprise-wide risk assessment process, facilitated by a database management/reporting software tool.
- A strong risk culture, evidenced by transparency, communication, proactive management, risk training, etc.

---

# Consolidated Supervision Going Forward

# Dodd-Frank Provisions

---

Changes for thrift institutions will unfold over time

- ÿ Federal Reserve philosophy of consolidated supervision
- ÿ Trickle-down effect of heightened prudential standards for systemically important institutions
- ÿ Basel III

---

# Appendix

# Appendix

---

## Federal Reserve Developments

- ÿ Jan. 2011/Apr. 2011: Joint Implementation Plan
- ÿ Feb. 8, 2011: Notice on reports (76 Fed. Reg. 7082, 7091)
- ÿ Apr. 22, 2011: Notice of intent regarding supervision (76 Fed. Reg. 22662)
- ÿ July 22, 2011: Notice of intent and request for comment on continuing application of OTS rules for SLHCs, with replacement of control provisions
- ÿ S&R Letters
  - ÿ 11-11—Supervision
  - ÿ 11-12—Deregistration
  - ÿ 11-13—Declaration of dividends

# Appendix

---

## OCC Developments

- ÿ Jan. 2011/Apr. 2011: Joint Implementation Plan
- ÿ Feb. 8, 2011: Notice on reports (76 Fed. Reg. 7082)
- ÿ July 6, 2011: Joint notice with FDIC on enforcement of OTS regulations (76 Fed. Reg. 39246)
- ÿ July 21, 2011: Final rule on transfer of functions and preemption and visitorial powers (76 Fed. Reg. 43549)
- ÿ July 21, 2011: Interim final rule on transfer of OTS regulations (to be published Aug. 9, 2011)

# Appendix

---

## FDIC Developments

- ÿ Jan. 2011/Apr. 2011: Joint Implementation Plan
- ÿ Feb. 8, 2011: Notice on reports (76 Fed. Reg. 7082, 7087)
- ÿ July 6, 2011: Joint notice with OCC on enforcement of OTS regulations (76 Fed. Reg. 39246)

# Contacts

---

## Banking & Financial Services

### **Dwight C. Smith**

Tel.: (202) 887-1562  
[dsmith@mofo.com](mailto:dsmith@mofo.com)

### **Oliver Ireland**

Tel.: (202) 887-1614  
[oireland@mofo.com](mailto:oireland@mofo.com)

## Global Financial Services

### **Jeff Curry**

Tel.: (202) 346-8876  
[jeff.curry@fticonsulting.com](mailto:jeff.curry@fticonsulting.com)