
Thrift Institutions After Dodd-Frank: The New Regulatory Framework

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Table of Contents

I.	Executive Summary	1
	A. Savings and loan holding companies	1
	B. Savings associations	3
II.	Savings and Loan Holding Companies	5
	A. Control	5
	B. Capital and liquidity	7
	C. Source of strength	11
	D. Activities	13
	E. Examination and supervision	14
	F. Reporting	19
	G. Application processing	20
	H. GUTHCs and intermediate holding companies	20
	I. Mutual holding companies	21
III.	Savings Associations	22
	A. Activities and operations	24
	B. Federal preemption and state enforcement	27
	C. Change in control	33
	D. Examination and supervision	33
	E. Reports and applications	34
	F. Enforcement	35
IV.	Conclusion	35

On July 21, 2011, thrift institutions entered a new regulatory structure, with the transfer of regulatory responsibility for these institutions from the Office of Thrift Supervision (“OTS”) to the other federal banking agencies and with other changes under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank” or the “Act”).¹ Dodd-Frank and related reforms, including new international capital standards, will, over time, shape the operations of savings and loan holding companies (“SLHCs”) and their subsidiary thrifts. For the most part, the changes will bring the thrift and bank charters closer together, and SLHCs will be treated nearly the same as bank holding companies (“BHCs”). Reinforcing the similarity in treatment are various amendments Dodd-Frank has made to the same provisions in the thrift statute and the banking statutes. Some important distinctions nevertheless will remain, including a slightly greater range of activities for thrift institutions and the qualified thrift lender test.

For some SLHCs, especially those with significant nonbank businesses, the changes may have far-reaching effects. Indeed, in some cases, management of a savings institution may want to consider the relative merits of thrift and bank charters in light of its particular operations and business plans. Certain thrift organizations probably should retain the federal or state charter, however, including mutual savings associations, grandfathered unitary thrift holding companies, any thrift institutions that engage in real estate development or brokerage, and, possibly, those with greater concentrations of commercial real estate loans.

We do not address here the consumer protection and mortgage-related provisions of the Act, which are the subject of several User Guides that we have published.² This bulletin covers changes to federal preemption, but a comprehensive discussion appears in our Federal Preemption User Guide.³

I. Executive Summary

The majority of the Dodd-Frank changes will affect SLHCs, although on a day-to-day basis, primarily through examination and supervision, changes will be felt most acutely at the savings association level. Highlights for both SLHCs and savings associations are as follows.

A. Savings and loan holding companies

- **Control**

The FRB has replaced the OTS control rules with its existing rules for bank holding companies. Among other changes, a greater number of non-controlling investors likely will be required to enter into passivity commitments, and a non-controlling investor may not hold a seat on the board of directors. The new rules apply primarily on a going-forward basis, but in certain circumstances the FRB may review ownership structures created before July 21, 2011.

¹ Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010). OTS officially was abolished on October 21, 2011.

² See Residential Mortgage User Guide (<http://www.mofo.com/files/Uploads/Images/ResidentialMortgage.pdf>); Mortgage Servicing User Guide (http://www.mofo.com/files/Uploads/Images/100830User_Guide_Mortgage_Servicing.pdf); Consumer Financial Protection User Guide (<http://www.mofo.com/files/Uploads/Images/101111-Dodd-Frank-Consumer-Financial-Protection.pdf>).

³ This User Guide is available at <http://www.mofo.com/files/Uploads/Images/100723UserGuide.pdf>.

- **Capital**

SLHCs ultimately will be required to adhere to the same capital standards as BHCs—and these capital standards are themselves in flux. SLHCs should take into account at least three sets of changes to capital planning.

- **Composition of capital.** The Collins Amendment to Dodd-Frank requires that BHCs and SLHCs adhere to the same capital requirements that now exist for their subsidiary insured depository institutions—effectively excluding (after a transition period) trust-preferred and other hybrid securities from Tier 1 capital. Basel III introduces a range of other requirements for the composition of Tier 1 capital. These changes will phase in over several years and at different speeds, depending on the size of the institution.
- **New capital ratios.** The Act does not provide for new capital ratios other than to require that capital rules incorporate a countercyclical element. However, Basel III provides a more robust set of ratios that U.S. regulators could apply to BHCs and SLHCs of much smaller size than those formally subject to Basel III.
- **Liquidity.** Dodd-Frank requires that the FRB adopt liquidity standards for the largest banks and systemically important nonbank financial institutions. Two new liquidity ratios are under review by the Basel Committee on Banking Supervision (“BCBS”), as part of the Basel III process.

- **Source of strength**

All SLHCs are or will be required to serve as a source of strength for their subsidiary savings associations. Regulations implementing the doctrine are due in another year, on July 21, 2012. The FRB arguably has authority to enforce the doctrine now.

- **Financial holding company activities—the well-capitalized and well-managed requirements**

SLHCs engaged in activities permissible only for financial holding companies must be “well-capitalized” and “well-managed.”⁴ The “well capitalized” requirement does not force SLHCs into the full capital framework for BHCs, however.

- **Examination and supervision**

Each agency has its own philosophy and approach. In general, regulatory oversight is likely to be more intensive.

- **Reporting requirements**

Largely over a two-year period, SLHCs will begin to be required to submit to the FRB many of the same reports as BHCs. These requirements may necessitate changes in what types of data SLHCs compile and how they compile it.

⁴ This requirement does not apply to grandfathered unitary thrift holding companies.

- ***Applications***

SLHCs are now required to file the same applications and follow the same procedures as BHCs.

- ***Mutual holding companies***

These companies now must follow new rules on application processing, dividend waivers, the submission of offering or proxy materials, and stock repurchases.

- ***Intermediate holding companies***

Grandfathered unitary thrift holding companies (“GUTHCs”) may be required to form intermediate holding companies that will control all of the financial activities of the institution. The FRB is still analyzing how best to deal with these companies and has not yet issued a proposal.

B. Savings associations

The enactment of Dodd-Frank has or will result in several changes to the operations of savings associations. The Act amends federal banking law in several ways that affect banks and thrifts equally, but a few amendments are aimed specifically at savings associations. The transfer of the supervision of savings associations from OTS to the Office of the Comptroller of the Currency (“OCC”) and the Federal Deposit Insurance Corporation (“FDIC”) will mean other changes perhaps more important for routine operations than the specific provisions of Dodd-Frank. In particular, the two agencies have the supervisory authority to limit activities that are legally permissible for savings associations but not for banks.

- ***Commercial real estate lending***

Dodd-Frank does not amend the commercial real estate lending authority of a federal thrift, and this authority is broader than that available to national banks. The OCC historically has taken a stricter view of CRE lending than did OTS. Dodd-Frank and the OCC Interim Rule leave the broader authority for savings associations in place, but the OCC or the FDIC easily could impose institution-specific limits through its supervision function.

- ***Service corporations***

Under a provision of HOLA unchanged by Dodd-Frank or by the OCC, this type of subsidiary of a federal savings bank may engage in the broadest range of financial activities—residential real estate development and real estate brokerage among them—of any affiliate of an insured depository institution, including a holding company. This type of subsidiary is worth considering as a vehicle for new and broader business operations.

- ***Lending limits***

The Act extends the limits on loans to one borrower and to insiders to capture credit exposures arising from various transactions, including derivatives and repurchase agreements.

- ***Transactions with affiliates***

The Act also expands sections 23A and 23B to cover new arrangements or transactions with affiliates that create credit risk. For example, any fund for which a bank (or an affiliate) serves as an investment adviser is now deemed to be an affiliate of the bank for 23A and 23B purposes. The definition of a covered transaction is broadened to include derivatives and the borrowing and lending of securities. Repurchase agreements with affiliates are now subject to collateralization requirements.

- ***Insider transactions***

New limitations both on extensions of credit to insiders and on asset sales and purchases with insiders have now taken effect.

- ***QTL test***

Dodd-Frank imposes new sanctions for the failure by a savings association to comply with the qualified thrift lender test (the "QTL Test"). The principal change is that the one-year grace period to return to compliance is eliminated. These sanctions took effect the day after the enactment of Dodd-Frank.

- ***Preemption***

Dodd-Frank makes important changes to federal preemption in two key respects. First, the Act eliminates preemption for operating subsidiaries and agents on a going-forward basis. Second, four basic OTS preemption regulations, former sections 545.2, 550.136, 557.11, and 560.2 have been narrowed considerably. In addition, the Act has caused the OCC to revise its approach to preemption for national banks and, now, federal savings associations.

- ***Increased enforcement efforts by the states***

State attorneys general now have authority to enforce federal regulations against thrift (and other) financial institutions, in addition to the power to bring civil suits against federal savings associations.

- ***Examination and supervision***

Both the OCC and the FDIC have their own approaches to examinations. The impact on savings associations will vary by the particular association involved and is difficult to forecast.

- ***Reporting***

Beginning with the first quarter of 2012, savings associations will file the same call report as banks, and the thrift financial report will be eliminated.

- ***Applications***

Applications by savings associations and the processing of these applications historically has been largely the same as for banks. OCC has revised some of the filing requirements for federal savings associations. State-chartered savings associations should expect to follow the existing FDIC rules for state nonmember banks.

- **Enforcement**

The OCC now has enforcement authority over federal savings associations, and the FDIC has the same authority over state savings associations. The primary statutory authority for enforcement actions is the same for the OCC and the FDIC as it was for OTS, and the nature of these actions should not change. The OCC and the FDIC have different enforcement policies than did OTS, however, and certain changes around the edges of enforcement activity may emerge.

II. Savings and Loan Holding Companies

Dodd-Frank revises the regulation of SLHCs in many ways that will have significant consequences. The FRB has begun to implement the statutory changes, but there is still a long way to go. To date, the FRB has issued five different rules, proposals, and notices that give effect to many of the new Dodd-Frank requirements.⁵ The single most important release is the FRB Interim Final Rule, which creates two new parts to the FRB regulations: Regulation LL (“Reg LL”), which addresses SLHCs in ways roughly comparable to the requirements for BHCs, and Regulation MM (“Reg MM”), which deals with mutual holding companies (“MHCs”).

A. Control

For many years, OTS undertook a somewhat different analysis from the FRB regarding the circumstances under which an investor would be deemed either to control or not to control an SLHC or a savings association.⁶ Reg LL replaces the former OTS control rules with the substantive Regulation Y (“Reg Y”) requirements for BHCs. The reconciliation of the OTS rules with those of the FRB will affect primarily investors seeking to make passive investments in SLHCs.

- **Investments triggering control considerations.** Any investor that holds 10 percent or more of any class of voting securities now must enter into passivity commitments or become a bank holding company or control person. The former OTS rules did not go so far: a 10 percent investor was required to rebut control only if another “control factor” was present—typically the fact that the investor was one of the two largest investors in the SLHC.
- **Passivity commitments.** The former OTS rules set forth a standard rebuttal agreement for a 10 percent investor that was required to rebut control. This agreement preserved certain rights for the investor, including the ability to name a director. Reg LL omits this standard rebuttal agreement. A non-controlling investor acquiring 10 percent or more of a class of voting securities must enter into passivity commitments that may vary to some

⁵ In chronological order of appearance: (i) Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies, 76 Fed. Reg. 22662 (Apr. 22, 2011) (the “FRB Supervisory Notice”); (ii) Notice of Intent, Continued Application of Regulations to Savings and Loan Holding Companies, 76 Fed. Reg. 43953 (July 22, 2011); (iii) Order Delegating Certain Actions Relating to Savings and Loan Holding Companies (Aug. 12, 2011) (delegations of supervisory and approval authority to individual FRB Governors, Federal Reserve Banks and others); (iv) Interim Final Rule 76 Fed. Reg. 56508 (Sept. 13, 2011) (the “FRB Interim Final Rule”); and (v) Proposed Agency Information Collection Activities, 76 Fed. Reg. (Aug. 25, 2011) (phase-in of certain reporting requirements) (“FRB Reporting Proposal”). Together with the OCC, the FRB also has issued a notice on the transfer of information collections from OTS, but this notice should have no impact on thrift institutions. See Joint Notice, 76 Fed. Reg. 56005 (Sept. 9, 2011) (“Joint Notice”).

⁶ The definitions of control in section 10(a)(2) of the Home Owners’ Loan Act (“HOLA”) and section 2(a)(2) of the Bank Holding Company Act (“BHCA”) that guide the two approaches are substantially the same.

degree. In discussions with FRB staff, the FRB has reserved the right to require such commitments from investors holding 5 percent or more of a class of voting securities.

- **Procedure for non-controlling investors.** OTS formerly had a separate procedure for rebutting control. The Interim Rule eliminates this formal process. Investors in SLHCs now will be subject to the same practice as investors in BHCs. Potential control will be reviewed as part of an application under section 3 of the Bank Holding Company Act (“BHCA”) or in consultation with the FRB about passivity commitments or other mechanisms to avoid control and the necessity of a section 3 application.
- **Change in Bank Control Act notice.** The FRB’s Reg Y effectively requires a notice filing under the Change in Bank Control Act (“CBCA”) by any investor that acquires 10 percent or more of any class of voting securities of a BHC (or a state member bank).⁷ In certain circumstances, an investment may trigger the CBCA notice requirement, but the investor has been considered non-controlling under section 10 of HOLA or section 2 of the BHCA. Under the former OTS rules, such an investor in an SLHC or a savings association was not required to provide the CBCA notice. Reg LL now requires that such an investor submit this notice.
- **Policies.** Together with the statutory and regulatory provisions above, two FRB policies have informed (if not dictated) the structure of non-controlling investments. The first, dating from 1982, suggests (but effectively requires) that an investor may avoid control only if it acquires less than 25 percent of the total equity of a BHC or bank, even if the equity is in a form other than preferred stock. The policy mirrors the definition of control of an SLHC in HOLA.⁸ (The policy statement also imposes other restrictions on the terms of a non-controlling investment.)

The second, a more recent addition, revises the 1982 statement (as well as accreted FRB thinking) to allow an investor to acquire up to 33 percent of the total equity of a BHC or state member bank, provided that the investment consists of no more than 15 percent of a class of voting securities (or non-voting securities convertible into voting shares at the election of the investor) and the investor does not hold any board seats.⁹ Such an investor may hold one board seat and possibly another if certain conditions are met. The policy statement also imposes other restrictions on the terms of the investment, communications between a non-controlling investors and management, and business relationships between the investor and the institution.

The FRB will not, as a general rule, revisit existing ownership structures previously approved by OTS. This policy does not represent a wholesale grandfathering, however. The FRB will examine an existing structure if an SLHC proposes a material transaction, such as an additional expansionary investment, significant recapitalization, or significant modification of its business plan. All new investments will, of course, be subject to Reg LL and review by the FRB.

⁷ The CBCA formally requires the notice only when an investor acquires 25 percent or more of the voting stock of a BHC or state member bank. See 12 U.S.C. § 1817(j)(1). Reg Y allows an investor that acquires 10 percent or more but less than 25 percent of such voting stock to rebut control, rather than file the notice, 12 C.F.R. § 225.41(c), but in practice it can be difficult to rebut control successfully and most such investors file the notice.

⁸ The policy statement is at 12 C.F.R. § 225.143. The statutory requirement is in section 10(a)(2)(B) of HOLA, 12 U.S.C. § 1467a(a)(2)(B).

⁹ This statement, the Policy statement on equity investments in banks and bank holding companies, is styled 12 C.F.R. § 225.144, but in fact is not included in Reg Y as it appears in the Code of Federal Regulations. It may be found at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20080922b1.pdf>.

B. Capital and liquidity

Over the next several years, new capital requirements will roll out for all insured depository institutions and their holding companies. Dodd-Frank anticipates broad reforms to the current bank regulatory capital requirements but offers few specifics. Outside of Dodd-Frank, the FRB and the other federal banking regulators have been participating in the Basel III process, which is likely to lift the capital requirements for all but the smallest BHCs and SLHCs.

Before turning to coming events, the current capital standards for BHCs that could be applied to SLHCs contain at least three provisions that may be unfamiliar to SLHCs that are accustomed only to capital requirements at the savings association level.

- ***Deductions of nonfinancial equity investments.*** BHCs are permitted to make investments in nonbanking entities through their merchant banking authority and a handful of other statutory provisions.¹⁰ These investments must, however, be deducted from the core capital elements of Tier 1 in certain amounts, ranging from 8 to 25 percent of the value of the investments. The particular percentage depends on the amount of the total nonfinancial investment relative to Tier 1 capital. (Amounts that are not deducted are risk-weighted at 100 percent.)¹¹ The same rule will apply to SLHCs engaged in nonfinancial activities. For those SLHCs that have permissible nonfinancial investments, material deductions from Tier 1 could be required.
- ***Limitations on the inclusion of “restricted core capital elements” in Tier 1 capital.*** The FRB has imposed restrictions on what can be included in the Tier 1 capital of a BHC other than common stock and noncumulative perpetual preferred stock. These restrictions already apply to savings associations but are not a concern because the only capital instrument at a savings association typically is a class of voting common stock, all of which has been issued to the association’s parent. The application of the BHC rules will affect capital planning by SLHCs.

There are currently five restricted core capital elements: (i) qualifying cumulative perpetual preferred stock; (ii) minority interests relating to certain preferred stock issued by a bank subsidiary; (iii) minority interests relating to common or certain preferred stock issued by a subsidiary that is not a bank; (iv) qualifying trust preferred securities; and (v) subordinated debentures issued to the Treasury Department as part of the TARP program by a subchapter S corporation or a mutual holding company. The rules are complex, but, as a starting point, these five elements may not constitute more than 25 percent of Tier 1 capital. (There is some leniency for the TARP subdebt.) Under different parts of Dodd-Frank and Basel III, eventually there will be significantly greater limits on the inclusion of these elements in Tier 1.

- ***Leverage ratio/goodwill.*** A relatively small point, but, in calculating its leverage ratio, a bank or thrift must deduct goodwill. The Federal Reserve has not imposed this requirement on BHCs, but both Dodd-Frank and Basel III will require the deduction at the holding company level.

¹⁰ The use of this authority to invest in private equity funds appears to have been checked by the Volcker Rule provisions in section 619 of Dodd-Frank, 12 U.S.C. § 1851. The recent inter-agency proposal on the Volcker Rule does not address explicitly the interplay between the merchant banking authority and Volcker Rule restrictions on ownership of private equity funds. See 76 Fed. Reg. 68846 (Nov. 7, 2011).

¹¹ Savings associations have been required to deduct investments in “non-includable” subsidiaries from core capital, see 12 C.F.R. § 167.5(a)(2), but this rule appears to be somewhat less stringent than the bank holding company rule.

Looking ahead, the threshold question is what new capital requirements will reach the vast majority of SLHCs and BHCs, i.e., those with fewer than \$50 billion in consolidated assets. There is no clear answer, but changes are coming from several directions. We would observe that Basel III nominally covers only the largest and globally active banking institutions but that we expect Basel III standards to trickle down to all institutions.¹²

At least three provisions in Dodd-Frank will change the current capital standards for SLHCs (as well as for BHCs). The finalization of Basel III likely will result in changes to capital composition and the risk-weighting of assets. The FRB (and the other federal banking agencies) also have inherent authority to impose new capital requirements on an institution-by-institution basis. The range of possible changes include the following:

- **Composition of capital—Dodd-Frank.** Section 171 of Dodd-Frank, also known as the Collins Amendment, directs the federal banking agencies to set new minimum risk-based and leverage requirements for all SLHCs and BHCs. These requirements must be at least as stringent as those that now apply to banks and savings associations.¹³
- **Composition of capital—Basel III.** The required composition of Tier 1 capital seems likely to change. Tier 1 capital is expected to consist “predominantly” of common equity and retained earnings. Historically, the FRB has required that common stock constitute at least 50 percent of Tier 1 capital. A new requirement has not been specified, but we may expect that it will materially exceed 50 percent. Based on regulatory actions during the financial crisis to shore up bank capital and on certain enforcement actions, we anticipate that the federal bank regulatory agencies will require something greater than 51 percent.

Components of Tier 1 that are not common equity will be required to be subordinated to all creditors, must include a provision enabling the issuer to defer dividend or coupon payments, and must have no incentives to redeem the instruments in times of stress.

- **Trust preferreds and other hybrid instruments.** Crucially, the requirement in the Collins Amendment that holding companies become subject to the same capital rules now applicable to their subsidiary insured depository institutions means that trust-preferred securities and other hybrid instruments will be excluded from Tier 1 capital on a going-forward basis. Holding companies with consolidated assets of less than \$15 billion—a universe that includes the vast majority of SLHCs—may continue to include in Tier 1 any trust preferreds issued before May 19, 2010.¹⁴ (The \$15 billion-plus institutions must phase out their pre-May 19, 2010, trust preferreds from Tier 1 over the period between January 2013 and January 2016.)
- **Five-year grace period for SLHCs.** The new minimum requirements under section 171 will not apply to SLHCs until July 21, 2015. The practical effect of this provision is not entirely clear. The grace period does not affect the FRB’s separate authority to set capital requirements for holding companies, and this authority could be the vehicle for new capital requirements for SLHCs. At the same time, it is clear that the grace period does not cover the elimination of trust-preferred securities from Tier 1, nor does it apply to new countercyclical capital measures that are required in section 616 of the Act.

¹² In light of the leeway that the FRB has given to BHCs with less than \$500 million in consolidated assets on certain debt issues, see Small Bank Holding Company Policy Statement, 12 C.F.R. part 225, App. C, it is possible that some Basel III requirements would not trickle down that far.

¹³ Small BHCs—those with less than \$500 million in consolidated assets—are fully exempt from this requirement. Similarly sized savings and loan holding companies may have, like all other thrift holding companies, a five-year exemption (see below), but they do not have the same permanent exception.

¹⁴ The Dodd-Frank treatment of these securities is slightly different from Basel III, but Dodd-Frank of course governs.

- **Minority interests in consolidated subsidiaries.** Currently, minority interests in the form of common stock or noncumulative perpetual preferred in depository institution subsidiaries are fully includable in Tier 1 capital. Minority interests in the same subsidiaries that are in the form of cumulative preferred and minority interests in the form of common stock or noncumulative perpetual preferred in non-depository subsidiaries may in the aggregate (and including certain other equity instruments) comprise up to 25 percent of a bank holding company's Tier 1 capital. Basel III will reduce the includable amounts of these interests, using a complicated series of calculations in which "surplus" capital is subtracted from the interests in ways that reflect the nature of the equity instruments.
- **New deductions from capital.** Basel III enumerates several types of assets that must be deducted from Tier 1 capital, either for the first time or in greater amounts than before. Asset classes affected include investments in other financial institutions, mortgage servicing rights, cash flow hedge reserves, gains on sale in securitization transactions, defined benefit pension fund assets and liabilities, and treasury stock.
- **New capital ratios.** Basel III introduces a more complicated set of capital ratios, for which the FRB and the other federal banking agencies already have statutory authority to implement. The new measurements would phase in over several years. Within the next two years, the following standards should come into effect at least on an international basis and for the largest institutions:
 - *Tangible common equity ratio.* This new ratio—which is not risk-based—begins at 3.5 percent on January 1, 2013, and grows to 4.5 percent by January 1, 2015.
 - *Tier 1 risk-based capital.* The new minimum of 4.5 percent (up from the current 4 percent for U.S. entities) takes effect in 2013. In 2015, it will be 6 percent.
 - *Total risk-based capital.* The new international standard will be 8 percent in 2013, up from 6 percent. The standard rule for U.S. banking institutions already is 8 percent and has been at this level for some time .

Other Basel III capital changes will phase in over a longer period but are likely to have a substantial impact.

- *Capital conservation buffer.* This buffer requires additional common equity Tier 1 capital simply on the theory that banking institutions should hold capital above the regulatory minimums. Under Basel III, this buffer does not come into play until 2016. At that point, a banking institution will be required to hold an additional 0.625 percent in Tier 1 common equity capital, measured against risk-based assets. This amount increases incrementally over the following three years so that by January 1, 2019, the buffer will be 2.5 percent.

Over the last three years, of course, the federal banking agencies effectively have created conservation buffers in specific situations. For example, for a well-capitalized institution, a Capital Purchase Plan investment by the Treasury Department was a form of a conservation buffer and could vary between 1 and 3 percent of risk-weighted assets.

- *Countercyclical buffer.* Sections 616(a)-(c) of Dodd-Frank requires the federal banking agencies to promulgate capital rules with a countercyclical component, that is, an element forcing banking institutions to raise capital in prosperous times so that

it can be drawn down in times of financial stress.¹⁵ Under Basel III, this buffer essentially is an extension of the conservation buffer. The countercyclical buffer is to be phased in along the same time frame as the conservation buffer. Basel III caps the countercyclical buffer at 2.5 percent (once fully in place), but the ceiling is solely for international reciprocity purposes, and regulators may impose higher requirements on domestic institutions. Specific buffer requirements will be set on a national basis (with up to 12 months' advance notice) and will be based on a complicated calculation involving the relationship between the ratio of private sector debt to gross domestic product and the trend of that ratio.

- *Contingent capital.* Dodd-Frank contemplates a contingent capital requirement—i.e., an instrument that converts to equity in times of financial stress—at least for the largest U.S. banks (and other systemically significant financial institutions). The Act formally requires only a study of contingent capital by the Financial Stability Oversight Council (“FSOC”) to be completed within two years and authorizes—but does not require—the FRB to issue a rule after the report has been completed. Dodd-Frank does not otherwise identify the types of instruments that might be subject to a conversion requirement, nor does it set forth a trigger other than “financial stress.” Contingent capital has been a subject of active discussion at the international level, although no international consensus has emerged.¹⁶
- *Leverage ratio.* For completeness purposes, we note that Basel III includes an explicit leverage ratio for the first time. Thrift organizations in the U.S. already are accustomed to leverage requirements, and there are specified minimums for savings associations. A leverage requirement will be new at the SLHC level (although not new for BHCs). The Basel III proposal is 3 percent, which would phase in slowly over several years. Savings associations currently must maintain a leverage ratio of 4 percent in order to be adequately capitalized. The impact of even a 3 percent requirement on an SLHC, particularly one with significant nonbank operations, could be significant, however.
- *Liquidity.* The FRB historically has measured holding company liquidity in a far more granular manner than did OTS. Basel III introduces two new liquidity measures, although their fate is a little uncertain.¹⁷
 - *FRB measurements.* OTS assessed liquidity at an SLHC largely in two ways: the ability to meet contractual obligations from current earnings (the “fixed charge coverage ratio”) and a comparison of the maturities of assets and liabilities over the short, medium, and long term.¹⁸ In addition to these tools, the FRB recommends review of an array of factors, including a comparison of unpledged liquid asset reserves to liquidity needs; the ratios of volatile wholesale funding to total assets, of volatile retails deposits to total deposits, and of volatile funding to total liabilities; illiquid asset concentrations; funding concentrations; and contingent liabilities.¹⁹

¹⁵ These provisions are codified in 12 U.S.C. §§ 1467a(g)(1) (SLHCs), 1844(b) (BHCs), and 3907(a)(1) (insured depository institutions).

¹⁶ See, e.g., Basel Committee on Banking Supervision, Consultative Document: Global systemically important banks: Assessment methodology and the additional loss absorbency requirement 17-20 (July 19, 2011).

¹⁷ See Basel Comm. on Banking Supervision (“BCBS”), Basel III: International framework for liquidity risk management, standards, and monitoring (Dec. 2010). This document is available at <http://www.bis.org/publ/bcbs188.pdf>.

¹⁸ See OTS Holding Company Handbook § 600 at 600.9.

¹⁹ See FRB Bank Holding Company Examination Manual § 4020.4 (incorporating by reference the Commercial Bank Examination Manual § 4020.1 at 8).

- *Liquidity coverage ratio.* Basel III proposes a calculation of this ratio (the “LCR”)—the ratio of an institution’s high-quality, unencumbered liquid assets to total net cash outflows over the next 30 days—in order to measure the ability of a banking organization to meet liquidity needs over the next 30 calendar days. Regulators will effectively set the denominator by specifying a “significantly severe liquidity stress scenario” that will determine liquidity needs. Several factors will inform the regulators’ decisions, and liquidity needs may be driven by several different sources, not simply depositors. The desired outcome is that the LCR exceed 100 percent. The LCR will be subject to a three-year observation period beginning Jan. 12, 2012; it then is expected to be applied formally on Jan. 1, 2015. The BCBS is accelerating review of this ratio in order to give banking organizations sufficient time to assess compliance.
- *Net stable funding ratio.* This ratio (the “NSFR”) is intended to provide a liquidity assessment over a one-year period. Many of the participants in the BCBS are dissatisfied with the ratio as proposed—FRB Governor Tarullo has said that the ratio “needs considerable work”²⁰—and it is headed back to the drawing board. As a starting point, however, it is useful to understand that the NSFR would require that available amounts of stable funding exceed the required amount of stable funding over the course of a year. “Available stable funding” includes all Tier 1 and Tier 2 capital, any other preferred stock not includable in Tier 2, and borrowings and liabilities with effective remaining maturities of more than one year. Deposits and unsecured wholesale funding are also includable, subject to various haircuts. With respect to required amount of stable funding, Basel III identifies the amounts of funding necessary to support different types of assets and applies an adjustment factor (much like risk weights used in Basel II). An observation period for the NSFR begins on Jan. 1, 2013, with full implementation scheduled for Jan. 1, 2018.

C. Source of strength

Dodd-Frank and Reg LL subject all SLHCs to the source-of-strength doctrine: an SLHC must “serve as a source of financial and managerial strength to its subsidiary savings associations.”²¹ In addition, it must “not conduct its operations in an unsafe or unsound manner.”²² This regulation does not explicitly authorize the FRB to compel an SLHC to recapitalize a subsidiary savings association. The rule, however, does incorporate HOLA section 10(g)(5), which is a broad grant of enforcement authority over SLHCs. The FRB has the same authority as it has with respect to BHCs to force an SLHC to terminate an activity or to divest a nonbank subsidiary. In order to do so, the FRB must determine both that the control of a nonbank subsidiary or an activity of the SLHC constitutes a serious risk to the financial safety, soundness, or stability of a subsidiary thrift and that it is inconsistent with sound banking principles.²³

OTS historically rejected the source-of-strength doctrine, although the substance may have been implicit in the supervision of specific SLHCs. The OTS holding company examination manual took care not to mention the source-of-strength doctrine, but the manual’s discussion of capital adequacy on a consolidated basis and of the ability to raise funds in the future encompasses support of a subsidiary thrift. The prompt corrective action regime also contemplates the source-of-strength

²⁰ Tarullo, *The International Agenda for Financial Regulations* (speech before the American Bar Ass’n banking law committee, Nov. 4, 2011).

²¹ 12 C.F.R. § 238.8(a). The statutory basis is section 616(d) of Dodd-Frank, to be codified as section 38A of the Federal Deposit Insurance Act.

²² *Id.*

²³ See 12 C.F.R. § 238.8(b).

doctrine: an SLHC must provide at least a partial guarantee of an undercapitalized subsidiary thrift's compliance with a capital restoration plan.²⁴

From a planning perspective, SLHCs should bear in mind that the requirement is to maintain the “ability” to provide assistance. This ability will be the subject of every holding company examination. Accordingly, every SLHC will need to think through its capacity to provide financial support, regardless of the condition of the subsidiary savings association.

The ability to act as a source of strength could entail different approaches to capital policy at a holding company. One obvious way to demonstrate ability would be to hold liquid assets at the holding company in a sufficient amount to contribute the necessary funds to a distressed subsidiary. Alternatively, a holding company should be able to demonstrate its ability to access the capital markets for additional funds. Either course has little meaning for the large number of SLHCs that are shell entities. There is no point in holding liquid assets in reserve at the holding company; these funds could always be put to better use at the operating subsidiary thrift. Access to the capital markets by a shell company will be solely a function of the condition of the thrift subsidiary; accordingly, a holding company brings no greater ability to raise funds than does the subsidiary.

What of a duty on the part of a thrift holding company to make a capital contribution when its subsidiary savings association becomes distressed? Dodd-Frank is on its face ambiguous: a holding company is required to “serve” as a source of strength, but source of strength is defined simply as the “ability” to provide support. The Federal Reserve has been clear, however, that the doctrine is not limited to the demonstration of “ability,” and that it requires the contribution of capital when needed. The agency has enforced the duty in several written agreements and consent orders in recent years with the boilerplate that a holding company use its resources “to serve as a source of strength to the [subsidiary bank], including, but not limited to, taking steps to ensure that the [subsidiary bank] complies with” an order or agreement that the bank has entered into with its regulator.²⁵ The underlying bank-level enforcement document typically sets new capital requirements for the bank, requires the submission of a recapitalization plan, and specifies acceptable ways of raising new capital—always including (but not limited to) contributions from the holding company.

Yet section 616(d) and the existing consent orders do not necessarily suggest that a federal bank regulator will respond differently than it does now when the only source of new bank capital is the holding company and the company declines to provide it. This scenario has arisen repeatedly since 2008. Typically (if not always), a holding company refuses to make additional capital contributions on the view that doing so disadvantages its shareholders and creditors. We are not aware that the FRB has sought to litigate the matter.²⁶ It could be argued that the codification of the source-of-strength doctrine in Dodd-Frank removes the impediment to enforcement that courts have found in litigated cases—the MCorp decision²⁷ and a handful of other proceedings—but whether the FRB or the FDIC will take on this issue remains to be seen.

In any event, and notwithstanding the uncertainties surrounding implementation of the doctrine, SLHCs should devote time and energy to analyzing the possible sources of distress at a subsidiary thrift and to determining how the company may be in a position to provide further assistance.

²⁴ See 12 U.S.C. § 1831o(e)(2)(c)(ii); 12 C.F.R. § 165.5(i).

²⁵ See, e.g., *In re Capital Funding Bancorp, Inc.*, Consent Order at 3 (No. 11-091-B-HC, Oct. 31, 2011); Written Agreement by and among Huntington Bancshares, Inc., Federal Reserve Bank of Dallas, and Banking Commissioner of the Texas Department of Banking at 2 (No. 11-110-WA/RB-HC, Oct. 17, 2011).

²⁶ The FDIC has asserted the doctrine unsuccessfully in claims in bankruptcy against the estates of insolvent holding companies, but no broadly applicable guidance has emerged.

²⁷ *MCorp Financial, Inc. v. Bd. of Governors of the Fed. Res. Sys.*, 900 F.2nd 852 (5th Cir. 1990), *aff'd in part and rev'd in part on other grounds*, 502 U.S. 32 (1991).

D. Activities

Under OTS oversight, an SLHC generally was free to engage in permissible activities without application or notice to OTS. The FRB takes a different approach, which depends on the nature of the activity. The permissible activities of an SLHC fall into at least one of four statutory categories: financial activities under section 4(k) of the BHCA, activities closely related to banking under section 4(c) of the BHCA, activities permitted for multiple SLHCs before March 5, 1987 (the “1987 List” activities), and insurance agency or escrow activities.

- **Financial activities.** The Gramm-Leach-Bliley Act in 1999 added section 4(k) to the BHCA, which allowed qualifying BHCs to engage in financial activities not previously allowed. These activities primarily include insurance underwriting, securities dealing, and merchant banking. In order to conduct these activities, a BHC must elect financial holding company (“FHC”) status: it must be well-managed and well-capitalized, as must its subsidiary insured depository institution subsidiaries, and its subsidiary banks must have at least a satisfactory rating under the Community Reinvestment Act. SLHCs were allowed to engage in the same activities, but without having to meet the qualifying standards that applied to BHCs. Dodd-Frank eliminates this advantage. An SLHC now must elect FHC status and satisfy (in broad terms) the prerequisites as a BHC. If an activity is permissible under both section 4(k) and another provision, an SLHC may rely on the other provision and avoid the section 4(k) requirements.

Reg LL sets forth a well-capitalized standard for SLHCs that is less stringent than that for a BHC. An SLHC is well-capitalized if (i) all of its insured depository institution subsidiaries are well-capitalized and (ii) the SLHC is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FRB to meet and maintain a specific capital level for any capital measure.²⁸ The SLHC itself is not required to meet a quantitative consolidated capital requirement.

An SLHC is well-managed if, at its most recent examination (even if the examination was conducted by OTS), the SLHC received (i) at least a satisfactory composite rating and (ii) at least a satisfactory rating for management.²⁹ Under the OTS examination policies for SLHCs, a composite CORE rating and a risk management component rating of 1 or 2 should constitute well-managed status.

An interesting question for SLHCs is whether, if well-managed (or well-capitalized) status is difficult to maintain, any financial activities at the holding company level should be transferred into service corporation subsidiaries.³⁰ These subsidiaries do not appear to trigger the new well-capitalized and well-managed requirements for holding companies. Service corporations can make all of the same investments as an FHC, plus a few others. It is likely that the investments in these corporations would have to be deducted from a savings association’s core capital.

An FHC election now requires a written election stating the SLHC’s intent to be come an FHC and certifying that it has met the criteria.³¹ Unless the FRB objects within 61 days of the filing, the SLHC will be deemed an FHC. The election is required even in order to engage in activities commenced before July 21, 2011, when, at the time the activities began,

²⁸ See 12 C.F.R. § 238.2(s).

²⁹ See 12 C.F.R. § 238.2(t), incorporating by reference 12 C.F.R. § 225.2(s).

³⁰ As we discuss below, the service corporation concept and the OTS rules have survived Dodd-Frank and the transfer of OTS regulations to the OCC.

³¹ See 12 C.F.R. § 238.65.

the SLHC was not required to make an FHC election. Elections by SLHCs that are made necessary by ongoing activities must be filed by December 31, 2011. If an SLHC is unable to make an election—e.g., because it is not well-capitalized—then the SLHC must file a declaration with the appropriate Reserve Bank that explains the deficiency and how the SLHC will achieve compliance by June 30, 2012. The limitations on and duties of BHCs that cease to meet the FHC requirements will apply to SLHCs that fail at the outset or that later cease to comply.

- **1987 List.** This term is a reference to the activities permissible for a multiple SLHC before March 5, 1987. These activities were enumerated in the former OTS regulation, and Reg LL incorporates this list without change.³² An SLHC now must file a notice with the FRB at least 30 days before launching a new 1987 List activity. This process includes newspaper publication and a period for public comment. If an activity qualifies as both a 1987 List activity and a BHCA section 4(c) activity, then an SLHC need only comply with the procedures for a 1987 List activity, i.e., filing a notice.
- **BHCA § 4(c).** An SLHC may engage in any activity that is permissible for BHCs under this provision of the BHCA. These activities primarily are those that the FRB has concluded are closely related to the business of banking and listed in Reg Y.³³ OTS formerly required an SLHC to obtain approval before engaging in a section 4(c) activity. Reg LL imposes the same requirement, but the application procedures differ from those of OTS.³⁴
- **Insurance agency or escrow business activities.** An SLHC has been able to engage in these activities under a provision separate from the authorities for the sections 4(k) and 4(c) and 1987 List activities.³⁵ OTS did not require a notice or other filing for these lines of business, and neither does the FRB.

E. Examination and supervision

The FRB will undertake “more intensive” supervision of SLHCs, according to the FRB Supervisory Notice. Capital adequacy is likely to be a particular focus, and the ratios the Federal Reserve applies to assess leverage differ from those traditionally used by OTS. Two other important changes in the examination function will occur.³⁶ First, thrift holding companies will see an entirely new set of examiners. The Act guarantees OTS staff positions and salary preservation at the OCC or the FDIC. Because there is no similar guarantee at the Federal Reserve, few, if any, OTS examiners have joined the Federal Reserve. Second, reporting requirements for BHCs will apply to SLHCs, but the requirements largely do not take effect until 2013.

- **Consolidated supervision**

Not surprisingly, the greatest differences between the supervision philosophies of OTS and the FRB will be felt by complex SLHCs engaged in nonbanking activities. For many of the smaller SLHCs, the examination process will rely substantially if not entirely on the condition of the subsidiary thrift.

OTS described its supervisory regime as one that “evaluates activities or operations with a high risk profile, including risks that have a direct impact on the thrift relationship or indirectly

³² See 12 C.F.R. § 238.53(b).

³³ See 12 C.F.R. § 225.28.

³⁴ See 12 C.F.R. § 238.54(b).

³⁵ See 12 U.S.C. § 1467a(c)(2)(B).

³⁶ One aspect of supervision are assessments on regulated holding companies. Assessments are new to the FRB but are required by section 318(c). As of this writing, the FRB has not released a proposal for assessments.

pose higher than normal risk to any material subsidiary, including the thrift.” The FRB takes a broader view. In the FRB Supervisory Notice, the FRB explains that

the Board’s consolidated supervision of SLHCs may entail more rigorous review of internal control functions and consolidated liquidity, as well as the conduct of discovery reviews of specific activities. In addition, the Board’s supervisory program may entail heightened review of the activities of nonbank subsidiaries (consistent with applicable law and regulation) and may entail greater continuous supervisory monitoring of larger SLHCs.

Breaking this statement down, there are two lessons for all SLHCs and two additional take-aways for larger SLHCs engaged in nonbanking activities.

First, as to all SLHCs, the FRB tends to concentrate more on internal structure and procedures than OTS has done. In particular, risk management is scrutinized with care. In practice, this will mean that an SLHC must be prepared to identify the persons responsible for identifying and assessing risks, to describe its procedures for controlling risk, and to explain the role of senior management and the board in reviewing risk management. Among other things, the boards of SLHCs may find that the FRB expects them to participate more extensively in risk management than the OTS has required. Further, an SLHC will need to document with care its risk management process.

The second lesson for all SLHCs relates to consolidated liquidity. The starting point for liquidity analysis is the Interagency Policy Statement on Funding and Liquidity Risk Management,³⁷ so in this respect, supervision should be relatively uniform. However, the OTS handbook for SLHCs identifies three liquidity issues in broad terms—ability to meet short-term obligations, debts owed to the SLHC by any subsidiary, and duration matching (or lack thereof) between assets and liabilities.³⁸ The comparable discussion in the BHC manual is far more granular³⁹ and will, at a minimum, require greater preparation for an examination. The necessary analysis will become even more complex if the Basel III liquidity ratios take effect.

For SLHCs engaged in nonbanking activities, OTS historically has not attempted supervision of any of these activities in and of themselves but has examined these SLHCs in order simply to assess their relationships with their subsidiary savings associations. By contrast, since BHCs first gained the ability in 1999 to engage in relatively unrestricted nonbanking financial activities, the FRB has taken an active interest in the safety and soundness of those businesses, nearly (but not quite) on an independent basis. Originally, the FRB was required to defer to the functional regulator of nonbank subsidiaries (e.g., the SEC in the case of a broker-dealer). Dodd-Frank has lifted that deference requirement. SLHCs, as well as BHCs, can expect greater attention to their nonbanking operations.

Finally, with respect to continuous supervisory monitoring, any SLHCs with greater than \$10 billion in assets, such monitoring is a virtual certainty, particularly in the first few years of FRB supervision. Even SLHCs with less than \$10 billion in assets may be subject to continuous monitoring. Continuous supervision for these SLHCs that are not deemed large and complex is conducted almost entirely off-site, but that is in part because the FRB has in place a much more detailed reporting system for SLHCs than the OTS had established. SLHCs currently must provide a quarterly report that incorporates the quarterly financial statements provided in periodic SEC filings or that are prepared internally for management

³⁷ See 75 Fed. Reg. 13656 (Mar. 22, 2010).

³⁸ See OTS Holding Companies Handbook § 600, at 600.9.

³⁹ See FRB, Bank Holding Company Supervision Manual § 4010.2.

purposes. By contrast, the FRB has a series of FR Y-9 reports, as well as other reports, that require specific and detailed information that might not otherwise have been prepared.

- ***Supervisory portfolios***

The FRB's framework would have different effects on different SLHCs. The FRB divides BHCs into six supervisory portfolios,⁴⁰ a different method than OTS's use of three categories, one of which is limited to a handful of institutions. Both the FRB and OTS regimes distinguish between complex and non-complex institutions. The relevant factors are much the same, but non-complex SLHCs under the OTS process effectively would be treated as complex by the FRB if they have either (i) assets in excess of \$1 billion, (ii) a material amount of debt outstanding, or (iii) risk management consolidated at the holding company level.

Briefly, SLHCs could expect the following. Smaller SLHCs and grandfathered unitary thrift holding companies could be particularly affected.

- ***Less than \$500 million in assets.*** These SLHCs presumably would qualify for the FRB's policy statements on small BHCs.⁴¹ These statements exempt small BHCs from the industry-wide capital requirements. The reporting requirements for small BHCs also are lighter than for other BHCs; a small BHC need only file semi-annually (rather than quarterly), and the required contents are more limited.

There is one regulatory capital wrinkle for these SLHCs that the FRB has the capacity to iron out, although it has not yet done so. Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") requires that the current bank-level capital requirements be applied at the holding company level. Among other results, this directive would exclude trust-preferred securities from Tier 1 capital. Small BHCs are permanently exempt from this requirement. Identically-sized SLHCs do not, however, enjoy the same full exemption, although they are able to take advantage of a five-year grace period for all SLHCs. The implications of this change warrant specific attention by each small SLHC,⁴² and some inevitably would

⁴⁰ The definitions of these categories and the basic nature of supervision are set forth in two FRB Supervision and Regulation Letters, SR 02-1 (Jan. 9, 2002) (BHCs of \$5 billion or less) and SR 08-9 (Oct. 16, 2008) (BHCs of \$10 billion or more). By way of a refresher, OTS assigned an SLHC to one of three categories, and for the vast majority of SLHCs only two categories were relevant. Category I included noncomplex and low-risk institutions; Category II encompassed complex or higher risk companies; and Category III SLHCs that were conglomerates. Whether an institution was a Category I or a Category II institution depended primarily on four threshold questions: (i) whether the holding company had significant activities other than operating a thrift, (ii) whether the holding company was engaged in activities other than investing cash from dividends or proceeds from stock sales; (iii) whether the holding company had minimal debt that it could service with its own resources; and (iv) whether, in its cash management operations, the company invested solely in highly liquid securities or in high risk, highly-leveraged instruments. Any SLHC with a composite CORE rating of 3, 4, or 5 would be deemed Category II. Category III institutions had multiple entities engaged in different businesses; they were identified on a case-by-case basis by the regional office and headquarters staff in Washington, D.C.

⁴¹ SLHCs of this size should note that the FRB imposes three conditions before a BHC is eligible for the small bank policies: the BHC may not (i) be engaged in significant nonbanking activities either directly or through a nonbank subsidiary; (ii) conduct significant off-balance sheet activities (including securitizations and asset management or administration) either directly or through a nonbank subsidiary; or (iii) have a material amount of debt or equity securities outstanding (other than trust-preferred securities) that are registered with the Securities and Exchange Commission.

⁴² In at least some cases, the five-year period may be sufficient time for outstanding trust-preferred securities to run off or to be redeemed. However, small BHCs may continue to issue trust-preferreds and include them in capital, an option not available to small SLHCs.

be adversely affected. We believe, however, that the FRB has intrinsic authority under its general regulatory authority to level the playing field.

- **Less than \$1 billion in assets.** This category includes smaller SLHCs that may be able to take advantage of the less onerous capital and reporting requirements for small BHCs. This category also includes, of course, SLHCs with assets between \$500 million and \$1 billion, to which the full-blown capital and reporting requirements would apply. In other respects, however, the FRB does not distinguish between the two for supervisory purposes.

Many of the SLHCs in this group could be affected by the transfer of OTS authority to the FRB. Under the OTS regime, SLHCs with assets of less than \$1 billion generally were treated as Category I institutions. Under the FRB's approach, these SLHCs will fall into one of three different sub-categories. The consequences are as follows:

- First, for noncomplex SLHCs that control thrifts with satisfactory composite and management ratings, the FRB will assign the same ratings to the holding company, and the actual examination will consist of a review of recent examination reports and related correspondence.
- Second, for similar SLHCs but with a subsidiary thrift in less than satisfactory condition, with less than a satisfactory management rating, or with a material supervisory issue, the FRB would conduct an off-site examination to determine management and composite ratings. (Note that this examination may be lighter than those for larger holding companies; the FRB assigns only management and composite ratings, not the full range of ratings.) On-site examinations may be necessary.
- Third, for SLHCs with less than \$1 billion in assets but that nevertheless are complex, the FRB is likely to follow largely the same approach as for SLHCs that had been assigned to OTS's Category II. This examination will be "full scope." That is, the FRB will assign the full set of holding company ratings to these SLHCs—thus increasing the prospect for an on-site examination.

These probable changes give rise to the possibility that SLHCs accustomed to a modest level of supervisory oversight as OTS Category I institutions will become subject to an examination that was thought under the OTS regime to be appropriate for Category II institutions.

- **Between \$1 billion and \$5 billion in assets.** For these institutions, the FRB does not draw any formal distinction between complex and non-complex. Examinations of these SLHCs will be full-scope, often with a full or partial on-site examination. Of course, in practice supervision would vary depending on each SLHC's particular operations.

The significance of this category is that SLHCs of this size that were treated as Category I institutions under the OTS system now almost certainly will be supervised essentially as OTS examined Category II institutions.

- **Between \$5 and \$10 billion in assets.** There is something of a lacuna for these institutions in the FRB's recent written guidance on examinations. Earlier guidance,

however, encompasses these holding companies.⁴³ The guidance implies that all BHCs of this size are complex and makes clear that (as with other BHCs), an examination focuses on the particular risks of each institution. Regular on-site examinations are the norm.

SLHCs of this size may be the least affected by the changes. These institutions almost certainly were Category II in OTS parlance, and the FRB's risk-focused examinations are likely to parallel the OTS approach.

- **More than \$10 billion in assets.** The FRB sometimes refers to these institutions as regional BHCs that are not large and complex banking organizations. These BHCs are monitored on a continuous basis, but typically the FRB does not maintain a day-to-day onsite presence.

In addition to generally heightened supervision, each SLHC of this size should be prepared to conduct stress tests, as is required by section 165(i) of Dodd-Frank. Supervision of non-thrift subsidiaries of SLHCs of this size is likely to be markedly more intense. The FRB examines the financial condition of comparable bank subsidiaries in some detail, and, after Dodd-Frank, is no longer required to defer to the primary functional regulator of these subsidiaries.

- **Large and complex banking organizations.** The definition of these institutions has varied over the years, but now may have been settled—for BHCs—by Dodd-Frank.⁴⁴ The provisions of Dodd-Frank addressing systemic risk suggest that any BHC with more than \$50 billion in assets is systemically important and, by inference, large and complex. At a minimum, the FRB must create heightened prudential standards for these institutions. How similarly sized SLHCs will be handled is unclear. The automatic treatment of the \$50 billion-plus institutions clearly applies only to BHCs. While there are a few SLHCs that will exceed the \$50 billion threshold, the FSOC will have to make a decision on a case-by-case basis as to whether any one SLHC (or any other nonbanking financial company) is systemically important. Even without such a determination, though, the FRB could subject these largest SLHCs to more rigorous standards.

Without trying to tease out the differences between the former OTS and the current FRB approaches to institutions of this size and, given the small number of affected SLHCs, suffice it to say that the SLHCs of this size have been deemed Category III in the OTS regime and should be accustomed to continuous supervision, although probably of a somewhat less intense variety than the FRB will undertake. SLHCs of this size should prepare for a continuous on-site presence by the FRB.

- **Grandfathered unitary SLHCs.** There is no provision in the FRB's supervisory framework for GUTHCs. The impact of supervision by the FRB has the potential to be severe, but much depends on the FRB's use of the intermediate holding company structure. The FRB traditionally has examined a BHC and its nonbanking subsidiaries in order to assess the BHC's overall condition and not strictly its relationship with bank subsidiary—a far broader approach than OTS has taken with

⁴³ See S&R Letter No. 99-15 (SUP) (June 23, 1999); SR Letter No. 97-24 (SUP) (Oct. 27, 1997).

⁴⁴ The FRB first separately identified LCBOs for supervisory purposes in 1997, S&R Letter No. 97-24. Additional supervisory provisions were added in S&R Letter No. 99-15 (these are the same letters that cover institutions between \$5 and \$10 billion). A subset of large and complex BHCs are those subject to the advanced approach in Basel II—institutions with more than either \$250 billion in consolidated assets or \$10 billion in foreign exposures, see 72 Fed. Reg. 69396 (Dec. 7, 2007), codified in 12 C.F.R. part 225, App. G.

GUTHCs engaged in nonfinancial activities. The FRB has, however, almost no experience supervising institutions engaged in such activities. At least in a technical sense, the FRB could require GUTHCs to establish intermediate holding companies that would own all financial assets of the GUTHC and the FRB then could limit its examination to the intermediate holding company structure. Whether the FRB would feel comfortable doing so is another matter, and any decision is likely to be several months off.

- **Examination ratings**

OTS used, and the FRB uses, nominally different criteria in examining holding companies, which result in some changes for SLHCs. The OTS framework used a “CORE” analysis: capital adequacy, organizational structure, risk management and earnings. The FRB employs a RIF/C(D) system in which risk management (R), impact (I), and financial condition (F) result in a composite score, the “C.” “D” incorporates the composite CAMELS rating of each bank subsidiary.

Without taking apart each regime in detail, two differences are apparent. First, the OTS framework did not identify asset quality as a specific element of the examination, but the FRB will review this aspect of a holding company’s operations. Second, the “impact” element of the FRB framework addresses the result on a bank subsidiary of safety and soundness issues at other, nondepository subsidiaries. This element has no real counterpart in the OTS regime—and reflects the greater attention the FRB pays to the holding company structure as a whole, rather than simply the relationship with a depository institution subsidiary.

F. Reporting

The FRB has a substantially more complex set of reporting requirements for BHCs than OTS had for SLHCs. Under the FRB Reporting Proposal, most SLHCs would transition to the FRB reporting requirements over a two-year period. Insurance companies that are SLHCs and those GUTHCs where the savings association subsidiaries’ consolidated assets make up less than five percent of the total consolidated assets of the GUTHC (measured as of the quarter end prior to the reporting date quarter end) would be exempt from these requirements.

The proposed requirements include the following, organized by year of implementation:

- 2011

For the remainder of this year, all SLHCs will file with the FRB the same current and annual H-b(11) reports that they would have been required to file with OTS, as well as Schedule HC from the Thrift Financial Report.

- 2012

All SLHCs (including exempt SLHCs) will continue to file the H-b(11) reports, and exempt SLHCs would continue to file the Schedule HC. Non-exempt SLHCs will now be required to file reports in the FR Y-9 series, as required, as well as a year-end report, either the FR Y-6 or the FR Y-7. The FR Y-9 series of reports collects holding company financial data. In particular, the FR Y-9C consists of standardized financial statements similar to call reports for banks. The FR Y-6 and -7 reports collect financial data, an organization chart, verification of domestic branch data, and information about shareholders. The FR Y-7 is required for “qualifying” foreign banking organizations and the FR Y-6 for all others. Few, if

any, SLHCs would file the FR Y-7. The timing of these new reporting requirements would coincide with the requirement that savings associations file call reports with the OCC and FDIC beginning with the March 31, 2012 reporting period.

- 2013

All appropriate FRB reports will be required for non-exempt SLHCs. As in 2012, all SLHCs would file the H-b(11) reports, and the exempt SLHCs will continue to file Schedule HC. The additional reports for non-exempt SLHCs will include the FR Y-8 (23A transactions with affiliates), the FR Y-11 and -11S (financial statements for nonbank subsidiaries), the FR Y-12 and -12A (equity investments in nonfinancial companies and certain merchant banking investments) and FR 2314 and 2314S (information on foreign subsidiaries of U.S. banks and BHCs). Any SLHCs that would qualify as foreign banking organizations will be required to file the FR Y-7 series.

This proposal is not exhaustive. The FRB has not yet provided instructions on the mechanics of filing. The FRB also has said that it will issue a separate proposal for the FR Y-10 report later in 2011 or in early 2012. The FR Y-10 report collects organizational structure and activity information in order populate the National Information Center database with a comprehensive list of subsidiaries and affiliates of each SLHC.

G. Application processing

Under the OTS regime, SLHCs (that were not also MHCs) had few application or notice requirements, apart from the original application to become an SLHC and certain notice or application requirements to engage in 1987 List or BHCA section 4(c) activities. This environment has now changed to some degree. The application or notice process for 1987 List or section 4(c) activities appear to be somewhat more elaborate than OTS had required. The most significant change will occur with respect to FHC activities. OTS had allowed SLHCs to engage in FHC activities largely without prior notice or limitation. Now, in addition to formal election of FHC status, an SLHC is subject to the application or notice requirements that apply to certain activities.⁴⁵

Regarding processing, as a general rule, the Interim Rule requires that applications by SLHCs be treated in the same manner as those by BHCs. Perhaps the most noticeable procedural change is the elimination of the formal period during which OTS would review an application solely for factual completeness, and of the specific time periods for comments and responses before OTS would take final action. Under Reg LL, applications now are subject only to an overall processing period, typically 30 to 60 days. Publication requirements may affect these periods, of course.

H. GUTHCs and intermediate holding companies

The grandfathering of unitary thrift holding companies in existence on May 4, 1999, is largely unaffected by Dodd-Frank. In addition to the new requirements for SLHCs across the board, however, one potential requirement for the grandfathered companies has been added. The Federal Reserve may (and in some situations must) require that a grandfathered unitary establish an intermediate holding company between it and the thrift and other subsidiaries engaged in financial activities.⁴⁶ The purpose of the intermediate holding company is to enable the Federal Reserve to focus on the financial activities within the overall organization and, by implication, to avoid regulation of nonfinancial activities.

⁴⁵ See 12 C.F.R. §§ 225.85-.89, 238.66(d).

⁴⁶ Dodd-Frank § 626, adding section 10A to HOLA. An intermediate holding company would be required if the FBR makes certain findings about its ability to supervise the SLHC. Certain internal financial activities could be allowed to continue to be held outside the intermediate holding company structure.

The evident purpose of the new requirement is to streamline supervision, rather than to shield the top-tier SLHC and its nonfinancial activities entirely. The Federal Reserve still may undertake limited examinations of, and require reports from, grandfathered holding companies with intermediate holding company subsidiaries and may in some cases undertake enforcement actions. Additionally, creation of an intermediate holding company does not relieve the grandfathered company from the source-of-strength doctrine or from holding company capital requirements.⁴⁷

I. Mutual holding companies

The Interim Rule creates a separate Reg MM for mutual holding companies. The rules on the reorganization of a mutual savings association into an MHC are largely the same as those that OTS had applied. Four sets of substantive changes from the former OTS rules warrant attention.

- ***Application processing***

As part of the FRB's overall effort to conform the processing periods for applications filed by thrift institutions to those for BHCs, Reg MM eliminates the former OTS practice of a six-to-eight week review process for conversion applications by MHCs. The FRB will now process these applications under its 30- or 60-day periods that apply to other thrift institution applications under Reg LL. The FRB notes that it has the authority to extend its review period if necessary.

- ***Dividend waivers***

A practice that generated considerable discussion and analysis at OTS was the waiver of dividends by an MHC. Such waivers work to the economic benefit of the other shareholders, creating an inherent conflict of interest for directors who hold stock in the savings association. Section 625 of Dodd-Frank clarifies the practice by requiring written notice to the FRB at least 30 days in advance of the proposed waiver and a non-objection by the FRB. Notice is not required if no insider holds any share of stock in the class of stock to which the waiver would apply.

The required notice when an insider holds stock in the savings association must contain a board resolution concluding that the waiver is consistent with the fiduciary duties of the board to the MHC members. The resolution also must contain a description of the conflict of interest and the steps taken to address the conflict (such as a waiver from the insider), a finding that the waiver is consistent with the fiduciary duties of the board, an affirmation that the MHC is able to meet the terms of any loan extended to the MHC (where the MHC has pledged the stock of the savings association as collateral) and an affirmation that a majority of the mutual members eligible to vote have, within the twelve months prior to the declaration of the dividend, voted to approve the waiver. The proxy statement used in connection with the member vote must include a description of the proposed waiver and the reasons the board has requested the waiver, disclosure of any MHC director's ownership of stock in the savings association and of any steps taken to eliminate the conflict.

The approval or non-objection criteria that the FRB will use depend on whether an MHC is "grandfathered," i.e., that it waived dividends before December 1, 2009. For grandfathered MHCs, section 625 of Dodd-Frank precludes the FRB from objecting to a waiver if the waiver

⁴⁷ As noted above, a GUTHC is exempt from the well-capitalized and well-managed requirements for holding companies engaged in financial, nonbank activities. This exemption also should apply to intermediate holding companies.

would not be detrimental to the safety and soundness of the savings and association and if the board of the MHC has expressly determined that the waiver is consistent with board's fiduciary duties to the MHC's mutual members.

Section 625 does not address the approval standards for non-grandfathered MHCs. The Interim Rule requires that these MHCs meet the requirements for grandfathered MHCs and certain other conditions. The most significant requirement may be that any director who holds stock covered by the waiver must recuse himself from the board vote on a resolution approving the waiver, and the board vote must be a majority of the entire board of directors, not merely those voting on the resolution. A nine-member board where five of the directors must recuse themselves cannot satisfy this condition. Alternatively, all officers and directors of the MHC or any of its affiliates, any associate or such officer or director, and any employee stock benefit plan (whether tax-qualified or not) in which the officer or director participates must waive their rights to dividends.

In addition, for non-grandfathered MHCs, the amount of the entire dividend declared by a savings association must, in the FRB's judgment, be reasonable. The amount of the waived dividends must be excluded from the capital accounts of the savings association in calculating future dividend payments. A non-grandfathered MHC also must account for a dividend waiver in a way that permits the FRB to consider the waived dividends in evaluating the proposed exchange ratio in the event of a full conversion. This accounting requirement does not apply to grandfathered MHCs because the FRB may not consider waived dividends in reviewing the exchange ratio for a full conversion by a grandfathered MHC.

- ***Offering circulars, forms of proxy, and proxy statements***

The former OTS rule barred an MHC planning a full conversion from conducting an offering or soliciting proxies until OTS had declared effective the appropriate offering circular, form of proxy, and proxy statement. The interim rule removes this "declared effective" requirement. The FRB will review the circular or proxy materials in considering the application as a whole and may comment on or require changes to these materials. The decision when to disseminate the materials is left to the MHC. In some but not all cases, materials must be reviewed and declared effective by the SEC or approved by a state securities regulator.

- ***Stock repurchases***

The Interim Rule makes two changes to the former OTS rules on repurchases within the first year after an MHC reorganizes into full stock form. First, the prior notice period for a repurchase is extended from the ten days under the OTS rules to 30 days. The FRB may extend this period up to an additional 60 days.

Second, a full application may be required, although the specific facts that would trigger an application are not entirely clear. The preamble to the Interim Rule observes that a stock repurchase within a short period of time after a conversion would generally constitute a material change in the business plan submitted with the conversion application. In such a case, the prior approval of the FRB would be necessary in order to effect a change to the business plan.

III. Savings Associations

The regulation and supervision of savings associations by the OCC and the FDIC do not mark as great a departure from OTS practices as do the regulation of SLHCs by the FRB. However, the new regulatory framework for savings associations may have a substantially greater impact on a day-to-

day basis. In certain areas, Dodd-Frank attempts to align the regulation of federal savings association with those of national banks. At the same time, Dodd-Frank also makes substantial changes to the rules for national banks. As a result, when considering its legal powers or obligations, each savings association must consider three questions:

- whether the pre-Dodd-Frank law for savings associations continues to apply,
- whether the pre-Dodd-Frank provisions of the National Bank Act—with which a savings association already may be familiar—now apply, or
- whether it is subject to a new requirement that likely is also new for national banks.

The Act leaves much of HOLA unchanged, and, while national banks and federal savings associations are now regulated by the same agency, significant differences between the two charters remain. Dodd-Frank leaves largely untouched the body of formal and informal OTS actions, as well as advisory materials, that have accreted over the years. The OCC has authority to withdraw, revise, or replace any of these actions or guidance (subject to procedural restrictions in the Administrative Procedure Act or elsewhere). Assuming that OCC is inclined to do so, such changes will take some time. At least for the moment then, OCC has confirmed that the powers and duties of savings associations, as embodied in HOLA and the OTS regulations and interpretations, diverge in many ways from those of national banks. The OCC has highlighted the differences in two publications: a paper and a companion chart that discuss many of the differences between federal savings association and national bank powers in detail.⁴⁸

Of course, not all of these differences will survive over the long haul. The OCC has nearly sole rulemaking authority over all savings associations, regardless of charter.⁴⁹ To exercise this authority, and as part of its existing rulemaking authority over national banks, the OCC has undertaken a multi-phased review of its and the now-former OTS regulations. The first phase is now complete. This phase consisted of two releases: (i) a final rule (the “OCC Final Rule”), addressing various internal agency functions and Dodd-Frank provisions that had taken effect upon enactment or on July 21, 2011, including new provisions on federal preemption and visitorial powers; and (ii) a re-publication of OTS regulations (with a few changes) in the OCC regulations (the “OCC Interim Final Rule”).

The OCC has said that future phases of its regulatory review will be comprehensive and substantive, addressing duplicative or overlapping regulations that now separately govern national banks and savings associations, and repealing or modifying unnecessary differences in regulatory approach. We expect the OCC to roll out several proposals gradually over the next several months.

On a parallel track, the OCC recently announced a two-stage process for the integration of OTS supervisory policies into the OCC policy framework.⁵⁰ The OCC has taken other steps as well, including the addition of thrift-focused positions to the OCC’s management ranks,⁵¹ the revision of its

⁴⁸ See Key Differences Between National Bank Regulatory Requirements and Federal Savings Association Regulatory Requirements, <http://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/Key-differences-document-public.pdf>; Summary of the Powers of National Banks and Federal Savings Associations (Aug. 1, 2011), <http://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/pub-other-fsa-nb-powers-chart.pdf>.

⁴⁹ See note 50 *infra* for an example of the FDIC’s residual rulemaking authority for savings associations. The FDIC also has participated in one joint notice with the OCC regarding OTS regulations to be enforced by the FDIC and the OCC. See List of Office of Thrift Supervision Regulations to be Enforced, 76 Fed. Reg. 39246 (July 6, 2011).

⁵⁰ OCC Bulletin 2011-47 (Dec. 8, 2011).

⁵¹ See FRB, FDIC, OCC, OTS, Joint Implementation Plan at 13-16 (Jan. 2011), accessible at http://www.federalreserve.gov/boarddocs/rptcongress/regreform/joint_implementation_20110125.pdf. The OCC’s

Enforcement Action Policy to include federal savings associations,⁵² the creation of two advisory committees that mirror committees established by OTS,⁵³ and extending the OCC appeals process to federal savings associations.⁵⁴

Given the continuing but perhaps slowly eroding differences between national banks and federal (and in some cases state) savings associations, thrift institutions should take the opportunity to review their business lines, the authority on which they rest, and the consequences if national bank regulations were to apply. Below we consider changes with respect to activities and operations, preemption, control, and examination and supervision.

A. Activities and operations

While an exhaustive review of HOLA and how it may have moved closer to the National Bank Act is beyond the scope of this paper, we will address certain changes in Dodd-Frank that may have important results. Other existing powers under HOLA and unchanged by the Act may take on greater importance after Dodd-Frank. Accordingly, we assess below the QTL Test, insider transactions, service corporations, commercial and commercial real estate lending, affiliate transactions, loans to one borrower, and dividends and other capital distributions.

- **Qualified thrift lender test**

SLHC status and the avoidance of BHC status have depended for decades on compliance by each savings association subsidiary with the QTL Test. As all SLHCs know, the test generally requires that 65 percent of a savings association's assets be invested in assets relating to residential mortgage loans.⁵⁵ Certain other assets are includable as well.

After failing a test, a savings association has had one year in which to rehabilitate itself and avoid sanctions. If the association is unable to do so, then three restrictions take effect: (i) any new activities by the association are limited to those available to national banks; (ii) interstate branching is limited to that permissible for national banks; and (iii) the association is subject to the same limits on dividend payments that apply to a national bank. The holding company also would be required to register with the FRB as a BHC and become subject to the various restrictions in the BHCA.

Dodd-Frank introduces three new restrictions in the event of QTL non-compliance—all of which took effect the day after the enactment of Dodd-Frank, July 22, 2010.⁵⁶ First, the one-year rehabilitation period has been eliminated, so limits on new activities take effect immediately. Second, dividend payments become permissible only if specifically approved by both the FRB and the OCC and only if necessary to meet holding company obligations. Third, the OCC has explicit authority to bring a formal enforcement action to compel compliance with the test.

management changes have included the addition of a Deputy Comptroller responsible for the examination and supervision of federal savings associations, a position mandated by section 314(b).

⁵² OCC Policies & Procedures Manual: Enforcement Action Policy, PPM 5310-3 (REV) (Sept. 9, 2011).

⁵³ The two are the Minority Depository Institutions Advisory Committee and the Mutual Savings Association Advisory Committee. See OCC News Release 2011-131 (Oct. 21, 2011).

⁵⁴ See OCC Bulletin 2011-44 (Nov. 1, 2011).

⁵⁵ An SLHC may elect an alternative test—the definition of a domestic building and loan association in the Internal Revenue Code, 26 U.S.C. § 7701(a)(19). The two tests do not materially differ: a savings association is likely to pass both tests or fail both tests.

⁵⁶ Dodd-Frank § 624, codified at 12 U.S.C. § 1467a(m)(3).

- **Insider transactions**

Currently, under section 22(d) of the Federal Reserve Act, a bank may purchase from, or sell to, a director an asset only if either the transaction is on market terms or it has been authorized by a majority of disinterested directors. In practice, it is difficult to imagine that both the interested director and the disinterested directors could fulfill their fiduciary obligations without meeting both conditions. Savings associations are not subject to this statute, but the conflict of interest regulation covers the same ground, requiring in all cases that the director disclose his or her interest in the purchase or sale and recuse himself or herself from any discussion or vote by the disinterested directors.⁵⁷ It is implicit both that board approval requires a majority vote and that the transaction must be on market terms.

Section 615 of Dodd-Frank replaces these provisions with a more expansive although arguably less stringent requirement, which covers savings associations as well as banks. The restrictions on sales to or purchases from insiders now apply to transactions with executive officers and principal shareholders as well as to those with directors. These transactions must be on market terms, regardless of any board action. If the transaction exceeds 10 percent of the capital and surplus of the bank or thrift, then advance approval from a majority of disinterested directors is necessary. This amendment took effect on July 21, 2011.⁵⁸ Notwithstanding the suggestion that board action is not required for transactions below the 10 percent threshold, the fiduciary duties of the interested director would seem to require disclosure and recusal, and those of the disinterested directors a majority vote in every case.

Loans and other extensions of credit to insiders are subject to longstanding rules, based on section 22(g) and (h) of the Federal Reserve Act (incorporated by reference in section 11 of HOLA) and set forth in Regulation O, on amounts and on the procedures by which such transactions must be approved. Dodd-Frank expands the types of extensions of credit subject to these limits to include derivative transactions, repurchase agreements and reverse repurchase agreements, and securities lending and borrowing transactions. This new coverage took effect on July 21, 2011.

- **Service corporations**

Under HOLA, a federal savings association may create a service corporation subsidiary subject to the condition that the association's aggregate investments in all service corporation subsidiaries may not exceed 3 percent of the association's assets.⁵⁹ HOLA does not impose any restrictions on the activities of a service corporation. However, by regulation, OTS limited activities to those "reasonably related to the activities of financial institutions," and this provision remains in the OCC regulations.⁶⁰ OTS has identified a large number of preapproved activities, and other activities may be permitted upon application.

The range of possible service corporation activities appears to be wider than the set of financial activities available under the basic measure of financial activities, section 4(k) of the Bank Holding Company Act, and a corresponding provision in the National Bank Act.⁶¹ Specifically, a service corporation may undertake real estate development (and not merely

⁵⁷ See 12 C.F.R. § 163.200.

⁵⁸ See 12 U.S.C. § 1828(z).

⁵⁹ In addition, limits on ownership and geographic location apply to first-tier service corporations.

⁶⁰ See 12 C.F.R. § 159.3(e)(2).

⁶¹ For national bank authority, see 12 U.S.C. § 24a.

through debt-previously-contracted authority) and may act as a real estate broker for third parties, a power that the Federal Reserve has not authorized under section 4(k).⁶²

- **Commercial and commercial real estate lending**

One obvious and continuing difference between national banks and federal savings associations lies in commercial lending, including commercial real estate lending. Almost by definition, a national bank may make unlimited commercial loans. The commercial loans in a federal savings association's portfolio, however, may not represent more than 20 percent of total assets (with a sub-limit of 10 percent on loans that are not small business loans). Commercial real estate loans do not count toward the cap, so long as they do not exceed 400 percent of capital. A savings association might not even be able to max out under these limits because, in very rough terms, the QTL test caps commercial loans, including commercial real estate loans, at 35 percent of assets. In light of these limits, the change in regulators may not have a great effect on commercial lending by a federal savings association.

But a savings association engaged in a substantial amount of commercial real estate lending may be subject to more intense scrutiny by the OCC or the FDIC—both of which have greater experience than OTS in examining these assets. The 400 percent limit on commercial lending in HOLA exceeds the supervisory limit of 300 percent that the OCC and the FDIC have generally imposed on commercial real estate lending. OTS criticized several thrifts for excessive commercial real estate lending even where the amount of lending was within the statutory limits, but the OCC or the FDIC could take a harder line. The statutory buckets in HOLA do not prevent the OCC from imposing more stringent safety-and-soundness limits.

Accordingly, the immediate lesson for a federal savings association may be to measure its portfolio of commercial real estate loans against the 300 percent-of-capital ceiling and, if the portfolio exceeds the ceiling, to consider how it would address the issue with the OCC.

- **Affiliate transactions**

Dodd-Frank expands the scope of the current sections 23A and 23B affiliate transaction restrictions in a number of ways.⁶³

- The Act expands the definition of affiliate to include any investment fund for which a bank or savings association, or any of their affiliates, serves as an investment adviser.
- Several changes to section 23A are designed to capture the credit risk generated by sophisticated affiliate transactions. Repurchase agreements, reverse repurchase agreements, the borrowing and lending of securities, and derivative transactions now will be treated as extensions of credit, if these transactions create credit exposure for the depository institution involved.

⁶² A bank holding company may make small, passive investments in companies engaged in nonfinancial activities through its authority under section 4(c)(6) of the BHCA and through its merchant banking authority, but the restrictions on investment amounts or on the ability to manage or operate the investment appear to make these authorities more limited than those available to federal thrifts under the service corporation authority.

⁶³These sections continue to apply to savings associations by virtue of their incorporation by reference in section 11 of HOLA. The relevant regulation, 12 C.F.R. § 563.41, simply refers to the FRB's Regulation W, the regulation that governs affiliate transactions involving banks.

- The FRB is allowed but not required to take netting agreements into account in determining the amount of a covered transaction and whether it is fully secured. Any such interpretation must be issued jointly with, in the case of savings associations, the association's primary federal regulator, either the OCC or the FDIC.
- The Act also revises current practice with respect to exemptions. The Federal Reserve does not have sole authority to grant exemptions from either section 23A or 23B. For federal savings associations, the OCC and the FRB must jointly find that the exemption is in the public interest and consistent with the purposes of section 11 of HOLA. The two agencies must notify the FDIC. The FDIC has 60 days in which to block the exemption, but in order to do so, it must find that the exemption presents an unacceptable risk to the Deposit Insurance Fund (the "DIF"). The process is a little different for state savings associations since there is no role for the OCC. For these institutions, an exemption is available if the FDIC and the FRB jointly make both a public interest finding and a finding that there is no unacceptable risk to the DIF.

None of these changes will take effect until July 21, 2012, and to the extent that new regulations will be required, they will be part of the FRB's Regulation W. Previously, OTS had at least nominal authority in applying affiliate transaction restrictions to savings associations, although in most respects it was required by section 11 of HOLA to follow FRB requirements. This authority was not transferred to OCC.

- **Loans to one borrower**

Federal and state savings associations largely are subject to the same ceiling on loans to one borrower—that outstanding unsecured credits to a single debtor may not exceed 15 percent of the sum of unimpaired capital and surplus, with an extra ceiling of 10 percent unimpaired capital and surplus for credits fully secured by readily marketable collateral. As with other credit exposure-related changes, Dodd-Frank adds derivative transactions, repurchase agreements and reverse repurchase agreements, and securities lending and borrowing transactions to the room that these ceilings cover. This expansion will not take effect until July 21, 2012.

- **Dividends and other capital distributions**

The substantive limits on dividends by savings associations are the same as before Dodd-Frank. Now, however, savings associations must consider two regulators, the FRB and either the OCC (in most cases) or the FDIC. The vast majority of capital distributions by savings associations take the form of cash dividends to their holding companies. For these dividends, the FRB must be notified at least 30 days in advance of any proposed declaration of a dividend, and (with respect to federal savings associations) the OCC must receive an informational copy.⁶⁴ Any other capital distributions are reviewed by the OCC or the FDIC. For these distributions, the OCC has adopted the OTS requirements.⁶⁵ The FDIC has not spoken to this issue but presumably will follow the OCC's lead.

B. Federal preemption and state enforcement

Dodd-Frank addresses at some length federal preemption and the regulatory and enforcement roles of the states. A federal savings association will need to walk through the Act's several complex

⁶⁴ See 12 C.F.R. §§ 163.143(d) (copy to OCC), 238.103(a) (filing with FRB).

⁶⁵ See 12 C.F.R. part 163, subpart E.

changes to preemption law event, though, in the final analysis, the ability to rely on federal preemption in conducting multi-state operations is unlikely to change materially. We have reviewed these issues in detail in an earlier user guide.⁶⁶

The fundamental doctrinal change for federal savings associations is that the national bank preemption rules now apply.⁶⁷ Seven consequences of the Dodd-Frank preemption provisions warrant attention; note that the scope of the changes vary:

- i. The OCC has broadly revised preemption standards for both national banks and federal savings associations, although the applicable Dodd-Frank provision covered only consumer protection laws;
- ii. The exclusivity of the OCC's visitorial powers has been narrowed. State attorneys general ("State AGs") now have the authority to bring civil actions against national banks and federal savings associations. Separately, the CFPB has some (but not exclusive) visitorial powers;
- iii. An interesting question and one not resolved in Dodd-Frank is whether past preemption determinations of OTS (and OCC) survive;
- iv. State attorneys general (the "State AGs") may, in certain cases, enforce CFPB regulations against federal savings associations;
- v. Current federal consumer protection statutes contain their own preemption provisions, which are not affected by Dodd-Frank;
- vi. Four OTS preemption regulations have been replaced as a result of the Act's elimination of the "occupation of the field" doctrine; and
- vii. Operating subsidiaries and agents no longer are eligible for federal preemption, resulting in a potentially important change to the organization and operation of federal savings associations.

- ***Revised preemption standards***

The OCC Final Rule amends the agency's core regulations on preemption for national banks—and in doing so goes beyond the specific provision of Dodd-Frank. The OCC Interim Final Rule subjects federal savings associations to the new regulations as well. These regulations represent a greater change to the previous preemption doctrine for federal savings associations than for national banks.

Section 1044(a) of Dodd-Frank sets forth the criteria for the preemption of any "State consumer financial law."⁶⁸ This type of law regulates the terms and conditions of financial transactions between a consumer and a bank. (A law that, on its face, discriminates against a national bank does not qualify as a State consumer financial law.) Under section 1044(a), a State consumer financial law is preempted in any one of three circumstances. First, the application of a State consumer financial law has a discriminatory effect on national banks, in comparison with the effect on a bank chartered by the same state. Second, in accordance

⁶⁶ We have discussed in detail federal preemption after Dodd-Frank in our Federal Preemption User Guide (July 2010), available at <http://www.mofo.com/files/Uploads/Images/100723UserGuide.pdf>.

⁶⁷ See Dodd-Frank § 1046; 12 U.S.C. § 1465. Previously, the broad "cradle-to-grave" supervisory authority granted to OTS in sections 3 and 4 of HOLA was thought to provide more expansive preemption for federal thrifts than was available for national banks, although it is difficult to identify specific examples.

⁶⁸ See Rev. Stat. § 5136C.

with the U.S. Supreme Court's decision in *Barnett*⁶⁹ the law "prevents or significantly interferes with" the exercise of national bank powers.⁷⁰ Third, a provision of federal law other than Title X of Dodd-Frank preempts the law. The OCC must make any determination to preempt a state consumer financial law on a "case-by-case basis." Substantial evidence on the record is necessary for determinations under the *Barnett* standard, and the OCC must review its preemption determinations every five years. Section 1044(a) amends the National Bank Act; these changes are made applicable to federal savings associations by section 1046(a) of Dodd-Frank.⁷¹

Before Dodd-Frank, the OCC by rule preempted any state laws "that obstruct, impair, or condition a national bank's ability to fully exercise its Federally authorized ... powers,"⁷² an articulation based on *Barnett*. These regulations were not limited to consumer protection but applied broadly to any state statute that might affect the operations of a national bank as authorized under the National Bank Act. The post-Dodd-Frank rule is articulated inversely and relies simply on *Barnett*: a state law is not preempted "to the extent consistent with the decision in [*Barnett*]."⁷³ National banks accustomed to operating under the 2004 standard should not experience any change, since the 2004 language was replaced with a reference to the Supreme Court decision on which it was based. All of the OCC's *Barnett*-based preemption interpretations accordingly remain valid and will serve as the precedents for any preemption decisions for federal savings associations.

When proposed, the new rule briefly re-ignited the controversy over federal preemption for national banks. Several commenters, including the Department of Treasury, urged the OCC to interpret section 1044 as narrowing the federal preemption doctrine for national banks to cover only state laws that "prevent or significantly interfere with" federal law. The OCC rejected this view, and the *Barnett* standard remains in the OCC Final Rule, which is extended to apply to federal thrifts.⁷⁴ National banks and federal thrifts should bear in mind that although section 1044(a) deals only with the preemption of state consumer financial protection laws, the OCC Final Rule extends (not surprisingly) the *Barnett* standard to all preemption questions involving lending or deposit-taking. Any interpretations likewise will be based fundamentally on *Barnett*.

While the impact on national banks from section 1044 may be modest, the *Barnett* standard marks an important change for federal savings associations. To the extent OTS relied on a *Barnett*-type standard in its preemption determinations—and typically it relied on a different theory of "occupation of the field," described below—it was whether a state law "interfere[d] with and burden[ed]" an operation of a federal thrift. This standard does not have a precise counterpart in *Barnett*, in contrast to the former and current OCC regulations, and the OCC approach now will govern. Moreover, the analyses underlying the OTS determinations are not as granular in nature as those of the OCC, and federal thrifts will be required to present a much more detailed and careful analysis to the OCC.

⁶⁹ *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996).

⁷⁰ This principle is commonly referred to as the "*Barnett* standard." Application of this standard involves the review of several factors regarding the impact of a state law on the exercise of national banking powers. See *Barnett*, supra n.48, at 33-34.

⁷¹ 12 U.S.C. § 1465.

⁷² 12 C.F.R. §§ 7.4007(b)(1), .4008(d)(1) (2011).

⁷³ 76 Fed. Reg. 43549, 43565 (July 21, 2011), to be codified in 12 C.F.R. §§ 7.4007(c), .4008(e) (2012). These new post-Dodd-Frank rules are not limited to consumer protection, although section 1044 of Dodd-Frank does not go beyond that issue. The OCC explained that section 1044 confirmed the existing *Barnett* standard and accordingly it was appropriate to extend the language incorporating *Barnett* to all areas of national bank preemption. See 76 Fed. Reg. 30557, 30562-63 (May 26, 2011).

⁷⁴ 12 C.F.R. §§ 7.4007(c)(8) (deposit-taking), 7.4008(e)(8) (lending). A new regulation, 12 C.F.R. § 4010(a), makes these rules applicable to federal savings associations.

- **Visitorial powers**

This concept may become more meaningful for federal thrifts.⁷⁵ The National Bank Act has given the OCC nearly exclusive power to conduct examinations and conduct other visitations of national banks,⁷⁶ and the OCC has long interpreted this provision to preclude state investigations or enforcement activity. Before Dodd-Frank, HOLA did not contain similar specific language, but HOLA's broad grant of regulatory and supervisory power to the OTS foreclosed the need for a specific provision on visitorial powers.⁷⁷

The OCC's interpretation of the reach of its exclusive visitorial powers was modified in a 2009 ruling by the Supreme Court in *Cuomo v. Clearinghouse Ass'n*.⁷⁸ *Cuomo* held that the OCC's visitorial powers did not preclude a state attorney general from bringing a civil action against a national bank based on a non-preempted state law. Section 1047(a) of Dodd-Frank codifies this result,⁷⁹ and section 1047(b) extends this principle to federal savings associations.⁸⁰ The OCC Final Rule accordingly contains visitorial powers regulations for both national banks and federal savings associations that have been revised to take account of these changes.⁸¹

Separately, section 1025 of the Act grants the CFPB examination and supervision authority over banks and savings associations with total assets in excess of \$10 billion or more with respect to the CFPB's consumer protection function. For banks and savings associations below this threshold, the CFPB may request reports relating to consumer financial protection. In all cases, the CFPB must work with the primary regulator and rely on existing reports to the extent necessary, but, ultimately, the CFPB has independent visitorial powers within its sphere, and the exclusivity of the OCC's visitorial powers has disappeared.

- ***Existing preemption regulations and other interpretations.***

The extent to which existing preemption regulations, orders, guidance, and interpretations by the OCC and OTS survive Dodd-Frank is complex and will require additional analysis. The rules for the transition of OTS functions to the Federal Reserve, the FDIC, and the OCC provide that essentially all determinations, interpretations, and other actions of OTS remain in effect according to their terms. The Act is not explicit, however, in reconciling this provision with the other preemption-specific provisions. Looking to the preemption provisions in the Act, three variables could affect whether OTS preemption determinations survive.

- *Is a contract involved?* The Act is explicit that regulations and other agency actions addressing the applicability of state law to any contract entered into on or before July 21, 2010, remain in effect. The Act does not rule out preemption in respect of contracts

⁷⁵ Previously, visitation rights for federal savings associations were implied in the general authority of OTS to examine and supervise these associations.

⁷⁶ 12 U.S.C. § 484.

⁷⁷ 12 U.S.C. §§ 1463(a), 1464(a).

⁷⁸ 129 S.Ct. 2710 (2009).

⁷⁹ 12 U.S.C. § 25b(i). Dodd-Frank adds a provision that the ability of the OCC to enforce Title 12 of the U.S. Code or section 5 of the Federal Trade Commission Act does not preclude a private party from enforcing rights granted under federal or state law in the courts.

⁸⁰ 12 U.S.C. § 1465(c). This section contains the same Dodd-Frank amendment regarding the rights of private parties to bring suit.

⁸¹ The revised visitorial powers regulation for national banks is 12 C.F.R. § 7.4000(b). The substance of this provision applies to federal savings associations under 12 C.F.R. § 7.4010(b).

entered into after July 21, but federal thrifts should be careful in evaluating whether to assert preemption claims as to these contracts.

- *Is the state law at issue a “state consumer financial law”?* As discussed above, such a law is one that (a) does not on its face discriminate against national banks and (b) “specifically regulates the manner, content, or terms and conditions of any financial transaction . . . or any account related thereto, with respect to a consumer. For these laws, federal preemption is available only if the law would have a discriminatory effect on a national bank, prevents or significantly interferes with the exercise of national bank powers, or is preempted by a federal law other than Title LXII of the Revised Statutes of the United States.⁸² This provision largely confirms existing law, and the new aspects relate to the process for making preemption determinations in the future. Under this provision, most, if not all, existing federal preemption determinations involving state consumer financial laws should survive.
- *Is the theory of preemption solely “occupation of the field”?* As discussed above, this theory no longer is available to support federal preemption. Whether this repeal reaches back is unclear. Conceivably a court could rely on this provision to overrule a pre-Dodd-Frank determination.

If the preemption issue does not involve a contract, does not relate to a state consumer financial law, and does not rest exclusively on “occupation of the field,” then it seems clear that existing preemption determinations of the OCC and OTS should remain operative.

- **State enforcement**

Federal thrifts are likely to see new enforcement and regulatory initiatives on the part of the states in the wake of Dodd-Frank. State AGs are permitted to bring civil actions to enforce any regulations issued by the CFPB, although they do not have authority to enforce Dodd-Frank statutory provisions on a stand-alone basis. The Act also confirms, as discussed above, the *Cuomo* holding that State AGs may go to court to enforce non-preempted state law against all thrifts (and banks). Before bringing an action, the State AGs must consult with the CFPB. State financial regulatory agencies do not have comparable authority.⁸³

It is not possible to predict what issues may attract the attention of State AGs. While they will not have any federal law to enforce until the CFPB begins to issue regulations, it would be prudent for all thrift institutions to refocus on consumer compliance matters. Savings associations may wish to take advantage of this interim period before final rules are issued in order to review their compliance programs. Once rules are issued, the State AGs could wield considerable power. In light of the cooperation between the State AGs and the nascent CFPB in developing a proposed settlement on home foreclosures and related issues, there is some potential for the State AGs to act as a kind of enforcement arm of the CFPB. Indeed, the State AGs can bring civil actions against thrifts with less than \$10 billion in assets to enforce CFPB rules, even though the CFPB itself lacks direct enforcement authority over these institutions.

⁸² This last provision is potentially complicated because Title LXII includes most, but not necessarily all, provisions of the National Bank Act as it has been amended.

⁸³ Of course, State AGs (as well as state regulators) have broad enforcement authority with respect to state-chartered thrifts.

- ***Other statutory preemption provisions***

While Dodd-Frank works some potentially important practical changes to federal preemption, federal thrifts should also bear in mind the limits of the Dodd-Frank modifications. Among other things, all of the federal consumer protection statutes for which rulemaking authority is granted to the CFPB contain their own preemption provisions. These statutes include the most significant federal financial consumer protection laws: the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, and the privacy provisions of the Gramm-Leach-Bliley Act. These provisions are *not* uniform and in some cases involve a complicated analysis of the roles of federal and state agencies. None of these provisions are modified by Dodd-Frank.

- ***OTS regulations modified***

Section 1046 of the Act states that HOLA “does not occupy the field in any area of State law.” This rather theoretical statement may have important ramifications for some activities by federal thrifts. Before Dodd-Frank, OTS preempted state law under one or more of three theories: the applicable federal statute or regulation explicitly preempts state law; state law conflicts with the operation of the relevant federal law; or the pertinent federal law covers an area of law so broadly that no state law may apply to this area. In a number of instances, courts and OTS have interpreted HOLA as a statute that fits the third theory; HOLA “occupies the field” of the regulation of federally chartered savings associations.⁸⁴

At least two consequences flow from the elimination of this theory in the construction of HOLA. First, OTS had in place four preemption regulations, all of which were based solely on “occupation of the field.”⁸⁵ The OCC Interim Final Rule effectively replaces the “occupation of the field” language with the conflict preemption theory: state law applies to federal savings associations to the extent that it applies to national banks. Second, OTS has invoked “occupation of the field” as the sole basis for the preemption of several state laws, including certain laws that have attempted to impose localized anti-discrimination and anti-predatory limits on residential mortgage lending and limitations on gift cards.⁸⁶ These interpretations will cease to be available as legal support for future federal preemption decisions, although, by virtue of a savings provision in Dodd-Frank,⁸⁷ the interpretations should continue to be valid for the circumstances that they addressed, at least until the OCC decides to modify any of them.

Given the removal of this foundation for much of OTS-generated law on preemption, every federal savings association should assess the extent to which it relies on federal preemption to avoid state licensing or other restrictions, and whether this preemption is based on an “occupation of the field” interpretation by OTS. Where there may be an issue, it also would be worthwhile reviewing specific policies, practices, and contract forms. It would appear that at least contracts are grandfathered, as discussed below.

- ***Operating subsidiaries and agents***

Beginning in the early 1990s, OTS expanded federal preemption to cover operating subsidiaries and, eventually, agents (subject to some important restrictions). The OCC did

⁸⁴ Explicit statements of preemption in federal statutes that were not expressly amended or repealed by Dodd-Frank continue to remain in effect.

⁸⁵ 12 C.F.R. §§ 545.2 (operations), 550.136 (fiduciary activities), 557.11 (deposit activities), and 560.2 (lending activities).

⁸⁶ See OTS Op. Ch. Counsel P-2006-3 (June 9, 2006).

⁸⁷ Dodd-Frank § 316(b)(2).

so as well, but to a lesser extent, particularly with respect to agents, than did OTS. Operating subsidiaries often have been used to house various residential mortgage loan operations. Recently, federal thrifts have sought to use agents to expand their mortgage origination business.

Section 1045 of Dodd-Frank explicitly strips these arrangements of the benefit of federal preemption. The OCC Interim Final Rule amends the former OTS regulation on operating subsidiaries to make clear that state law applies.⁸⁸ (Preemption with respect to agents was set forth solely in interpretations by OTS.)

Two aspects of this change are particularly noteworthy. First, the elimination of preemption for operating subsidiaries and agents is not limited to state consumer financial laws. Second, section 1045 contains no grandfathering clause, although, per above, contracts entered into before the enactment of Dodd-Frank based on then-existing preemption rules or interpretations remain valid.

C. Change in control

Thrift institutions now are subject to the same bifurcated review of changes in control as banking institutions have been since 1964. In general, an investor that is a company and that seeks control, directly or indirectly, of a savings association, must obtain approval from the FRB as an SLHC and also must file a notice with the OCC (or, in the case of state-chartered thrifts, the FDIC) under the Change in Bank Control Act. Previously, OTS was in charge of both processes and implemented them through the same regulation.

Now, however, prospective controlling investors are subject to the potentially more stringent rules of the FRB on holding companies. The change-in-control notices, however, remain subject to the former OTS approach, which the OCC reissued in the OCC Interim Final Rule. The former OTS rules are not the same as the OCC rules for changes in the control of national banks. This peculiar situation may not have much significance in practice, though. Any investor in a federal savings association or its holding company that owns 10 percent or more of a class of voting securities but less than 25 percent will be required to enter into passivity commitments with the FRB. Such an investor would have an opportunity to rebut control with the OCC and avoid a CBCA notice as well. In general, the provisions of a CBCA rebuttal are more lenient than the FRB's passivity commitments. It is not apparent that an investor ever would be in a situation where it would not be required to address control issues with the FRB, but would be required to file a CBCA notice or a rebuttal with the OCC.

D. Examination and supervision

All savings associations now have new examiners and supervisors. Safety and soundness naturally continues to be the touchstone of examinations and supervision, but each agency has its own approach. The impact on thrift institutions is almost impossible to predict, but a few observations are in order. To begin, the OCC and FDIC provide their own guidance to examiners that in form (and, possibly in some instances, in substance) differ from that of the FDIC. Certainly for savings associations accustomed to reviewing the OTS examination handbook, there are now new materials to consider. The OCC has a large collection of activity- or asset-specific booklets. The FDIC has its Risk Management Manual of Examination Policies, together with other guidance documents. All regulators use a preexamination request for information and certain documents. These are not uniform across the agencies, and savings associations should be prepared to respond to different kinds of requests.

⁸⁸ 12 C.F.R. § 159.3(n)(1) replaces 12 C.F.R. § 559.3(n)(1).

Changes in examinations by the OCC and the FDIC are more qualitative; anecdotally, both agencies tend to focus on management procedures—including documentation of decisions, risk management, and corporate governance—in ways that OTS did not.

The structure of supervision at the OCC will result in changes for federal savings associations in at least two ways. First, the OCC has made significant organizational changes in order to handle the influx of federal savings associations. In addition to a new deputy comptroller for thrift institutions (required by Dodd-Frank), each regional office has (or will have) a third associate regional director and an adviser to the regional director on thrift institution issues. (The third associate regional director does not necessarily handle only thrift institutions.)

Second, every national bank is supervised and examined by one of three divisions at the OCC, depending on the size and complexity of the bank. The OCC has assigned each federal savings associations to one of the divisions, using essentially the same criteria. The Mid-Size and Community Bank division will supervise the vast majority of federal savings banks.

Assessments for supervision will change in modest ways. Historically, OTS and the OCC used somewhat different methodologies for calculating assessments. To recap the OTS approach, an assessment had three components: size, condition, and complexity. A savings association was complex for assessment purposes if it administered over \$1 billion in trust assets, held a principal balance of more than \$1 billion in assets covered by recourse to the association or a direct credit substitute provided by the association, or the principal amount of loans serviced for others was over \$1 billion. The OCC uses similar size and condition components, but treats complexity a little differently. In lieu of the three OTS categories, the OCC imposes special assessments on credit card-only and trust-only banks (if the trust-only bank has fiduciary assets of more than \$1 billion). For state savings associations, section 318(d) of Dodd-Frank allows but does not require the FDIC to set assessment fees for state-chartered depository institutions; as of this writing, the FDIC has not released a proposal, and it seems unlikely that the agency will do so..

E. Reports and applications

Call reports will replace the thrift financial reports beginning with the report for the first quarter of 2012. OTS began to provide guidance for the transition last February,⁸⁹ and the OCC recently has provided additional information.⁹⁰ In particular, the OCC has identified several differences between the call report and the TFR. There are two important threshold issues. First, the call report is calibrated to some degree on the asset size of the reporting institution; smaller institutions will have reduced reporting requirements. Second, the call report makes no provision for special valuation allowances. In the call report, savings associations now must write off loans for which the associations had been able to establish SVAs in the TFR.

Additionally, certain other reporting requirements in the call report may require some changes in systems for data gathering. These changes include: (i) the income statement and the consolidated valuation allowances are reported on a year-to-date basis; (ii) average balances must be based on weekly or daily calculations (monthly calculations are not permitted); and (iii) the Tier 1 leverage ratio is based on average total assets over a quarter, rather than a quarter-end measurement.

⁸⁹ See CEO Memos 378 (Feb. 3, 2011), 379 (Feb. 15, 2011).

⁹⁰ The OCC held a teleconference on October 13, 2011. The written presentation is at <http://www.occ.gov/about/who-we-are/occ-for-you/bankers/bankers-education/krm-handout-package.pdf>, and the transcript is at <http://www.occ.gov/about/who-we-are/occ-for-you/bankers/bankers-education/migration-from-tfr-to-call-report-10-13-script.pdf>.

Savings associations also should be aware that the FRB, FDIC, and OCC recently proposed several changes to the call report for all banks and savings associations.⁹¹ Most changes would take effect for the second quarter 2012 reporting period, but a few would take effect in the first quarter. The proposals include one savings association-specific change, which would amend Schedule RC-M of the call report to include data on compliance with the QTL test. This change would be made for the first quarter of 2012.

As a rule of thumb, a federal savings association can expect application filing and processing requirements similar to those of the OTS. Indeed, the OCC Interim Final Rule re-publishes the OTS rules with a few changes to reflect slight differences in the application process. (For example, the OCC does not have quite the same 15- and 30-day back-and-forth process before an application is deemed complete.) Before filing a notice or application, a federal savings association should review part 116 of the OCC Interim Final Rule to ensure that it is following the appropriate procedures. It is also worth noting that the application procedures for national banks are at least different in form,⁹² and these differences should be among those that the OCC reconciles in forthcoming rulemaking.

F. Enforcement

Although Dodd-Frank did not affect the substantive enforcement authority of the OCC (or the FRB or FDIC) under section 8 of the FDIA, federal savings associations should be aware that the OCC recently issued a revised enforcement action policy covering both national banks and federal thrifts.⁹³ National banks will not experience any change.

Some federal savings banks might see some differences in OCC practices, however. For example, the OCC tends to require greater documentation in connection with informal actions and to make greater use than did OTS of the “safety and soundness plan” concept in section 39 of the FDIA. The treatment of 3-rated federal savings banks also might differ. OTS maintained a presumption that a 3-rated institution should be subject to some kind of enforcement action, if only commitments by the board of directors. The OCC policy statement does not include such a presumption, but the statement lends itself to an inference that the OCC will take formal enforcement action against a 3-rated more readily than did OTS.

IV. Conclusion

Dodd-Frank presents a daunting challenge to most savings associations and their holding companies, which now must accustom themselves to the same type of regulation as banks and bank holding companies. At a minimum, thrift institutions should review their material business lines to assess whether any of the operations could raise concerns with the FRB, OCC, or FDIC. At the holding company level, institutions should begin to examine the quality and amount of their capital and liquidity. At the association level, an institution should analyze the extent to which its operations rely on federal preemption and whether that reliance is justifiable after Dodd-Frank.

⁹¹ See 76 Fed. Reg. 72035 (Nov. 21, 2011).

⁹² See 12 C.F.R. part 5, subpart A.

⁹³ OCC Release 2011-37 (Sept. 12, 2011) (issuing PPM 5310-3 (REV)).

THRIFT INSTITUTIONS AFTER DODD- FRANK: THE NEW REGULATORY FRAMEWORK

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