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After the OTS—Should Thrifts Convert to Commercial Banks?

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A Brief Summary of the Federal Thrift Charter

Federal thrifts have been unique financial institutions which offered unlimited interstate branching and strong federal preemption of state laws. A unitary thrift charter allowed commercial entities to own and operate an FDIC-insured depository institution while conducting commercial and other activities not permitted to bank holding companies (BHCs) or affiliates of commercial banks.[1] The major disadvantage was meeting the qualified thrift lender (QTL)[2] test and the thrift asset rules, which created credit concentration risks, because thrifts' assets were inevitably centered in a few asset classes, particularly home loans.

Federal thrifts and their holding companies have had a single regulator, the Office of Thrift Supervision (OTS), which was viewed as supportive of the industry and exercised broad authority to preempt state law.[3] The *OTS Strategic Plan FY 2007-2012* stated that "OTS listens to, learns from, and collaborates with the institutions it regulates and the public it serves on how best to address their needs."[4] A key objective was supporting the competiveness of the thrift industry consistent with "safety and soundness and compliance with consumer protection laws," through, among other things:

- communicating the advantages of the thrift charter to encourage a competitive, viable industry;
- reducing examination burdens on the industry; and
- supporting the preemptive attributes of the thrift charter.[5]

Efforts Prior to Dodd-Frank to Eliminate the Federal Thrift Charter

Even prior to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),[6] studies and proposed legislation recommended consolidating the OTS and its predecessor.[7] In 1995, various bills, including the Thrift Charter Convergence Act of 1995 (the Convergence Act)[8] were introduced to change thrift regulation including by converting all thrifts to commercial banks and abolishing the OTS. Legislation was introduced again in 1997 to eliminate the federal thrift charter.[9] None of these proposals was adopted, although the Congressional Budget Office's *CBO Paper – Eliminating the Federal Thrift Charter* succinctly asserted the arguments for change—the thrift charter had become obsolete due to expansion by commercial banks and others into home lending and the elimination of OTS would streamline financial services regulation.[10]

The U.S. Department of the Treasury's (Treasury) *Blueprint for a Modernized Financial Regulatory Structure* (the Treasury Blueprint), developed in light of the financial crisis, included a proposal to phase out the thrift charter over two years, convert thrifts to national banks, and merge the OTS with the Office of the Comptroller of the Currency (OCC).[11] The Treasury Blueprint concluded "that the thrift charter is no longer necessary to ensure sufficient residential mortgage loans are made available to U.S. consumers."[12] Among other things, at the end of 2006, the commercial banking industry held more than twice the volume of residential mortgages than the thrift industry. Treasury also recommended that all savings and loan holding companies (SLHCs) become BHCs, which would be subject to supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve). Any SLHCs grandfathered (Grandfathered SLHCs) pursuant to Title IV of the Gramm-Leach-Bliley Act of 1999 (GLB Act),[13] would not be subject to the Bank Holding Company Act of 1956's (BHC Act) activity limitations, if they continued to meet the requirements to remain Grandfathered SLHCs, including the QTL test.[14]

The Dodd-Frank Act

Title III of the Dodd-Frank Act eliminates the OTS and transfers its duties to other federal banking agencies. Although the thrift charter was retained and a separate body of law governing thrifts and SLHCs will remain, these laws and rules will be administered, and likely changed, by the commercial bank regulators. The Dodd-Frank Act also eliminates the most important benefits of the federal thrift charter, while continuing the most important historical constraints upon federal thrifts, such as the QTL test and limits on permissible types of assets.

When Congress was considering the Dodd-Frank Act, thrift failures were prominent. Washington Mutual Bank failed on September 25, 2008, following the collapse of IndyMac Bank on July 11, 2008. While only 48 thrifts failed during 2007-2010 compared to 322 banks, the thrifts that failed included the largest depository institution failures in United States history. The thrift industry had been shrinking for decades. In 1985, there were 3,274 thrifts, which declined to 1,103 in 1999, and 764 in 2009.[15] OTS was losing some of its largest members, such as Washington Mutual and IndyMac, which also raised questions about OTS's funding, approximately 93 percent of which came from assessments and examination fees from the thrifts it regulated.[16] Despite OTS arguments,[17] the Dodd-Frank Act jettisoned OTS, concluding a debate that had lasted at least 15 years.

How the Dodd-Frank Act Affects the Federal Thrift Charter

— OTS and Consolidated Supervision

OTS has regulated both federal thrifts and their holding companies. In contrast, the Federal Reserve regulates BHCs, OCC regulates national banks, and state regulators and the FDIC or the Federal Reserve supervise state banks. Most state banks are not members of the Federal Reserve System, and therefore are regulated by their state and FDIC, and their holding companies, if any, are supervised by Federal Reserve regulators.

Beginning July 21, 2011, SLHCs (and their non-depository subsidiaries) will be regulated by the Federal Reserve, and federal thrifts will be regulated by OCC, which will exercise all thrift rulemaking authority not granted to the Federal Reserve. State-chartered thrifts will be examined and supervised by the FDIC and their state regulators.

OTS's rulemaking authority relating to SLHCs is being transferred to the Federal Reserve, along with the authority over rules regarding thrift transactions with affiliates, extensions of credit to insiders, and tying arrangements.[18] The Joint Implementation Plan by the applicable federal banking agencies,[19] and subsequent interagency proposals, clearly indicate that the Federal Reserve will more closely align its supervision of SLHCs with the Federal Reserve's policies and procedures applicable to BHCs.[20]

— Branching

Federal thrifts have been entitled to branch *de novo* on an interstate basis, and state anti-branching laws were preempted by the Depression-era Home Owners' Loan Act (HOLA)[21] governing federal thrifts. Until reciprocal interstate bank merger laws became popular with the states in the 1980s, it was difficult to acquire banks interstate, and even harder for commercial banks to branch across state lines.[22] During this period, only federal thrifts could expand by *de novo* interstate branching. However, the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994[23] opened interstate branching by banks by permitting states the option of permitting *de novo* interstate branching. The Dodd-Frank Act[24] removes the state "opt-in" requirement, and provides commercial banks with full *de novo* interstate branching powers.

— OTS Preemption of State Law

Perhaps the most important advantage of the federal thrift charter has been OTS preemption pursuant to HOLA Sections 4(a) and 5(a),[25] covering state fee, disclosure, licensing, inspection, and other restrictions upon lending activities, which facilitated uniform practices and services nationwide.[26] Usury and due-on-sale laws were preempted by 12 U.S.C. § 1463(g), 12 C.F.R. § 560.110, and OTS Regulations at 12 C.F.R. Parts 590 and 591. Courts, including the Supreme Court, regularly precluded state regulators from interfering with the lending practices of federal thrifts.[27] As a result, thrifts enjoyed less state supervision than commercial banks, including national banks, which were subject to state regulation wherever federal regulation did not conflict with it.

OTS also occupied the field of the regulation of the fiduciary activities of federal thrifts which facilitated interstate trust expansion. Several banking organizations with core wealth management and fiduciary operations, such as Northern Trust Company and Wilmington Trust Company, used federal thrift subsidiaries to expand interstate in reliance on these OTS rules.

However, the advantages of the thrift preemption eroded vis-à-vis national banks as OCC adopted broader preemption rules for national banks. In 2001, OCC adopted a wide-ranging preemption regime that extended the previous conflict preemption rules to something akin to field preemption of state regulation of banks.[28] In *Watters v. Wachovia Bank*,[29] the Supreme Court in 2007 deferred to OCC's broad new preemption regulations, holding that OCC's preemption regulations preempted state licensing and registration requirements with respect to national banks' operating subsidiaries. This ruling was scaled back two years later in *Cuomo v. Clearing House Association, L.L.C.*,[30] where the Court determined that OCC had overstepped its legal authority in claiming that a state attorney general could not sue a national bank for violations of valid state consumer protection and anti-discrimination laws. The Dodd-Frank Act codifies *Cuomo* by providing that no provision or other limits restricting the visitorial powers to which a national bank is subject shall be construed to limit or restrict the authority of any state attorney general to bring an action against a national bank.[31]

Furthermore, the Dodd-Frank Act eliminates federal thrift preemption as a separate doctrine and applies to federal thrifts the same standards applicable to national banks.[32] This new standard, effective July 21, 2011, also specifies that federal preemption authority will be available only to national banks and federal thrifts, and not to their respective operating subsidiaries or affiliates.

OCC issued a final rule on July 20, 2011 that, among other things, amends OCC rules pertaining to preemption and visitorial powers, including removing language from OCC rules that provides that state laws that "obstruct, impair or condition" a national bank's powers are preempted.[33] The final rule clarifies that federal thrifts and their subsidiaries are subject to the same visitorial powers provisions in the Dodd-Frank Act that apply to national banks and their subsidiaries. In addition, the Dodd-Frank Act precludes the field preemption standard previously applied by OTS and federal courts under HOLA.

Further eroding federal preemption, Title X of the Dodd-Frank Act established the Bureau of Consumer Financial Protection (CFPB) and granted concurrent and broad enforcement powers to the states in the area of consumer financial protection.[34] Accordingly, preemption of state law is less of an issue now, and following the Dodd-Frank Act, the federal thrift charter offers little, if any, advantages over national banks as to preemption.

— SLHCs and the Unitary Thrift Charter

Prior to the Dodd-Frank Act, SLHCs enjoyed important advantages over BHCs. SLHCs were subject to informal, institution-specific capital reviews, but were not subject to formal, consolidated capital requirements. Absent specific enforcement actions, SLHCs were not required to be a "source of strength" to their subsidiary thrift. In contrast, the Federal Reserve imposes consolidated capital requirements on all BHCs with $500 million or more of assets and "source of strength" requirements on all BHCs. These are key Federal Reserve supervisory elements for BHCs under the BHC Act[35] and Regulation Y.[36]

The Dodd-Frank Act now subjects SLHCs generally to the same source of strength and activity limitations as BHCs. The Dodd-Frank Act applies "source of strength"[37] requirements for SLHCs and other entities controlling FDIC-insured institutions that are not "banks" for BHC Act purposes.[38] With respect to formal capital requirements, the Dodd-Frank Act provides SLHCs with a five-year phase-in period for the new minimum leverage capital and risk-based capital requirements.[39]

The Dodd-Frank Act also imposes the same financial activities restrictions on SLHCs that are applicable to BHCs that qualify as financial holding companies (FHCs) under the BHC Act.[40] SLHCs, as well as their thrift subsidiaries, must be both "well capitalized" and "well managed" for the SLHC to engage in the same financial activities as FHCs. This alignment of SLHC powers with those applicable to FHCs significantly levels the playing field between SLHCs and BHCs, except for Grandfathered SLHCs.[41]

A series of reforms passed by Congress in 1996 opened a window for non-thrifts and non-banks to take advantage of the unitary thrift charter.[42] During this period, a number of companies converted to a unitary thrift charter, including insurance companies, investment banks, and auto companies. However, this loophole was closed by the GLB Act in 1999,[43] which prohibited new affiliations between SLHCs and commercial firms, while permitting Grandfathered SLHCs to retain their unitary thrift subsidiaries.[44]

Section 626 of the Dodd-Frank Act adds a new Section 10A to HOLA and authorizes the Federal Reserve to determine whether to require Grandfathered SLHCs engaged in non-BHC Act activities to form "intermediate holding companies" (IHCs). New HOLA subsection 10A(b)(1)(A) deems IHCs to be SLHCs subject to regulation by the Federal Reserve. In contrast, Section 604(i) of the Dodd-Frank Act amends Section 10 of HOLA to provide that a company described in HOLA Section 10(c)(9)(C) (*i.e.*, a Grandfathered SLHC) is not an SLHC solely by virtue of its control of an IHC.

As a result of the interaction among Dodd-Frank Act Sections 604, 616, and 626, including HOLA Section 10A, only IHCs and not the Grandfathered SLHCs, are subject to capital requirements to be established by the Federal Reserve. Instead, HOLA Section 10A(b)(3) only requires Grandfathered SLHCs that directly or indirectly control an IHC to serve as a source of strength to their subsidiary IHCs. Further, new Section 38A of the FDI Act only requires the IHC to serve as a source of strength to its thrift subsidiary. The Federal Reserve has requested comments on its regulation of SLHCs and IHCs.[45]

QTL Test and Lending Limits

Although it eliminated key advantages of the federal thrift charter, the Dodd-Frank Act retained the QTL test and the asset limitations governing federal thrifts.

A thrift must meet the QTL test, which requires thrifts to maintain qualified thrift investments equal to at least 65 percent of its portfolio assets.[46] The principal types of qualified thrift investments include unrestricted amounts of residential real estate loans, home equity loans, mortgage-backed securities, credit card and credit card account loans, small business loans and education loans, and a basket of other consumer loans and certain types of other assets not to exceed 20 percent of total assets.

A federal thrift also can meet an alternative QTL test by qualifying as a "domestic building and loan association," as that term is defined in section 7701(a)(19) of the Internal Revenue Code (IRC).[47] To qualify under that provision, a thrift must have at least 60 percent of its total assets in specified types of assets, the most significant of which are residential real estate loans, government obligations, mortgage-backed securities, home improvement loans, and education loans.

Federal thrifts can hold commercial loans not secured by real estate in an aggregate of up to 20 percent of their total assets, provided that commercial loans in excess of 10 percent of their assets must be loans to small businesses.[48] Consumer loans, commercial paper, and corporate debt are limited in the aggregate to 35 percent of total assets, exclusive of credit card and education loans.[49] In addition, loans secured by commercial, agricultural, or other nonresidential real estate are limited to 400 percent of a thrift's capital.[50] In contrast, national banks and state-chartered commercial banks can invest in all of these types of loans and securities subject only to loan to one borrower limitations, concentration, and safety and soundness considerations.

In testimony regarding the Convergence Act in 1995, Jonathan L. Fiechter, Acting Director of OTS, stated concerns which remain today:

> The OTS fully supports reforming the thrift charter. The combination of the qualified thrift lender ("QTL") test, which forces thrifts to concentrate their lending and investment activities in residential mortgages . . . has caused problems at some thrift institutions. Commercial banks have greater ability to alter their lending and investment activities in response to shifting market conditions. The typical thrift, by contrast, has an infrastructure geared toward residential mortgage lending and must remain in this market in both good years and lean years. . . .
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> Arguably, in the past, the disadvantages of forced specialization by thrifts in home lending were offset by a number of regulatory benefits, including liberal branching authority, the deposit rate ceiling differentials, support from the Federal Home Loan Bank System and Federal Home Loan Mortgage Corporation, and favorable tax treatment. But in the last 15 years, virtually all of these benefits have either been eliminated or shared with competitors. Thus, the benefits created to offset the lower rates of profitability associated with residential mortgage lending have been reduced in recent years.[51]

In light of the adverse changes to the thrift charter and the Dodd-Frank Act's numerous other changes, the disruptions in the housing and mortgage markets, and the elimination of OTS, thrifts, especially federal thrifts, should carefully evaluate their charters and SLHCs and consider a commercial bank charter. Commercial entities that are Grandfathered SLHCs which engage in activities not permitted to BHCs may need to retain their federal thrift charters, but should carefully consider the Federal Reserve's proposals on SLHC and IHC regulation and capital, and the financial activities they could be required to conduct in an IHC or IHC subsidiaries.

Other Dodd-Frank Act Considerations

The Dodd-Frank Act and the transition rules[52] provide for transfers of OTS personnel to OCC, but it is uncertain how many will actually transfer and for how long. OTS's last strategic plan estimated that in 2010, 55 percent of OTS's personnel would be at retirement age. OTS examiners will have to requalify as national bank examiners. Parallel examination staffs for federal thrifts utilizing national bank examiners and former OTS examiners are contemplated, at least initially. In addition, many OTS staff are being transferred outside the districts where they presently live or work. It would be normal for attrition to occur as a result of retirements and more experienced examiners may decide not to undergo the requalification process or relocate. Of the approximately 1,000 OTS staff, an estimated 100 have left the regulatory world, and 200 have gone to other regulators.[53] As a result, thrifts may be seeing new examiners and new regulatory personnel, even where their former OTS regulators transfer to OCC.

Although the Dodd-Frank Act retained the thrift charter, thrift rulemaking and supervision were given to the commercial bank regulators who are unfamiliar with the federal thrift rules and the regulation of the thrift industry. It is unlikely that these regulators will be as proactive on behalf of the industry and its competitiveness as OTS. The commercial bank regulators are reasonably likely to apply their experience and principles with commercial banks to their regulation of thrifts and SLHCs, including IHCs, as well as in rulemaking. For example, the Federal Reserve states:

> The Board believes that it is important that any company that owns and operates a depository institution be held to appropriate standards of capitalization, liquidity, and risk management consistent with the principles of safety and soundness. As a result, it is the Board's intention, to the greatest extent possible taking into account any unique characteristics of SLHCs and the requirements of . . . HOLA, to assess the condition, performance, and activities of SLHCs on a consolidated risk-based basis in a manner that is consistent with the Board's established approach regarding . . . BHC supervision. As with BHCs, our objective will be to ensure that the SLHC and its nondepository subsidiaries are effectively supervised and can serve as a source of strength for, and do not threaten the soundness of, its subsidiary depository institutions.[54]

The new thrift regulators are less likely to follow prior OTS principles. Instead they likely will make changes, especially in tone and direction as they deal with HOLA and OTS regulations governing thrifts, and likely will seek as much consistency as lawful between the regulation of thrifts and SLHCs, and the regulation of commercial banks and BHCs.

A long term goal of eliminating OTS has been regulatory streamlining, especially as the number of thrifts and the aggregate size of the thrift industry has declined. The thrift industry has lost many of its largest institutions and lacks the breadth and depth of political and economic influence that it had historically. This enabled Congress, in the recent economic crisis, to eliminate OTS after years of attempts to dismantle it. According to FDIC's latest Quarterly Banking Profile,[55] there are approximately 1,121 savings institutions, 724 of which are federal thrifts, and the industry has aggregate assets of $1.257 trillion. There are 968 state and federal thrifts, 86.4 percent of the total, which have $1.0 billion or less in assets, and their aggregate assets are $250.6 billion. Only 21 have more than $10.0 billion in assets.

Consolidation is likely among all depository institutions, but especially among the smallest and least diversified, such as small thrifts. Institutions will need to fund their increasing compliance burden, especially under the wide range of changes and new regulations spawned by the Dodd-Frank Act, while otherwise cutting costs in a low growth economy with correspondingly low organic revenue growth, and a low interest rate environment that challenges interest margins. Fatigue among thrift management, especially with a new regulatory regime and new regulators in a difficult economic environment should stimulate consolidation.

These trends will make it increasingly costly and difficult to justify maintaining a thrift industry subject to separate rules and regulations from its commercial bank counterparts. In the short term, elimination of the QTL test and the asset limitations of HOLA would help thrifts compete, reduce their operating costs, especially for accounting and QTL test compliance, and reduce risk through diversification. Congress or the bank regulators may seek further legislative action in the intermediate term to repeal HOLA, and force traditional thrifts to become state or federal commercial banks. Congress has recognized the benefits provided by thrifts and other non-bank entities that support the economy by helping commercial firms finance their sales and other activities. Accordingly, if the thrift charter is abolished, at a minimum, any Grandfathered SLHCs should be exempted from the BHC Act's activity limitations. Thrift managements considering conversion should have qualified personnel to underwrite and manage the new types of permitted assets pursuant to business plans and internal controls appropriate for commercial banks.

Thrift Charter Conversions

Thrifts should consider these trends and evaluate their charters in light of their present position and long-term plans, and potential continued pressure against maintaining the thrift charter. From 1998 through 2010, 120 thrifts converted to commercial banks, and only 43 commercial banks became thrifts.[56] Prominent among the thrifts that converted were Webster Bank, Capital One Bank, FSB and First Niagara Bank, which became national banks in 2003, 2004 and 2010, respectively. Others are considering conversion or have converted more recently.[57]

HOLA authorizes federal thrifts in operation prior to November 12, 1999 to convert directly into national or state banks, subject to the approval of OCC or the appropriate state banking regulator and the appropriate proposed federal banking regulator (FDIC or Federal Reserve), respectively.[58] The resulting commercial bank is required to meet all applicable financial, management, and capital requirements as a commercial bank. If more than one commercial bank is proposed to result from the conversion, FDIC approval is also required. HOLA[59] specifies that these conversions do not require a Bank Merger Act application under Section 18(c) of the FDI Act.[60]

Section 35 of the National Bank Act[61] permits conversion of thrifts into national banks upon board of directors' approval, a vote of 51 percent of the thrift's shareholders, and approval of OCC. This statute is implemented by OCC Regulation § 5.24,[62] which requires OCC to determine that the resulting national bank can operate safely and soundly in compliance with applicable laws, regulations, and policies. Among other things, OCC may deny a conversion application "when conversion would permit the applicant to escape supervisory action by its current regulator." Similarly, the *FFIEC Statement on Regulatory Conversions* affirms that charter conversions should be undertaken for legitimate business and strategic reasons and not to circumvent regulatory ratings or enforcement actions, "Conversion requests submitted while serious or material enforcement actions are pending with the current chartering authority or primary federal regulator should not be entertained because such requests could delay or undermine supervisory actions."[63] Section 612 of the Dodd-Frank Act provides additional procedures and requirements for conversions of troubled institutions.

Regulators are reluctant to take on troubled institutions from other regulators. Pre-filing meetings are encouraged and often a pre-conversion examination of the institution by its proposed new regulator. A conversion is most likely to succeed quickly when the converting thrift is well capitalized and well managed without any enforcement actions. The conversion filing should outline the purposes of the conversion, and a business plan will be essential if there is a substantial change in the business proposed to be conducted.

Thrifts considering a charter conversion will want to carefully evaluate a number of operational, legal, and regulatory issues, including:

- activity limits, including loan to one borrower rules, investment limits, and asset concentration risks, and potential interest rate risks and volatility imposed upon thrifts by the QTL test and existing HOLA requirements versus as a commercial bank;

- existing and proposed capital requirements and instruments that count as capital, including the requirements of Section 171 of the Dodd-Frank Act (often referred to as the Collins Amendment);

- whether the institution's existing assets and activities will be permitted post-conversion, and if not, the costs of disposing of the assets or discontinuing these activities if regulatory approval is not received;

- powers and activities authorized for different types of depository institution subsidiaries;

- costs of regulatory assessments and fees charged by the regulatory agencies for examinations and supervision, especially when comparing state and national bank charters and which type of commercial bank charter is most suitable for them;

- respective state and federal regulatory agencies' expertise with respect to various activities conducted or planned to be conducted, and the time and costs of the transition to new regulators;

- historic valuation discounts for thrift and SLHC shares compared to bank and BHC share valuations;

- ownership or holding company activity issues under the BHC Act or state law;

- director qualification issues;

- interstate operations and future branching;

- fiduciary activities, especially where conducted interstate, where a national bank charter may be advantageous compared to a state commercial bank charter;

- required insurance and blanket bonds;

- Federal Reserve stock required if the resulting bank is a national bank or state bank that is a Federal Reserve member; and

- compensation arrangements in light of the Dodd-Frank Act and Federal Reserve and FDIC policies on compensation.

Conclusions

The Dodd-Frank Act eliminated the most important advantages of federal thrifts, but left the obsolete

QTL test and asset limitations that hinder thrifts from fully competing and diversifying risks. Regulation of federal thrifts by commercial bank regulators acting under unfamiliar provisions of HOLA and OTS regulations will be new to the regulators and the thrift industry, and both may find it challenging. The bank regulators are under considerable pressure generally in this period of economic stress to implement the Dodd-Frank Act's mandated regulations, and administering the thrift industry under the separate laws and regulations applicable to thrifts will add to their burden. Ultimately, further legislation may eliminate the thrift charter as proposed by the Treasury Blueprint, as the size of the thrift industry declines and the separate regulatory scheme under HOLA becomes overly costly to administer for relatively few thrifts. Any new legislation should remove the QTL test and eliminate HOLA's asset limitations, and continue to allow Grandfathered SLHCs and their unitary thrift subsidiaries to continue as affiliates of commercial businesses, by permitting their activities under the BHC Act.

Thrifts should consider now their future as a thrift or as a commercial bank. They should compare the thrift charter with both national and state bank charters. Legislative and regulatory actions over the past 20 years have narrowed the differences in the powers and activities among state and national banks[64] and the differences among regulations and regulators, yet subtle but important differences remain. Many of the smaller community thrifts may be more comfortable as state banks with the FDIC as their principal federal regulator, since the FDIC regulates most community banks. Larger or specialized thrifts, including those with interstate operations, may find the OCC or the Federal Reserve to have greater experience with similar organizations or activities. All may find it easier to be a commercial bank regulated as such rather than a thrift regulated pursuant to the Dodd-Frank Act's hybrid scheme, HOLA and OTS regulations administered by commercial bank regulators.

Converting from a thrift to a commercial bank offers various advantages and is permitted by federal and various states' statutes. Careful planning is required for a successful conversion, and in the current environment, the regulatory process may be elongated. The short and long term rewards may create value for thrift shareholders and reduce the challenges presented by the Dodd-Frank Act.

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1 For example, securities firms engaged in underwriting and dealing activities not permitted generally under the Glass-Steagall Act, as well as insurance companies, could own thrifts, but not commercial banks prior to the Gramm-Leach Bliley Act of 1999 (Pub. L. No. 106-102 (1999)).

2 12 U.S.C. § 1467a(m).

3 The OTS also has regulated all thrift holding companies that are not bank holding companies under the Bank Holding Company Act of 1956.

4 OTS, *OTS Strategic Plan FY 2007-2012* at 4 (August 2007) (Strategic Plan).

5 *Id.* at 6.

6 Pub. L. 111-203 (July 21, 2010).

7 *See* Rose Marie Kushmeider, *The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation*, FDIC Banking Review, Vol. 17 No. 4 (2005).

8 H.R. 2363, 104th Cong. (1995). In the same year, the Bank Regulatory Consolidation and Reform Act, H.R. 17, 104th Cong. (1995) and the Federal Deposit Insurance Amendments Act of 1995, H.R. 1769, 104th Cong. (1995) were introduced and also would have eliminated the OTS.

9 Financial Services Competitiveness Act of 1997, H.R. 10, 105th Cong. (1997) (as introduced in the House) and Depository Institution Affiliation and Thrift Charter Conversion Act, H.R. 268, 105th Cong. (1997). Another motivation was to improve the funding of the FDIC's Savings Association Insurance Fund (SAIF), which insured thrift deposits. Ultimately, SAIF was merged with the Bank Insurance Fund (BIF) as a result of the Federal Deposit Insurance Reform Act of 2005, Title II, subtitle B of Pub. L. 109-171 (enacted February 8, 2006), with the FDIC maintaining the Deposit Insurance Fund or "DIF" for all FDIC-insured institutions.

10 Congressional Budget Office, *CBO Paper—Eliminating the Federal Thrift Charter* (June 1997) *available at* http://www.cbo.gov/ftpdocs/4xx/doc433/thrift.pdf.

11 U.S. Department of the Treasury, *Blueprint for a Modernized Financial Regulatory Structure* (March 31, 2008) *available at* http://www.treasury.gov/press-center/press-releases/Documents/Blueprint.pdf (Treasury Blueprint).

12 *Id.* at 96.

13 Pub. L. 106-102 (November 12, 1999).

14 *Id.* at p.98.

15 Office of Thrift Supervision, *OTS 2009 Fact Book: A Statistical Profile of the Thrift Industry* (March 2010) *available at* http://files.ots.treas.gov/481165.pdf.

16 Strategic Plan, *supra* note 4 at p. 18.

17 *See, e.g.,* Written Testimony of John E. Bowman, Acting Director of the OTS regarding Federal Regulator Perspectives on Financial Regulatory Reform Proposals before the House Committee on Financial Services, 111th Cong. (Sept. 23, 2009).

18 The Federal Reserve is well-versed in these areas which are covered by Federal Reserve, Reg. W (affiliate transactions (12 C.F.R. Part 223)), Reg. O (credit to insiders (12 C.F.R. Part 215)), and the anti-tying provisions of Section 105 of the BHC Act (12 U.S.C. § 1841 *et seq*.).

19 Federal Reserve, FDIC, OCC, OTS, *Joint Implementation Plan: 301-326 of the Dodd Frank Wall Street Reform and Consumer Protection Act* (January 2011, revised April 2011) *available at* http://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-joint-implementation-plan.pdf.

20 *See*, *e.g.*, Federal Reserve, *Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies*, 76 Fed. Reg. 22662 (April 22, 2011) (the Federal Reserve SLHC Supervisory Guidance).

21 12 U.S.C. §§ 1461 *et seq*.

22 *See Northeast Bancorp v. Board of Governors*, 472 U.S. 159 (1985) which upheld the Federal Reserve's authority under the Douglas Amendment to the BHC Act to permit BHCs to acquire banks in other states where specifically authorized by such state's laws. *See also*, Thomas Hills, *The Rise of Southern Banking and the Disparities Among the States Following the Southeastern Regional Banking Compact*, 11 N.C. Banking Inst. 57 (2007).

23 Pub. L. No. 103-328, § 201(a) (1994).

24 Section 613 of the Dodd-Frank Act provides that *de novo* interstate banking must be allowed if "the law of the State in which the branch is located, or is to be located, would permit establishment of the branch, if the bank were a State bank chartered by such State." State law still regulates branching within each state.

25 12 U.S.C. §§ 1463(a) and 1464(a).

26 OTS promulgated regulations providing for "the plenary and exclusive authority of the [OTS] to regulate all aspects of the operations of Federal savings associations. . . . This exercise of the [OTS]'s authority is preemptive of any state law purporting to address the subject of the operations of a Federal savings association." 12 C.F.R. § 545.2. The OTS preempted the entire field of lending for federal thrifts (12 C.F.R. § 560.2).

27 *See, e.g., Fidelity Federal Savings and Loan Association v. De La Cuesta*, 458 U.S. 141 (1982) and *California v. Coast Federal Savings and Loan Association*, 98 F. Supp. 311 (S.D. Calif. 1951).

28 12 C.F.R. § 7.4006.

29 *Watters v. Wachovia Bank*, 550 U.S. 1 (2007).

30 *Cuomo v. Clearing House Association, L.L.C.*, 129 S.Ct. 2710 (2009).

31 Dodd-Frank Act § 1047(a).

32 Under the Dodd-Frank Act, preemption of a state consumer financial law will be permissible only if:

(i)application of the state law would have a discriminatory effect on national banks or federal thrifts as compared to state banks;

(ii)the state law is preempted under a judicial standard that requires a state consumer financial law to prevent or significantly interfere with the exercise of the national bank's or federal thrift's powers before it can be preempted, with such preemption determination being made by the OCC (by regulation or order) or by a court, in either case on a "case-by-case" basis; or

(iii)the state law is preempted by another provision of federal law other than Title X of the Dodd-Frank Act.

Dodd-Frank Act § 1044.

33 OCC, *Office and Thrift Supervision Integration; Dodd-Frank Act Implementation*, 76 Fed. Reg. 43549 (July 20, 2011) (amending 12 C.F.R. §§ 7.4007 (concerning deposit-taking), 7.4008 (non-real estate lending), and 34.4 (real-estate lending)). However, the preamble notes that the OCC has reconsidered its position concerning precedent that relied on the "obstructs, impairs, or conditions" standard. To the extent that an existing preemption precedent relies exclusively on the phrase "obstructs, impairs, or conditions" as the basis for a preemption determination, the preamble states that the validity of the precedent would need to be reexamined to ascertain whether the determination is consistent with the *Barnett* conflict preemption analysis. *See Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996).

34 Sections 1011(a) and 1042(a) of the Dodd-Frank Act.

35 12 U.S.C. § 1841 *et seq*.

36 Regulation Y, 12 C.F.R. § 225.4(a)(1), states: "A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not conduct its operations in an unsafe or unsound manner."

37 Dodd-Frank Act § 616(d) (adding a new Section 38A to the Federal Deposit Insurance Act (FDI Act)).

38 For example, thrifts, industrial loan companies, and credit card banks, under BHC Act, Section 2(c)(2) (12 U.S.C. § 1841(c)(2)).

39 Even if an SLHC converts to a BHC within the five-year phase-in period, the former SLHC will still enjoy the benefit of having five years to comply with the new capital requirements, as the delayed effective date is available to "any depository institution holding company that was not supervised by the [Federal Reserve] as of May 19, 2010." Dodd-Frank Act § 171(b)(4)(D). However, a converting SLHC may be subject to other incidents of being regulated as a BHC, including existing capital requirements and acceleration of the formal "source of financial strength" requirement.

40 BHC Act §§ 2(p) (12 U.S.C. § 1841(p)) and 4(l) (12 U.S.C. § 1843(l)).

41 *See* 12 U.S.C. § 1467a(c)(3).

42 *See* Deposit Insurance Funds Act of 1996, Subtitle G of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Title II of the 1997 Omnibus Consolidated Appropriations Act, Pub. L. 104-208 (enacted September 30, 1996).

43 Pub. L. No. 106-102 (1999).

44 12 U.S.C. § 1467a(c)(9).

45 Federal Reserve SLHC Supervisory Guidance, *supra* note 20.

46 12 U.S.C. § 1467a(m).

47 26 U.S.C. § 7701(a)(19).

48 12 U.S.C. § 1464(c)(2)(A); 12 C.F.R. § 560.30.

49 12 U.S.C. § 1464(c)(2)(D); 12 C.F.R. § 560.30.

50 12 U.S.C. § 1464(c)(2)(B); 12 C.F.R. § 560.30.

51 Written Testimony of Jonathan L. Fietcher Concerning Deposit Insurance and Thrift Convergence, Before the Subcomm. on Fin. Inst. and Consumer Credit of the U.S. House of Representatives, 104th Cong., at 11 (Sept. 21, 1995).

52 OCC, Final Rule, *Office and Thrift Supervision Integration; Dodd-Frank Act Implementation*, *supra* note 33.

53 Kate Davidson, *No Longer in Denial, OTS Employees Finally Move On*, American Banker (June 17, 2011).

54 Federal Reserve SLHC Supervisory Guidance, *supra* note 20.

55 FDIC, *Quarterly Banking Profile: First Quarter 2011* (March 31, 2011) *available at* http://www2.fdic.gov/qbp/2011mar/qbp.pdf

56 FDIC Statistics on Banking (March 31, 2011).

57 *See*, for example, Robert Barba, *Banks Weigh the Benefits of their Charters*, American Banker (April 4, 2011); Bank United's announced conversion in late June 2011 to a national bank following the IPO of its holding company, and Teche Holding Company press release dated June 22, 2011 announcing the conversion of its federal thrift subsidiary to a state chartered commercial bank. Other recently announced conversions include Riverview Community Bank, Vancouver, Washington (July 8, 2011) and Classic Bank, Ashland, Kentucky (July 11, 2011).

58 12 U.S.C. § 1464(i)(5).

59 12 U.S.C. § 1464(i)(5)(C).

60 12 U.S.C. § 1828(c).

61 12 U.S.C. § 35.

62 12 C.F.R. § 5.24.

63 FFIEC, Press Release, *FFIEC Issues Statement on Regulatory Conversions* (July 1, 2009) *available at* http://www.ffiec.gov/press/pr070109.htm.

64 *See, e.g.*, Section 24 of the FDI Act, 12 U.S.C. § 1831a, limiting certain activities of state banks to those permitted for national banks. Activities permissible for national banks are described generally at 12 U.S.C. § 24 and are identified in detail in OCC, *Activities Permissible for a National Bank, Cumulative: 2010 Annual Edition* (May 2011) *available at* http://www.occ.gov/static/publications/corpapps/bankact.pdf.

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