

SEPTEMBER 14, 2011

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Changed Supervision of Savings and Loan Holding Companies and Savings Associations

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), transferred federal supervisory and rulemaking authority over savings and loan holding companies ("SLHCs") and savings associations from the Office of Thrift Supervision ("OTS") to other federal banking agencies on July 21, 2011 (the "Transfer Date"). This required transition subjects SLHCs and savings associations to new regulators and new regulations.

The Board of Governors of the Federal Reserve System (the "Fed") now regulates SLHCs and their nonbank subsidiaries, the Office of the Comptroller of the Currency (the "OCC") regulates federal savings associations, and the Federal Deposit Insurance Corporation (the "FDIC") regulates state savings associations. Although Dodd-Frank expressly preserved the substance of most OTS regulations (and interpretations), the Fed has signaled its intention to revise supervisory and regulatory standards for SLHCs to align them more closely with the standards that apply to bank holding companies ("BHCs"), and the OCC has indicated that it would consider appropriate changes to better harmonize the requirements for national banks and federal savings associations. The FDIC also has indicated that it may consider changes to former OTS regulations. In addition, Dodd-Frank mandates new requirements for SLHCs and savings associations.

This memorandum highlights important changes for SLHCs and savings associations and recent developments in guidance from the federal banking agencies.

I. Savings and Loan Holding Companies

On the Transfer Date, the Fed issued a notice and request for comments concerning the OTS regulations that it plans to enforce with respect to SLHCs and a supervisory letter detailing the Fed's approach to the supervision of SLHCs during the first supervisory cycle following the Transfer Date.¹ The Fed also has published a notice detailing its intention to apply certain elements of its current supervisory program for BHCs

¹ See Notice of Intent and Request for Comment, Continued Application of Regulations to Savings and Loan Holding Companies, 76 Fed. Reg. 43953 (July 22, 2011); Supervision and Regulation Letter SR 11-11, Supervision of Savings and Loan Holding Companies (July 21, 2011).

to SLHCs, including the Fed’s consolidated supervision programs for large holding companies and small, noncomplex holding companies, as well as the BHC examination rating system.² On August 12, 2011, the Fed issued an interim final rule that consists of three components: (a) a new Regulation LL, containing regulations governing SLHCs generally; (b) a new Regulation MM, containing regulations governing SLHCs in mutual form; and (c) technical amendments necessary to facilitate the transfer of powers.³ Taken together, these initiatives set the stage for the transition to Fed regulation for SLHCs.

- A. Control Determinations. The Fed has indicated that it does not anticipate revisiting OTS determinations with respect to existing investments and ownership structures, unless an SLHC proposes a material transaction, such as an additional expansionary investment, significant recapitalization or significant modification to its business plan.
- The definitions of control in the Home Owners’ Loan Act of 1933 (“HOLA”) and the Bank Holding Company Act of 1956 (the “BHCA”) are broadly similar. However, the control analysis conducted by the Fed has differed in some material ways from OTS policy and precedent.
 - The Fed intends to eliminate OTS regulations relating to control determinations and rebuttals, in favor of following the practices and procedures applicable to BHCs, including passivity and anti-association commitment requirements in certain cases.
 - The Fed will review investments in and relationships with SLHCs using the same control analysis that it applies in the context of investments in BHCs and will consider potential control relationships for investors in SLHCs in light of control indicia used by the Fed to determine whether a company has a controlling influence over the management or policies of a banking organization. The Fed described these indicia in its 2008 policy statement on noncontrolling equity investments.
 - In general, this policy statement enables an investor to own nearly one-third of the total equity of a banking organization without being deemed to control the banking organization, provided that the investor does not own 15% or more of the total voting stock

² See Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies, 76 Fed. Reg. 22662 (Apr. 22, 2011).

³ See Interim Final Rule and Request for Comment, Savings and Loan Holding Companies, 76 Fed. Reg. 56508 (Sept. 13, 2011).

and does not otherwise exercise a “controlling influence” over the banking organization through its governance rights or business relationships. However, pursuant to HOLA, which remains in effect, a person who has contributed more than 25% of the capital of an SLHC is deemed to control the SLHC.

- Unlike the OTS, the Fed will require investors in SLHCs to file a Change in Bank Control Act notice where an investment would exceed certain trigger levels, even in circumstances where the Fed has determined that a company would not have control for BHCA purposes based on passivity commitments. The OTS did not require the filing of such notices by investors that had successfully rebutted control to the OTS.
- The Fed expects to pursue further rulemakings that will update and streamline the regulations related to control determinations for both BHCs and SLHCs.

B. Capital Requirements. The Fed will apply to SLHCs the same consolidated risk-based and leverage capital requirements that are applicable to BHCs to the extent possible, while considering the unique characteristics of SLHCs and requirements of HOLA. Prior to the Transfer Date, the OTS did not require SLHCs to calculate or report formal capital ratios, although SLHCs were expected to hold “a prudential level of capital” appropriate to support their activities.

- BHCs with total assets of more than \$500 million must maintain risk-based capital ratios and Tier 1 leverage capital ratios, applied on a consolidated basis to the holding company and all of its subsidiaries.
- Examiners will assess the capital planning and adequacy of SLHCs, and are expected to consider the appropriate levels and mix of various capital instruments and stress testing practices.
- The Fed will issue regulations to codify consolidated capital requirements and the source of strength doctrine applicable to SLHCs (which became effective on the Transfer Date), and the Fed has indicated that its forthcoming notice of proposed rulemaking implementing Basel III will address the proposed application of Basel III-based requirements to SLHCs.

- C. Dividends. Any savings association that is a subsidiary of an SLHC is now required to provide 30 days notice to the Fed before declaring any dividend. Although the Fed is not the primary federal regulator for savings associations, it has sole authority to permit or deny planned dividends by a stock savings association subsidiary of an SLHC pursuant to revisions to HOLA made by Dodd-Frank.⁴ Prior to the Transfer Date, such notices were filed with the OTS, which previously served as the primary federal regulator for both savings associations and SLHCs.
- OCC regulations provide that federal savings associations must submit to the OCC an “informational copy” of any dividend notice filed with the Fed.⁵ The Fed also has indicated that it will provide copies of all such notices to the state or federal regulators of a savings association and seek their comments. In the supplementary materials accompanying the Fed’s Regulation LL, the Fed notes that it will “work closely” with a savings association’s primary regulators when reviewing dividend notices, although the Fed’s recent supervisory guidance makes clear it may disregard the recommendations and findings of a savings association’s primary regulators.⁶
 - This dividend notice requirement differs significantly from the requirements currently applicable to banks in a holding company structure. Specifically, neither a national bank nor a state nonmember bank subsidiary of a BHC is required to notify the Fed before declaring a dividend. Moreover, the Fed generally has no statutory or regulatory authority to block a dividend by a bank subsidiary of a BHC that has been approved by the bank’s primary federal or state regulator.
 - The Fed outlined the standards it will apply to the review of such notices in a recent supervisory letter and codified these standards in Subpart K of Regulation LL.⁷

⁴ 12 U.S.C. §1467a(f). By contrast, under Dodd-Frank, a savings association that is a subsidiary of a mutual holding company must file its notice with both the Fed and the savings association’s federal supervisor. 12 U.S.C. § 1467a(o)(11).

⁵ 12 C.F.R. §163.143(d).

⁶ Supervision and Regulation Letter SR 11-13, Guidance Regarding Prior Notices with Respect to Dividend Declarations by Savings Association Subsidiaries of Savings and Loan Holding Companies (July 25, 2011).

⁷ 12 C.F.R. Part 238, Subpart K.

- D. Supervisory Approach. The Fed has indicated that its consolidated supervision program for SLHCs, particularly those with nonbank subsidiaries, will be “more intensive” than the former OTS regime.
- The Fed will use the first cycle of SLHC inspections (which will occur in late 2011 or early 2012) to gain a better understanding of the practical issues facing SLHCs, with a particular focus on SLHCs that engage in commercial, insurance or broker-dealer activities.
 - Supervision of SLHCs will be transitioned into the Fed’s supervisory portfolios of BHCs with similar characteristics and profiles.
 - Generally, an SLHC will be categorized as a community, regional or large banking organization, taking into account any unique characteristics of SLHCs. For example, inspection procedures will vary by an SLHC’s size.
 - The Fed is contemplating a separate supervisory portfolio dedicated to the supervision of SLHCs with significant commercial, insurance or broker-dealer activities.
 - Rating System. The Fed will apply to SLHCs “RFI/C(D)” rating system applicable to BHCs (Risk management, Financial condition, potential Impact on the subsidiary depository institution, Composite rating and the rating of each subsidiary Depository institution).
 - Stress Testing and Capital Planning. In June 2011, the Fed proposed new stress testing and capital planning requirements for all banking organizations with total assets in excess of \$10 billion and \$50 billion, respectively.⁸ These proposals, if adopted as proposed, will apply to SLHCs as well as BHCs.
- E. Nonbank Activities.
- Subpart G of Regulation LL implements Section 606(b) of Dodd-Frank, which amends HOLA to require that SLHCs be well-capitalized and well-managed at both the holding company and the savings association subsidiary level in order to engage in nonbank financial activities

⁸ Proposed Joint Guidance with Request for Public Comment, Proposed Guidance on Stress Testing for Banking Organizations with more than \$10 Billion in Total Consolidated Assets, 76 Fed. Reg. 35072 (June 15, 2011); Proposed Rule, Capital Plans, 76 Fed. Reg. 35351 (June 17, 2011).

permissible for a financial holding company (“FHC”) under Section 4(k) of the BHCA.

- The Fed will subject SLHCs that wish to conduct nonbank financial activities to the same election, notice and ongoing requirements that are applicable to BHCs that have elected to be treated as FHCs. SLHCs were not previously required to elect to be treated as an FHC, nor were they subject to application requirements to engage in FHC activities.
- By December 31, 2011, all SLHCs that currently engage in such activities (except for grandfathered unitary SLHCs) are required to file with the Fed an election to be treated as an FHC. SLHCs that currently conduct these activities but are unable to satisfy the requirements to be declared an FHC, must file an alternate declaration with the Fed, detailing how the SLHC would comply with the FHC standards by June 30, 2012.
- The Fed intends to extend the same notice, remediation agreement and divestiture standards to SLHCs that fail to satisfy the FHC eligibility requirements as the Fed applies to BHCs that lose eligibility to be treated as FHCs pursuant to Section 4(m) of the BHCA.
- SLHCs may continue to engage in certain activities permissible for multiple SLHCs in 1987 (including real estate development) without FHC limitations. In addition, an SLHC will not be required to file an FHC election to engage in insurance agency or escrow business activities that are permissible under HOLA.
- The FHC requirements will not apply to grandfathered unitary SLHCs.
- SLHCs that engage in activities that are considered to be “closely related to banking” under Section 4(c)(8) of the BHCA as of the Transfer Date do not need to file an FHC election in order to continue these activities.

F. Applications. The Fed plans to align SLHC application procedures, including publication requirements and hearing procedures, with the current BHC regime.

- For the time being, the Fed will continue to use the OTS application forms, but will eliminate certain OTS application requirements for SLHCs, such as pre-filing meetings, submission of draft business plans and certain formal procedures for determining when an application is complete.

- OTS and Fed application procedures are substantially similar for banking activities (such as acquisitions of and noncontrolling investments in other banks, savings associations or their holding companies), with each agency generally requiring prior notice or approvals. However, SLHCs that have not elected to become FHCs are now required to obtain prior Fed approval to acquire or engage in new types of nonbanking activities and investments.
 - The Fed expects that SLHC applications will be processed at least as expeditiously as they were under OTS processing procedures.
 - The impact on OTS applications that were pending on the Transfer Date remains unclear. Based on preliminary contacts with Fed staff, it appears that staff may be receptive to completing the processing of pending applications without requiring new filings using BHC-applicable forms. However, it is possible that the Fed may require applicants to restart the applications process to some extent.
- G. Reporting Requirements. The Fed has indicated that it will transition the reporting requirements applicable to SLHCs to the Fed's current reporting forms and procedures.⁹ The reporting form required of BHCs (FR Y-9) is more extensive and detailed than the OTS form H-(b)(11) for SLHCs.
- In response to comments received on its initial proposal, the Fed proposes to exempt from the new reporting requirements grandfathered unitary SLHCs and certain SLHCs where a top-tier holding company is an insurance company that only prepares financial statements in accordance with statutory accounting principles (because such SLHCs engage in certain activities that are not amenable to bank-centric reporting). The Fed plans to consider other exemption requests on a case-by-case basis.¹⁰
 - All other SLHCs are subject to a two-year phase-in period, beginning no sooner than March 31, 2012, to submit regulatory reports on the Fed's FR Y-9 form and annual reports on the Fed's Form FR Y-6 or FR Y-7. The remaining BHC reports would be required by the March 31, 2013 reporting period.

⁹ Notice of Intent to Require Reporting Forms for Savings and Loan Holding Companies, 76 Fed. Reg. 7091 (Feb. 8, 2011).

¹⁰ See Proposed Agency Information Collection Activities; Comment Request, 76 Fed. Reg. 53129 (Aug. 25, 2011).

II. Federal Savings Associations

On the Transfer Date, the OCC issued an interim final rule and request for comments that codified as OCC rules the former OTS regulations that the OCC will continue to enforce with respect to federal savings associations. The rule also made certain nomenclature and technical amendments to align former OTS regulations with existing OCC regulations.¹¹

- A. In addition, the OCC made changes to implement certain provisions of Dodd-Frank, particularly to conform preemption standards for both savings associations and national banks to the Dodd-Frank mandated standard and to remove HOLA's prohibition on paying interest on demand accounts.
- B. Importantly, the OCC signaled in this rule its intention to reduce the differences in the way that national banks and federal savings associations are regulated.
 - The OCC indicated that it would consider substantive amendments to its regulations in circumstances where differences in regulatory approaches for national banks and federal savings associations are not required by statute or "warranted by features unique to either the national bank or federal thrift charter."

III. State Savings Associations

On June 14, 2011, the FDIC issued an interim final rule and request for comments that codified as FDIC rules the former OTS regulations that the FDIC will enforce with respect to state savings associations.¹² The final rule also made nomenclature and other technical changes, and the FDIC indicated that it may consider amending or rescinding any of the former OTS regulations in the future.

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For additional information, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under "Banking and Financial

¹¹ Interim Final Rule and Request for Comment, Office of Thrift Supervision Integration Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 48950 (Aug. 9, 2011).

¹² Interim Final Rule and Request for Comment, Transfer and Redesignation of Certain Regulations Involving State Savings Associations Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 76 Fed. Reg. 47652 (Aug. 5, 2011).



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CLEARY GOTTLIEB STEEN & HAMILTON LLP

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS

12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME

Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN

Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG

Bank of China Tower
One Garden Road
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING

Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES

CGSH International Legal
Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO

Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299