



## The Status of the Federal Thrift Charter Post-Dodd-Frank\*

Jim Sivon

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*Treasury recommends phasing out the federal thrift charter over a two-year period... the thrift charter is no longer necessary to ensure sufficient residential mortgage loans are made available to U.S. consumers. (Bush Administration's Blueprint for a Modernized Financial Regulatory Structure, March 2008)*

*We [Treasury] propose to eliminate the federal thrift charter... the fragility of thrifts has become readily apparent during the financial crisis. (Obama Administration's Financial Regulatory Reform: A New Foundation, June 2009)*

Despite the foregoing pronouncements by both the Bush and Obama Administrations, the final version of the Dodd-Frank Act did not abolish the federal thrift charter. The charter remains in tact. On the other hand, the Dodd-Frank Act eliminated most of the regulatory advantages federal thrifts enjoyed over commercial banks, without granting federal thrifts the authority to engage in a broader range of lending activities. This article reviews the status of the federal thrift charter following enactment of the Dodd-Frank Act and concludes that the value of the charter has been diminished.

### *Federal Thrifts Lose Consolidated Supervision by a Single Agency*

While the Dodd-Frank Act did not repeal the federal thrift charter, it abolished the Office of Thrift Supervision, dividing the authority of OTS between the OCC, the FDIC, the Federal Reserve Board, and the new Bureau

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of Consumer Financial Protection (CFPB). One consequence of this regulatory restructuring is that federal thrifts and their parent holding companies will no longer be subject to consolidated supervision by a single federal agency. The OCC will be responsible for supervising and regulating federal thrifts; the Federal Reserve Board will be responsible for supervising and regulating a parent holding company of a federal thrift; and the CFPB will supervise the institution for compliance with federal consumer protection if a federal thrift has assets in excess of \$10 billion. This creates some potential for regulatory overlap and increased compliance costs for federal thrifts.

*National Banks Given Parity in Branching*

In the pre-Dodd-Frank world, federal thrifts enjoyed more flexible branching powers than commercial banks. Federal thrifts could establish new or *de novo* branches in any state, subject to notice or approval by the OTS. In contrast, banks were permitted to engage in *de novo* branching in another state only if the laws of the host state expressly permitted the activity, and few states did so. The Dodd-Frank Act eliminated this disparate treatment. Banks may now establish *de novo* branches in any state, just like a federal thrift. Furthermore, in an encouragement to charter conversions, the Dodd-Frank Act provides that a federal thrift that becomes a bank may continue to operate any branch or agency that the thrift operated prior to the conversion.

*Thrift Holding Companies Continue to Enjoy Broader Powers than Bank Holding Companies, but will be subject to Heightened Supervision by the Federal Reserve Board, including Explicit Capital Requirements*

As noted above, the Dodd-Frank Act gives the Federal Reserve Board supervisory authority over thrift holding companies. This has several implications for federal thrifts and their parent companies. First, it exposes the parent and all non-depository subsidiaries of the holding company to enhanced supervision by the Board, including subsidiaries subject to other regulatory regimes, such as insurance companies. Second, the Act specifically requires savings and loan holding companies to meet the minimum capital standards applicable to bank holding companies. The OTS did not impose a specific capital standard for savings and loan holding companies. Instead, it applied a more subjective qualitative standard for individual companies. This capital requirement may pose some special compliance challenges for insurance companies that already are subject to different capital standards

under state law. Finally, the Dodd-Frank Act requires savings and loan holding companies to serve as a source of strength for thrift subsidiaries. While the OTS also viewed savings and loan holding companies as a source of strength for subsidiary thrifts, the Dodd-Frank Act codifies the requirement, and directs the Federal Reserve Board to issue regulations governing the standard by July 21, 2012.

On the other hand, the Act does not require thrift holding companies to meet all of the activity limitations applicable to bank holding companies. Savings and loan holding companies may engage not only in activities permissible for bank holding companies and financial holding companies, but also in activities that were permissible for multiple savings and loan holding companies as of March 5, 1987. The latter category of activities includes real estate development and management.

*Federal Thrifts Lose “Field Preemption”*

The Act modified the application of preemption to federal thrifts in two key respects. First, the Act bars the application of “field preemption” in cases involving state consumer financial laws. In those cases, federal thrifts will be subject to the same legal standard for preemption that applies to national banks. That standard, according to the OCC, is the “conflict” standard articulated by the U.S. Supreme Court in the so-called Barnett Bank case (*Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner*). Some courts have concluded, however, that a conflict standard is narrower than field preemption. If so, federal thrifts may now be required to comply with some state laws that previously did not apply to their operations.

Additionally, the Dodd-Frank Act eliminated the application of preemption for subsidiaries and agents of federal thrifts. This means that as of July 21, 2011, any subsidiaries of federal thrifts will need to comply with state consumer financial laws. The Act does provide, however, that contracts entered into by a subsidiary prior to July 21, 2011 will enjoy a preemption “grandfather,” and will not be subject to state consumer financial laws as long as those contracts remain in effect.

*The Qualified Thrift Lender Test Continues to Limit the Lending Activities of Federal Thrifts*

The Dodd-Frank Act did not alter the qualified thrift lender test (“QTL”

test) applicable to federal thrifts, which requires that at least 65 percent of a thrift's portfolio consist of qualified thrift investments, such as housing loans, home-equity loans, small business loans, credit card loans, and mortgage-backed securities. Nor did the Act modify other lending limitations that apply to federal thrifts, including specific limits on commercial loans, non-residential property loans, and consumer loans. These lending restrictions, combined with the QTL test, serve as an impediment to a diversified lending strategy.

*Summary*

In summary, the Dodd-Frank Act eliminated many of the advantages federal thrifts previously enjoyed over national banks, without granting any relief on current lending restrictions. Consolidated supervision by a single agency has been lost, along with the branching advantage federal thrifts enjoy over banks. Thrift holding companies may continue to engage in a slightly broader range of activities than bank holding companies, but will now be subject to enhanced supervision, including explicit capital requirements. Any advantages federal thrifts enjoyed over national banks due to the application of differing preemption standards have been removed. The bottom line is that the charter remains attractive for a business strategy that is focused on consumer and real estate lending, but carries fewer advantages over a bank charter.

*Jim Sivon is a partner with the law firm of Barnett Sivon & Natter, P.C.*