Federal Reserve Issues Regulations for Savings and Loan Holding Companies

August 19, 2011

Pursuant to Section 312 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), jurisdiction over savings and loan holding companies ("SLHCs") was transferred from the Office of Thrift Supervision (the "OTS") to the Board of Governors of the Federal Reserve System (the "Board") effective July 21, 2011. SLHCs are companies (other than bank holding companies) that control one or more savings associations. The Dodd-Frank Act provides that all orders, interpretations, regulations and guidelines of the OTS remain in effect until modified by the Board. On August 12, 2011, the Board issued Regulation LL, which sets forth most regulations relating to SLHCs, and Regulation MM, which addresses certain matters that are unique to SLHCs that are in mutual form.[1] The regulations will become effective upon publication in the Federal Register, but as interim rules they are also subject to public comment.

Regulations LL and MM retain much of the OTS's regulations relating to SLHCs, but also modify them in important ways. This memorandum focuses on the significant aspects of Regulation LL.

A. APPLICATION PROCEDURES AND FORMS

Regulation LL replaces the OTS application procedures for SLHCs with procedures that closely follow the Board's current procedures for bank holding companies, including the Board's timelines for processing applications. Regulation LL dispenses with certain OTS practices, such as the requirement for pre-filing meetings and the practice of not formally accepting an application until it is deemed to be complete, but these changes should not have a significant effect on either the prospects for or the timing of an approval. For the time being, the Board will continue to use the OTS's application forms, which are now available on the Board's website.

B. CONTROL REGULATIONS

1. Acquisition of Control Under HOLA

The Board is now the responsible agency for reviewing transactions that involve the acquisition of control of an SLHC or a savings association under Section 10 of the Home Owners' Loan Act ("HOLA"), and for reviewing acquisitions of control of SLHCs under the Change in Bank Control Act (the "CIBC Act"). An acquisition of control under Section 10 of HOLA, which

[1] Citations in this memorandum to the "Interim Final Rule" are to the draft Federal Register notice, which is available at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20110812b1.pdf.

generally occurs upon the acquisition of 25% or more of the voting securities, subjects the acquiring party to ongoing regulation as an SLHC, in much the same way as acquisition of control of a bank or a bank holding company under Section 3 of the Bank Holding Company Act of 1956, as amended (the "BHC Act"), subjects the acquiring party to ongoing regulation as a bank holding company.

Regulation LL, insofar as it implements Section 10 of HOLA, very closely resembles the provisions in Regulation Y that implement Section 3 of the BHC Act. Regulation LL closely tracks Regulation Y in describing the transactions that require Board approval (such as the formation of SLHCs, the acquisition of control of savings associations, and the merger of SLHCs). An important difference in the two regulations stems from the fact that while the BHC Act only applies to "companies" that acquire control of a bank or bank holding company and does not apply to individuals,[2] HOLA applies to individuals in certain circumstances. The approval of the Board is required before an officer, director or a person (which is defined to include an individual) who owns 25% or more of the voting shares of an SLHC may acquire control of a savings association that is not a subsidiary of the SLHC.

Regulation LL also tracks Regulation Y in exempting from the Board's prior approval requirements those transactions that are primarily subject to the Bank Merger Act but technically require a separate application under HOLA for a minor part of the overall proposal. In such transactions, an SLHC acquires, and merges with, another SLHC and immediately merges the insured depository institution subsidiaries of the resulting SLHC in a transaction that is subject to approval by the Office of the Comptroller of the Currency or the FDIC under the Bank Merger Act. Absent the exemption under Regulation LL, an applicant would be required to file with the Board essentially the same information under HOLA as it would be required to file with other banking regulators under the Bank Merger Act, leading to unnecessary duplication and regulatory burden. Regulation LL also contains an exemption from the prior approval requirement for internal corporate reorganizations, which is modeled on a similar exemption in Regulation Y.

In adopting Regulation LL, the Board stated that, in light of the close similarity of the definitions of "control" in HOLA and the BHC Act, "Regulation LL includes provisions interpreting the definition of control under HOLA in the same manner as that term is interpreted under the BHC Act, adopts procedures for reviewing control determinations that are identical for SLHCs and BHCs, and conforms the filing requirements under the [CIBC Act] for SLHCs to those for BHCs."[3] The Board is correct in stating that the definitions of control in HOLA and the BHC Act are similar, in that control under both statutes exists if a company holds 25% or more of the voting shares or is able to elect a majority of the board of directors. The definitions of control under HOLA and the BHC Act, however, contain several key differences, as discussed below. The Board incorporated the HOLA definition into Regulation LL rather than copying the definition of control that is in Regulation Y. As a consequence, it is

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[2] While not subject to the BHC Act, individuals who acquire direct or indirect control of a bank are subject to the CIBC Act, as discussed below.

[3] Interim Final Rule, at 5.

unclear whether the Board will ultimately interpret the definition of control under HOLA in *exactly* the same manner as that term is interpreted under the BHC Act.

One difference is that the definition of control in HOLA (incorporated in Regulation LL) applies to the acquisition of control by "a person directly or indirectly or by acting in concert with other persons". The BHC Act applies only to acquisitions of control by companies and, while individuals who are bound together under a formal agreement may be deemed a "company", the BHC Act does not include a concept of "acting in concert". A determination that parties are "acting in concert" does not require a formal agreement. It is sufficient that there is "knowing participation in a joint activity or parallel action toward a common goal."[4] The CIBC Act (discussed below) does cover persons who "act in concert" to acquire control. In the supplementary information that accompanied Regulation LL the Board did not discuss whether persons who act in concert to acquire control of an SLHC would be reviewed under HOLA or under the CIBC Act.

A second difference is that a person is deemed to control an SLHC if it contributes more than 25% of the capital of the SLHC. The Board interprets the BHC Act to permit a company to provide up to a third of the equity of a bank holding company or a bank without acquiring control, provided that if the company provides 25% or more of the equity, it may not hold more than 14.9% of the voting shares.[5]

A third difference, which was a matter of OTS interpretation rather than a statutory difference, relates to so-called silo structures. On at least one occasion, the OTS determined that a legally distinct holding company set up by a private equity group to become an SLHC by acquiring a controlling interest in a savings association would not cause the rest of the private equity group to be treated as part of the same SLHC. The Board has rejected this approach. Although this topic is not discussed in the supplementary information that was published to explain Regulation LL, there is no reason to believe that the Board will approve such structures for SLHCs going forward.

The Board did state more generally that, in adopting its BHC Act approach to interpreting control for purposes of HOLA, it would apply its rules only to new investments. The Board "would only reconsider the particular structures of past investments approved by the OTS if the company proposed a material transaction, such as an additional expansionary investment, significant recapitalization, or significant modification of business plan."[6]

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4 12 C.F.R. § 225.41(b)(2).

5 12 C.F.R. § 225.144.

6 Interim Rule, at 6. The term "company," as used in this portion of the supplementary information accompanying the Interim Rule, is not defined, but presumably it refers to a savings and loan holding company.

2. Acquisition of Control Under the CIBC Act

The responsible federal banking agency under the CIBC Act is now the Board, in the case of bank holding companies, state member banks, and SLHCs; the Office of the Comptroller of the Currency in the case of national banks and federal savings banks; and the FDIC, in the case of state nonmember banks and state savings associations. The CIBC Act requires a person (including an individual) that is acquiring control of a banking organization to provide certain financial and other information to the responsible federal banking agency so that the agency can determine whether the proposed controlling party is acceptable. However, a determination of control under the CIBC Act does not result in any ongoing supervision, regulation or reporting requirements.

The regulations adopted by the federal banking agencies under the CIBC Act establish (with some variations) a rebuttable presumption of control if a person (or more than one person acting in concert) acquires 10% or more of the voting securities of a banking organization that is registered under Section 12 of the Securities Exchange Act of 1934, or acquires 10% or more of the voting securities of, and is the largest holder of voting securities of, a banking organization that is not so registered. The Board, alone among the federal banking agencies (at least until recently), does not permit acquirers to rebut presumptions of control that arise under the CIBC Act regulations. The CIBC Act requires the submission of a notice that contains certain information regarding the transaction and the acquirers, and the Board insists that a CIBC Act notice be filed whenever the rebuttable presumptions are triggered.[7]

In contrast, the OTS, when it was responsible for changes of control of SLHCs and savings associations, viewed the concept of control as essentially the same under HOLA and the CIBC Act, addressed them pursuant to a single "Acquisition of Control" regulation, and generally permitted acquirers of more than 10% but less than 25% of the voting securities of a SLHC or a savings association to rebut control by submitting passivity commitments. The OTS "Acquisition of Control" regulation is not included in Regulation LL. Instead, Regulation LL includes CIBC Act procedures and regulations for SLHCs that are virtually identical to those that the Board has used in the past for bank holding companies and state member banks under Regulation Y.[8] As in Regulation Y, although Regulation LL does not explicitly address the point, it appears that transactions that are exempt from approval under HOLA because they are being reviewed by another agency under the Bank Merger Act, will also be exempt from review under the CIBC Act provisions in Regulation LL.

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[7] Although the acquirer is deemed to control the target in such cases for purposes of the BHC Act, it is not deemed to control the target for purposes of the BHC Act. If the Board concluded that a company would control the target for purposes of the BHC Act, then it would require a BHC Act application rather than a CIBC Act notice.

[8] As a result, unique features of the OTS's control regulation, such as rebuttable "control factors" and the "rebuttal of control agreement," are not included in Regulation LL.

C. REGULATION OF SLHC NONBANKING ACTIVITIES

SLHCs that control a single savings association (not counting those acquired in an acquisition from the FDIC as receiver) and that acquired control prior to (or pursuant to an application filed prior to) May 4, 1999 are not subject to restrictions under HOLA on the nonbanking activities in which they may engage. This exemption was not affected by the Dodd-Frank Act, although the Dodd-Frank Act will subject such companies to consolidated capital requirements beginning in 2015 and those requirements may cause many of the insurance companies and commercial organizations that rely on this exemption to give up their thrift charters. Other SLHCs, which are referred to in this memorandum as "Covered SLHCs", are subject to activity restrictions, and Regulation LL takes a different approach to those restrictions than had been the case under the OTS regulations.

1. Financial Holding Company Activities

Bank holding companies that qualify as "financial holding companies" are permitted by Section 4(k) of the BHC Act to engage in certain activities that are not permissible for other bank holding companies. Those activities include all types of securities and insurance activities, as well as merchant banking activities. To qualify as a financial holding company, a bank holding company and its depository institution subsidiaries must be well capitalized and well managed, the depository institution subsidiaries must have at least a satisfactory performance rating under the Community Reinvestment Act, and the bank holding company must elect financial holding company status.

Prior to the Dodd-Frank Act, the OTS interpreted HOLA to permit all SLHCs to engage in all activities that are permissible under Section 4(k) of the BHC Act. In contrast, and partly due to amendments that the Dodd-Frank Act made to HOLA,[9] Regulation LL requires Covered SLHCs to meet certain standards in order to engage in Section 4(k) activities.

A Covered SLHC may not engage in such activities unless it is well managed, its depository institution subsidiaries are well capitalized and well managed, the depository institution subsidiaries have at least a satisfactory performance rating under the Community Reinvestment Act, and the Covered SLHC elects such status. These requirements do not include a requirement that the SLHC be well capitalized in recognition of the fact that the capital requirements for SLHCs will not take effect until 2015. Covered SLHCs that are currently engaged in Section 4(k) activities must file a certification that they meet these requirements by December 31, 2011 or, if unable to do so, submit an explanation by that date as to how they will conform their activities to Regulation LL by June 30, 2012.

2. Section 4(c)(8) Activities

Bank holding companies that are not financial holding companies are permitted to engage in (and to acquire shares of companies that are engaged in) certain activities that the Board has determined are "closely related to banking" pursuant to Section 4(c)(8) of the BHC Act. The

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[9] *See* Dodd-Frank Act, § 606(b); 12 U.S.C. § 1467a(c)(2)(H).

Board generally requires bank holding companies to file a prior notice (a type of application) in order to engage in those activities. HOLA authorizes Covered SLHCs to engage in those activities as well, but the OTS has not required any form of notice or application. Regulation LL will require Covered SLHCs that wish to engage in, or to acquire shares of companies that are engaged in, "closely related" activities, to make the same filings as bank holding companies are required to file.

3. Insurance Agency Activities

A bank holding company may not engage in insurance agency activities (with limited exceptions) unless it qualifies as a financial holding company. However, because HOLA specifically authorizes Covered SLHCs to engage in insurance agency activities, Regulation LL permits Covered SLHCs to engage in such activities without having to submit a certification and adhere to limitations applicable to financial holding companies.

4. "1987 List" Activities

HOLA also specifically authorizes Covered SLHCs to engage in certain activities that they were authorized by regulation to engage in as of March 5, 1987. The most notable of these activities is real estate development, which is not even permissible for financial holding companies. The Dodd-Frank Act did not alter this authorization and, accordingly, Covered SLHCs are permitted by Regulation LL to engage in such activities. However, prior to engaging in such new activities or acquiring shares of a company engaged in such activities, a Covered SLHC is required to submit a notice to the Board similar to what it required in the case of Section 4(c)(8) activities and acquisitions. The Board may be reluctant to approve a notice relating to an activity, such as real estate development, in which it has generally not permitted banking organizations it regulates to engage.

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For more information, please contact a member of Simpson Thacher's Financial Institution Group.

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