

Federal Reserve Issues Regulations Governing Savings and Loan Holding Companies

On September 13, 2011, the Board of Governors of the Federal Reserve System (Board) issued an interim final rule, Regulation LL, governing the activities of savings and loan holding companies (SLHCs). As of July 21, 2011, the regulation and supervision of SLHCs and their nondepository subsidiaries were transferred to the Board under the authority of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Generally, Regulation LL captures prior SLHC regulations of the Office of Thrift Supervision (OTS) and conforms these regulations to current Board regulations governing bank holding companies (BHCs). In that regard, Regulation LL implements substantive changes to those prior OTS regulations, with many (but not all) of these changes implementing provisions of the Dodd-Frank Act. For example, certain SLHCs must now declare that they are well-managed and well-capitalized in order to conduct activities deemed to be financial in nature, in accordance with the Dodd-Frank Act.

Regulation LL does not affect the Home Owners Loan Act's (HOLA) exemption from activities restrictions for certain SLHCs that were grandfathered (Grandfathered SLHCs) by the Gramm-Leach-Bliley Act of 1999 (GLB Act). Thus, Regulation LL provisions affecting SLHC activities only apply to those SLHCs subject to activities restrictions under the GLB Act (Nonexempt SLHCs).

The Board is accepting comments regarding Regulation LL until October 27, 2011. Specifically, the Board is requesting comment on whether it has captured all regulations related to the supervision of SLHCs through this rulemaking and whether the Board has collected any OTS regulatory provisions in Regulation LL that do not apply to SLHCs or their nondepository subsidiaries.

A general description of the major regulatory modifications created by Regulation LL is set forth below.

Background

Section 312 of the Dodd-Frank Act transferred supervisory and rulemaking authority for SLHCs and their nondepository subsidiaries from the OTS to the Board as of July 21,

Brussels
+32 (0)2 290 7800

Denver
+1 303.863.1000

London
+44 (0)20 7786 6100

Los Angeles
+1 213.243.4000

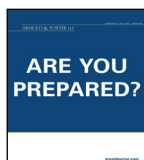
New York
+1 212.715.1000

Northern Virginia
+1 703.720.7000

San Francisco
+1 415.356.3000

Silicon Valley
+1 415.356.3000

Washington, DC
+1 202.942.5000



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2011.¹ Upon this transfer, the Board was statutorily required to identify those OTS regulations that the agency would continue to enforce.² The Board published a listing of those regulations on July 21, 2011. Through Regulation LL, the Board is transitioning these OTS regulations to regulations of the Board. Regulation LL contains all regulations applicable to SLHCs that are in stock form,³ and it will follow a structure similar to the Board's Regulation Y,⁴ which governs the regulation and supervision of bank holding companies (BHCs).

Conformity with Regulation Y

The Board conformed those OTS Regulations governing SLHCs that are substantively similar to provisions of the Bank Holding Company Act of 1956, as amended (BHCA) or Regulation Y to the language and format used in Regulation Y. These changes affected several areas of SLHC regulation, including the following:

Applications

The Board has replaced the OTS's procedures for the processing and filing of applications with the Board's procedures, while not altering the substantive standards of transactions that trigger the filing of an application. The Board is continuing to use OTS application forms, but the Board is eliminating OTS requirements for pre-filing meetings, the submission of draft business plans, and formal procedures that the OTS employed to determine when an application became complete. The Board is also publishing notices of proposed acquisitions of SLHCs in the *Federal Register* for public comment by interested persons.

Control Determinations

For savings association and SLHC control determinations, the promulgating release states that the Board intends to apply the same types of rules and processes to SLHCs that the agency currently applies to BHCs. Specifically, the Board intends to interpret the definition of "control" under HOLA in the same manner as it interprets control in the BHCA. The definition of control in HOLA is almost identical to the definition of control in the BHCA. For example, both of these statutes determine control through a three-prong test, measuring whether a company controls: a) 25 percent or more of another company's voting shares, b) the election of a majority of another company's board, or c) influence over another company's management or policies.⁵ Also, the Board's control determination review procedures, as well as filing requirements under the Change in Bank Control Act⁶ will apply to SLHCs in an identical manner to how these policies apply to BHCs.

Through this assimilation, any prior OTS regulations regarding control determinations and rebuttal of control matters that are inconsistent with Board policy on these issues as they are applied to BHCs will not be included in Regulation LL. This determination by the Board to treat SLHCs the same as BHCs in the control area will affect several past OTS practices regarding control determinations.

- First, the Board will make control determinations by reviewing the influence of *all* investors in a savings association or SLHC and not just the two largest shareholders, which was the past practice of the OTS.
- Second, unlike the OTS, the Board will not provide a separate application process for a party to rebut control if a regulatory control factor is triggered under the BHCA.
- Third, under the Change in Bank Control Act, the Board will not allow investors to avoid required filings through the use of passivity commitments and rebuttal

1 12 U.S.C. § 5412.

2 12 U.S.C. § 5414(c).

3 The Board is implementing a separate regulation, Regulation MM, to collect regulations that separately apply to mutual holding companies which are SLHCs. Regulation MM only applies to a corporation organized as a holding company under the Home Owners Loan Act, 12 U.S.C. § 1467a(o), through reorganization from a savings association operating in mutual form. See 76 Fed. Reg. 56,508, 56,511 n. 28 (Sept. 13, 2011). Regulation MM will not apply to a mutual holding company that is not organized under 12 U.S.C. § 1467a(o) such as mutual insurance companies that established or acquired federal savings banks other than through a mutual conversion transaction using a mutual holding company structure pursuant to OTS regulations.

4 12 C.F.R. pt. 225.

5 Unlike the BHCA, HOLA conclusively deems a person to be in control of a savings association if that person owns or controls more than 25 percent of the voting shares of the savings association. 12 U.S.C. § 1467a(a)(2).

6 12 U.S.C. § 1817(j).

agreements. The OTS previously permitted these practices in lieu of filing a Change in Bank Control Act notice.

The Board's proposal to conform these control regulations does not apply to institutions with ownership structures that were previously approved by the OTS. Regulation LL applies to new ownership investments, and the Board is only reviewing the ownership structures of past applicants to the OTS if a company proposes a new material transaction such as a major business plan modification, recapitalization, or expansion effort. Because such a review can be triggered by business plan changes, many SLHCs that otherwise may not contemplate having its ownership structure reviewed by the Board may find itself under scrutiny.

Transactions Subject to the Bank Merger Act

The Board also has created an exception in Regulation LL to HOLA's prior approval requirement for transactions that also require prior approval through the Bank Merger Act.⁷ This exception mirrors similar provisions contained in Regulation Y.⁸ In accordance with HOLA and the Bank Merger Act, the OTS previously required both an SLHC and an SLHC's subsidiary savings association to submit requests for prior approval when the institutions acquired another savings association by merger. In order to eliminate unnecessary duplication of filings, the Board has created an exception to the approval requirement under HOLA subject to certain conditions. The Board will generally defer to the determination of the agency reviewing the merger proposal under the Bank Merger Act, either the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation. However, the Board retains jurisdiction over these transactions, and reserves the right to require an application if an SLHC's merger proposal presents issues that the Board determines to be unique to its jurisdiction.

Activities Closely Related to Banking

By conforming OTS regulations to Regulation Y, the Board is establishing new filing requirements for Nonexempt SLHCs

that engage in activities that the Board has determined by rule or order to be "closely related to banking."⁹ The OTS did not previously require filings for Nonexempt SLHCs to engage in these activities. However, Nonexempt SLHCs that begin new activities that are "closely related to banking" after July 21, 2011 must comply with the same filing requirements as BHCs governed by Regulation Y. These filing requirements include *prior approval* from the Board, unless the Nonexempt SLHC meets the following test and is deemed to be a well-run SLHC:

- A composite rating of "1" or "2" in the Nonexempt SLHC's most recent examination, or a rating of satisfactory or above if the most recent examination was prior to January 1, 2008;
- The Nonexempt SLHC is not in a troubled condition; and
- The Nonexempt SLHC is not proposing to commence the activity by an acquisition (in whole or in part) of a going concern.

If a Nonexempt SLHC has these above characteristics, then the company must alternatively provide notice to the appropriate Federal Reserve Bank within 10 business days *after* the commencement of the proposed activity.

Notice of Change in Director

Regulation LL transfers OTS regulations governing the filing of notices for changes of directors or senior executive officers in SLHCs in troubled condition. The Board conformed these provisions to similar requirements contained in Regulation Y for BHCs. As a result, the Board has added an appeal and informal hearing process in the event of the Board's disapproval of an SLHC's notice. OTS regulations did not previously grant these appeal and informal hearing rights to SLHCs.

Additional Substantive Changes to SLHC Regulations

Financial Holding Company Activities

In addition to conforming the previous OTS regulations to Board practice, the Board has used this issuance of Regulation LL to implement provisions of the Dodd-Frank Act that affect SLHCs. For example, the Regulation

⁷ 12 U.S.C. § 1828.

⁸ See 12 C.F.R. 225.12.

⁹ See 12 U.S.C. §§ 1843(c)(8) & (k)(4)(F).

contains new provisions that conditionally limit the ability of Nonexempt SLHCs to perform activities that are permitted for financial holding companies (FHCs). These activities include various types of securities, merchant banking, and insurance activities. Prior to the Dodd-Frank Act, the OTS interpreted the HOLA¹⁰ to permit SLHCs to conduct activities that were financial in nature and statutorily permitted for FHCs under the BHCA.¹¹ SLHCs were able to perform these financial activities without having to satisfy the same criteria required of FHCs to have well-managed and well-capitalized depository institution subsidiaries, to have at least a satisfactory rating under the most recent Community Reinvestment Act (CRA) examination, and to file a declaration and certification with the regulator.¹² However, the Dodd-Frank has implemented changes in the regulatory procedures of Nonexempt SLHCs that conduct the activities of an FHC.

Specifically, Section 606 of the Dodd-Frank Act amends HOLA to require Nonexempt SLHCs to meet all of the criteria that BHCs must meet to conduct the activities of an FHC. In addition, Section 606 adds to the regulatory criteria a requirement that a holding company, in addition to its depository institution subsidiary, must be well-capitalized and well-managed at the holding company and saving association levels before conducting activities that are permissible for FHCs. Regulation LL implements Section 606 of the Dodd-Frank Act by establishing a regulatory process for filings that a Nonexempt SLHC must make to the Board in order to be treated as an FHC. This filing process mirrors the process currently in place for BHCs seeking treatment as an FHC under Regulation Y.

Regulation LL requires that a Nonexempt SLHC seeking treatment as an FHC must be well-managed and well-capitalized, in addition to controlling a depository institution that has achieved at least a satisfactory rating under the

most recent CRA examination. A Nonexempt SLHC is well-managed if at its most recent examination the company received at least a satisfactory composite rating, and at least a satisfactory rating for management, if such rating is given. This definition is substantively identical to the definition of well-managed in Regulation Y.¹³ A Nonexempt SLHC is well-capitalized if each of the company's depository institutions is well-capitalized and the company is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the Board to meet and maintain a specific capital level for any capital measure.

A well-managed and well-capitalized Nonexempt SLHC seeking treatment as an FHC to conduct new activities must file a written declaration with the appropriate Federal Reserve Bank. Also, for Nonexempt SLHCs already engaging in activities that are financial in nature upon the enactment of Regulation LL, the Board requires the submission of a description of the activities and a written declaration by December 31, 2011 in order for an SLHC to continue these activities in compliance with Section 606. A complete written declaration for either new or existing activities that are financial in nature must:

1. State that the SLHC elects to be treated as a FHC in order to engage in FHC activities;
2. Provide the name and head office address of the SLHC and each depository institution controlled by the SLHC;
3. Certify that the SLHC and each depository institution controlled by the SLHC is well-capitalized as of the date the SLHC submits its declaration; and
4. Certify that the SLHC and each savings association controlled by the SLHC is well-managed as of the date the SLHC submits its declaration.

¹⁰ 12 U.S.C. § 1467a(c)(9)(A).

¹¹ 12 U.S.C. § 1843(k).

¹² See 12 U.S.C. § 1843(l)(1).

¹³ For the Nonexempt SLHC, if any, that has not been examined, it will be considered well-managed if after a review of the managerial and other resources of the company and after consulting with the appropriate federal and state banking agencies, the Board determines the company to be well-managed.

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If a Nonexempt SLHC is already engaging in activities that are financial in nature upon the enactment of Regulation LL and is unable to file a declaration, then that Nonexempt SLHC must submit an alternative declaration by December 31, 2011 including:

1. A list of activities that are financial in nature in which the SLHC engages;
2. A description of why the SLHC cannot file a declaration that can be declared effective; and
3. A description of how the SLHC will achieve compliance prior to June 30, 2012.

If that Nonexempt SLHC is unable to achieve compliance with these declaration requirements by June 30, 2012, then it will be subject to the notice, remediation agreement, and divestiture consequences of the BHCA.¹⁴ The BHCA permits the Board to order a company to divest ownership or control of any depository institution if after Board notice, and the expiration of 180 days, the conditions described in the Board notice are not corrected. However, the interim final rule notes that the Board will exercise discretion in its enforcement of these provisions and take into account the fact that SLHCs were not subject to the declaration criteria prior to the Dodd- Frank Act.

SLHC Activities Explicitly Authorized by HOLA

The Board is permitting Nonexempt SLHCs to continue conducting certain activities that are explicitly authorized in the HOLA. This includes activities that are financial in nature, as well as certain activities that BHCs or FHCs are not permitted to conduct. For example, the HOLA specifically allows SLHCs to engage in insurance agency and escrow activities,¹⁵ which are activities that are financial in nature under the BHCA.¹⁶ Because of this statutory authority, the Board will permit Nonexempt SLHCs to conduct these activities without having to meet the criteria that BHCs must meet when seeking treatment as an FHC.

Similarly, the HOLA permits SLHCs to engage in activities that multiple SLHCs were authorized to directly engage in on March 5, 1987.¹⁷ Some of these activities, such as real estate development, are impermissible for BHCs or FHCs. The Board will permit Nonexempt SLHCs to continue these activities subject to notice requirements under Regulation LL. The notice requirements are limited to Nonexempt SLHCs that are subject to restrictions on its activities under Regulation LL. Thus, Grandfathered SLHCs may continue to engage in these activities without any notice restrictions under Regulation LL.

¹⁷ 12 U.S.C. § 1467a(c)(2)(F)(ii).

Arnold & Porter LLP is available to respond to questions raised by Regulation LL or to provide any assistance in drafting comments to the Board. We also can assist in determining how Regulation LL may affect your business and ensuring that your business is compliant with the requirements of the interim final rule. For further information, please contact your Arnold & Porter attorney or:

A. Patrick Doyle

+1 212.715.1770
+1 202.942.5949
APatrick.Doyle@aporter.com

Alan Avery

+1 212.715.1056
Alan.Avery@aporter.com

Beth S. DeSimone

+1 202.942.5445
Beth.DeSimone@aporter.com

Brian P. Larkin

+1 202.942.5990
Brian.Larkin@aporter.com

¹⁴ 12 U.S.C. § 1843(m); see also 12 C.F.R. 225.83.

¹⁵ 12 U.S.C. § 1467a(c)(2)(B).

¹⁶ See 12 U.S.C. § 1843(k).

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