

OCC proposes regulations that would allow certain federal savings associations to operate with the powers of a national bank

By Aaron M. Kaslow, Esq., Kilpatrick Townsend & Stockton*

OCTOBER 1, 2018

The Office of the Comptroller of the Currency (OCC) has proposed a rule that would implement section 206 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (the Act), which requires the OCC to issue regulations to allow federal savings associations with total consolidated assets of \$20 billion or less as of December 31, 2017, to elect to operate with national bank powers.

Federal savings associations that make the election (referred to as a covered savings association) generally would have the same rights and privileges as a national bank and be subject to the same duties, restrictions, penalties, liabilities, conditions, and limitations that apply to national banks.

A covered savings association would retain its Federal savings association charter and bylaws and would continue to be treated as a federal savings association for purposes of governance matters, such as board of director governance procedures, shareholder governance procedures, payment of dividends, merger and other corporate changes.

Under the proposed rule, covered savings associations would be required to divest, conform, or discontinue nonconforming subsidiaries, assets, and activities, with appropriate lead-time, so that they do not operate, hold, or conduct subsidiaries, assets, or activities that would not be permissible for a national bank.

ELIGIBILITY

Under the Act and the proposed regulations, a Federal savings association that had total consolidated assets of \$20 billion or less as of December 31, 2017, may make an election to operate as a covered savings association.

The OCC proposes to use an institution's Call Report submitted for the quarter ending December 31, 2017, to determine if the institution meets this threshold.

Because the Act contemplates that "a Federal savings association" with a certain amount of assets "as of December 31, 2017,"

may make an election, under the proposed rule, institutions that were not Federal savings associations as of December 31, 2017, would not be eligible to operate as covered savings associations.

As a result, an institution that was a credit union, state savings association, or state bank on December 31, 2017, but that later converted to a Federal savings association charter, would not be eligible to make an election under the proposed rule.

Under the proposed rule, covered savings associations would be required to divest, conform, or discontinue nonconforming subsidiaries, assets, and activities.

Similarly, a de novo Federal savings association chartered after December 31, 2017, would not be eligible to make an election to operate as a covered savings association.

Under the Act, a covered savings association whose total consolidated assets grow to more than \$20 billion can continue to operate as a covered savings association.

The OCC has not indicated whether a Federal savings association whose assets grow to more than \$20 billion after December 31, 2017, would continue to be permitted to make an election to operate as a covered savings association, but the language of the Act and the proposed rule suggests that it would.

To make an election to operate as a covered savings association, a Federal savings association must be an "eligible savings association" as that term is defined under the OCC's rules for corporate activities.

Under those rules, an eligible savings association is a Federal savings association that:

- (1) is well capitalized as defined under the regulations regarding prompt corrective action;



- (2) has a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System;
- (3) has a Community Reinvestment Act rating of “outstanding” or “satisfactory,” if applicable;
- (4) has a consumer compliance rating of 1 or 2 under the Uniform Interagency Consumer Compliance Rating System; and
- (5) is not subject to a cease and desist order, consent order, formal written agreement, or Prompt Corrective Action directive or, if subject to any such order, agreement, or directive, is informed in writing by the OCC that the savings association may be treated as an “eligible savings association”.

The proposed rule specifies that a Federal savings association that is subject to a cease and desist order, consent order, formal written agreement, or Prompt Corrective Act directive would not be eligible to elect to operate as a covered savings association unless the OCC informs it in writing that it is eligible to do so.

PROCEDURE

Under the proposed rule, an eligible Federal savings association may make an election to operate as a covered savings association by submitting a notice to the OCC office that is responsible for the supervision of the savings association.

The notice, which must be signed by a duly authorized officer, must identify each branch or agency that the savings association operates or will operate on the effective date of the election that has not previously been the subject of an application or notice to the OCC.

In addition, the notice must identify and describe each nonconforming subsidiary, asset, or activity that the Federal savings association operates, holds, or conducts at the time it submits the notice. The notice should specify whether an asset or activity is held or conducted by the Federal savings association itself or by a subsidiary.

Under the proposed rule, an election to operate as a covered savings association would take effect on the date that is 60 days after the date on which the OCC receives the notice, unless the OCC notifies the Federal savings association that it is not eligible to make the election.

Although not specified in the proposed rule, the OCC has indicated that it could notify a Federal savings association that it is eligible to operate as a covered savings association before 60 days have elapsed.

The proposed rule would not require a Federal savings association to amend its charter or bylaws or to obtain the approval of shareholders or members before submitting a notice to the OCC.

TREATMENT AS A NATIONAL BANK

The Act provides that a covered savings association has the same rights and privileges as a national bank that has the main office of the national bank situated in the same location as the home office of the covered savings association and is subject to the same duties, restrictions, penalties, liabilities, conditions, and limitations that would apply to such a national bank.

The OCC has proposed two alternative formulations for expressing the scope of a covered savings association’s exercise of national bank powers: one version focuses on complying “with the same provisions of law” that would apply to a similarly located national bank and another focuses on engaging “in any activity” that is permissible for a similarly located national bank.

An eligible federal savings association may make an election to operate as a covered savings association by submitting a notice to the OCC office that is responsible for the supervision of the savings association.

The OCC expressly noted that a covered savings association would not be subject to the qualified thrift lender (QTL) test, which requires savings associations to maintain a housing and consumer focus, and the restrictions under the Home Owners’ Loan Act for failing to meet the QTL test.

Similarly, the OCC has confirmed that a covered savings association would not be subject to the limits on aggregate amounts of loans secured by liens on nonresidential real property, additional restrictions on loans to a single borrower, other borrowing limitations, and certain affiliate transaction requirements to which a federal savings association would otherwise be subject.

The statutes and regulations that govern the establishment or closing of a national bank branch would apply to a covered savings association seeking to establish a de novo branch or close an existing branch.

The proposed rule also would require a covered savings association to comply with national bank law with respect to subsidiaries. As a result, the regulations that set out requirements for the formation of operating subsidiaries,

bank service companies, and financial subsidiaries by national banks, would apply to covered savings associations.

Both subsidiaries and those activities conducted in a subsidiary that are impermissible for a national bank would be impermissible for a covered savings association.

The OCC has invited comment on whether the rule should allow covered savings associations to continue to operate a service corporation, which would otherwise become impermissible for covered savings associations, and under what conditions, if the service corporation is engaged only in activities that would be permissible for a national bank.

The proposed rule specifies that a covered savings association would continue to comply with the provisions of law that apply to a Federal savings association for purposes of:

- Governance (including incorporation, bylaws, board of directors, shareholders and distribution of dividends);
- Consolidation, merger, dissolution, conversion (including conversion to a stock bank or to another charter), conservatorship, and receivership;
- Provisions of law applicable only to Federal mutual savings associations;
- Offers and sales of securities at an office of a Federal savings association;
- Inclusion of subordinated debt securities and mandatorily redeemable preferred stock as Federal savings association supplementary (tier 2) capital;
- Increases in permanent capital of a Federal stock savings association;
- Adjudicatory, investigative, and formal examination proceedings and removals, suspensions, and prohibitions;
- Security procedures;
- Maintenance of records and recordkeeping and confirmation requirements for securities transactions;
- Nondiscrimination; and
- Advertising.

NONCONFORMING SUBSIDIARIES, ASSETS AND ACTIVITIES

The proposed rule establishes a transition process for bringing nonconforming subsidiaries, assets, and activities into conformance with the requirements for national banks.

The proposed rule would require a covered savings association to divest, conform, or discontinue nonconforming subsidiaries, assets, and activities at the earliest time that prudent judgment dictates but not later than two years after the effective date of an election.

The two-year period for divesting, conforming, or discontinuing nonconforming subsidiaries, assets, and activities is the same period that the OCC would generally allow for a Federal savings association converting to a national bank.

The proposed rule also would require a covered savings association to comply with national bank law with respect to subsidiaries.

Under the proposed rule, the OCC may require a covered savings association to submit a plan to divest, conform, or discontinue a nonconforming subsidiary, asset, or activity.

The proposed rule would allow the OCC to grant a covered savings association extensions of not more than two years each up to a maximum of eight years if the OCC determines that: (1) the covered savings association has made a good faith effort to divest, conform, or discontinue the nonconforming subsidiaries, assets, or activities; (2) divestiture, conformance, or discontinuance would have a material adverse financial effect on the covered savings association; and (3) retention or continuation of the nonconforming subsidiaries, assets, or activities is consistent with the safe and sound operation of the covered savings association.

The 10-year period in the proposed rule is consistent with the 10-year limitation on possession of OREO by national banks.

TERMINATION OF THE ELECTION

The proposed rule would permit a covered savings association to terminate its election, after an appropriate period of time as determined by the OCC, by submitting a notice to the appropriate OCC supervisory office. The OCC views an appropriate period of time to be relatively soon after the effectiveness of the request for termination, such as 60 or 90 days.

Generally, the effective date timelines and requirements that would apply to a notice of election would apply to a request for termination.

REELECTION

Under the proposed rule, a Federal savings association that wants to make a subsequent election after terminating a

previous election would be required to wait five years after the termination before making a subsequent election.

The cooling-off period is intended to prevent institutions from taking advantage of a potential overlap between transition periods for divesting nonconforming subsidiaries and assets and discontinuing nonconforming assets.

This article first appeared in the October 1, 2018, edition of Westlaw Journal Bank & Lender Liability.

* © 2018 Aaron M. Kaslow, Esq., Kilpatrick Townsend & Stockton

ABOUT THE AUTHOR



Aaron M. Kaslow is a partner in the Washington office of **Kilpatrick Townsend & Stockton** and team leader of the firm's Financial Institutions practice. He focuses his practice on corporate and securities matters, mergers and acquisitions, and regulatory matters for financial institutions. He also regularly advises on the formation of captive insurance companies, risk retention groups and other alternative risk transfer arrangements. He can be reached at akaslow@kilpatricktownsend.com. This expert analysis was first published Sept. 12 on the firm's website. Republished with permission.

Thomson Reuters develops and delivers intelligent information and solutions for professionals, connecting and empowering global markets. We enable professionals to make the decisions that matter most, all powered by the world's most trusted news organization.