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LEGAL UPDATES AND NEWS

OCC Releases a Proposed Rule to Allow Certain Federal Savings Associations to Elect to Operate with National Bank Powers

On September 10, 2018, the Office of the Comptroller of the Currency (the "OCC") issued a proposed rule implementing Section 206 of the Economic Growth, Relief and Consumer Protection Act (the "Regulatory Relief Act"), which added a new Section 5A to the Home Owners' Loan Act ("HOLA"). New Section 5A of HOLA permits a federal savings association with total consolidated assets of $20 billion or less as of December 31, 2017, to elect to operate with national bank powers without converting to a national bank charter. The deadline for submitting written comments on the proposed rule, which is summarized below in question and answer format, is November 17, 2018. The proposed rule is subject to change, and the OCC will issue a final rule after reviewing all comments on the proposal.

I. Background and Summary of Section 5A of HOLA

Background. The OCC charters and regulates both federal savings associations and national banks. Federal savings associations specialize in residential lending and are subject to specific lending and investment restrictions set forth in the HOLA. Specifically, a federal savings association must comply with HOLA-mandated commercial business and commercial real estate lending limits, and the qualified thrift lender ("QTL") test. Under the QTL test, at least 65% of a federal savings association's portfolio assets must consist of mortgage- and consumer-related assets.

Unlike federal savings associations, national banks can engage in a wider range of lending activities, since they are not subject to specific asset-type lending restrictions or the QTL test. Prior to the Regulatory Relief Act, a federal savings association that desired to increase its commercial or consumer lending beyond its HOLA limitations would have had to convert to a national bank or state commercial bank or, in some states, a savings bank charter. For some federal savings associations, a charter conversion can be time consuming and burdensome, and federal mutual savings associations would have to convert to the stock form of organization to be chartered as a national bank since there is no mutual national bank charter.

Summary of Section 5A of HOLA. To give federal savings associations the flexibility to exercise national bank powers without changing charters, Section 5A of HOLA permits a federal savings association with $20 billion or less in assets as of December 31, 2017, to elect to operate as a "covered savings association." A covered savings association would have the same rights and privileges as a national bank that has its main office situated in the same location as the home office of the covered savings association. For example, this would allow a covered savings association to exceed the commercial and consumer lending limits that currently apply under HOLA. A covered savings association, however, would be subject to the same restrictions and limitations as a national bank, which could require the association to divest, conform or discontinue nonconforming subsidiaries, assets and activities not permissible for national banks.

Under Section 5A of HOLA, a covered savings association would retain its federal savings association charter and would be treated as a federal savings association for purposes: (1) of governance, including charter and bylaws, board of directors, shareholders, members and payment of dividends; (2) of corporate changes, such as a merger, consolidation, dissolution, charter conversion, conversion from mutual to stock form, conservatorship and receivership; and (3) as otherwise determined by the OCC.

II. Summary of the Proposed Rule

Who is eligible to elect become a covered savings association?

A federal savings association (in either the mutual or stock form or a savings association subsidiary of a mutual holding company) 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 the institution's Call Report submitted for December 31, 2017 to determine if this threshold is satisfied. A covered savings association can continue to operate as a covered savings association, even if its total consolidated assets grow to more than $20 billion.

The preamble to the proposed rule clarifies that institutions that were not federal savings associations as of December 31, 2017 are not eligible to operate as covered savings associations. For example, an institution that was a credit union, state savings association or state savings bank on December 31, 2017 but later converted to a federal savings association charter would not be eligible to make an election under the proposed rule. Similarly, a de novo federal savings association chartered after December 31, 2017 would not be eligible for covered savings association status.

How would a federal savings association elect to become a covered savings association?

To become a covered savings association, a federal savings association must file an election notice with its regional OCC office responsible for its supervision, and it generally must be an "eligible savings association" as defined in the OCC's rules for corporate activities. The notice must identify the association's assets, subsidiaries and activities that do not conform to applicable rules and regulations for national banks. The election would automatically take effect on the 60th day after the OCC receives the election notice, unless the OCC notifies the association it is not eligible.

Under OCC rules, an eligible savings association is a federal savings association that: (1) is well capitalized; (2) has a CAMELs composite rating of 1 or 2; (3) has a consumer compliance rating of 1 or 2; (4) has a Community Reinvestment Act rating of "outstanding" or "satisfactory,"; and (5) is not subject to an enforcement action. The proposed rule does not address whether a covered savings association would forfeit its designation under Section 5A of HOLA if the association loses its status as an "eligible savings association" after making the election.

Is a federal savings association required to amend its charter or bylaws or obtain approval of shareholders or members before submitting an election notice to the OCC?

A federal savings association would not need to amend its charter or bylaws or obtain shareholder or member approval before submitting an election notice to the OCC. However, before submitting an election notice, an association should review its charter and bylaws to confirm that such approval is not required and that no charter or bylaw provisions are inconsistent with any new rights and restrictions as a covered savings association.

How is a covered savings association treated following an election?

Treatment as a National Bank. With few exceptions (as described below), a covered savings association would have the same powers and restrictions as a national bank. For example, a covered savings association is not subject to the QTL test (including the restrictions under HOLA for failing to meet the QTL test) and other lending restrictions under HOLA, including limits on aggregate loans secured by nonresidential real property, additional restrictions on loans to a single borrower, other borrowing limitations and certain affiliate transaction requirements applicable to a federal savings association but not a national bank.

The proposed rule does not, however, consider whether a savings and loan holding company of a covered savings association (which may include a stock holding company or a mutual holding company) would be treated by the Federal Reserve as having the same powers and restrictions as a bank holding company. Moreover, unlike bank holding companies, HOLA requires a savings association subsidiary of a savings and loan holding company to satisfy the QTL test. To require covered savings association subsidiaries to comply with the QTL test would defeat the purpose of new Section 5A of HOLA. This issue awaits clarification by the Federal Reserve.

Treatment as a Federal Savings Association. Following an election, a covered savings association would remain chartered as a federal savings association and would be treated as a federal savings association for corporate governance and reorganization/transactional purposes, as described above. The proposed rule provides that certain federal savings association rules and regulations would continue to apply to a covered savings association, including: (1) regulations applicable only to mutual savings associations; (2) rules of practice and procedure, such as for adjudicative, investigative and formal examination proceedings; and (3) regulations that are specific to federal savings associations with no corresponding specific national bank rule.

The proposed rule, however, clarifies that a covered savings association must comply with national bank rules and regulations with respect to subsidiaries, public welfare investment limits and establishing or closing a branch. Regarding subsidiaries, the preamble to the proposed rule provides that a covered savings association would be prohibited from operating a service corporation, which is a type of subsidiary that may engage in a broader range of activities than the association itself. Service corporations may be controlled by federal savings associations, but not national banks. However, national banks may establish operating subsidiaries which may only engage in activities that are permissible for national banks.

When must a covered savings association bring nonconforming subsidiaries, assets and activities into conformance with the requirements for national banks?

A covered savings association would have two-years from the effective date of an election to divest, conform or discontinue any non-conforming subsidiaries, assets or activities. The OCC is authorized to grant four extensions of two years each to the original two-year conformance period, which ensures that a covered savings association cannot contain or continue a nonconforming asset, subsidiary or activity for more than 10 years after the effective date of an election.

The preamble to the proposed rule gives an example of when an extension may be granted by the OCC. In the example, a service corporation subsidiary of a covered savings association owns nonconforming real estate in a market experiencing weak demand. Rather than requiring the covered savings association to sell the real estate at a loss and dissolve the service corporation within the required two-year conformance period, the OCC could instead grant an extension to allow market conditions to improve.

May a federal savings association terminate its election to operate as a covered savings association?

A covered savings association may terminate its election, after an appropriate period of time determined by the OCC, by submitting a notice to the appropriate OCC supervisory office. The OCC considers an appropriate period of time as 60 or 90 days after the request for termination.

Generally, the procedures for terminating an election would mirror the procedures for making an election as described above. As with making an election, a covered savings association must notify the OCC in writing of the election termination, provide a list of nonconforming subsidiaries, assets and activities that would not be permissible for a federal savings association and bring into compliance its nonconforming subsidiaries, assets and activities with the requirements for a federal savings association

within the same two-year conformance period (subject to the same rules regarding extensions of this period). The federal savings association would also not be permitted to continue lending activities that would cause the savings association to violate the QTL test.

A federal savings association that terminates its election would be permitted to reelect to operate as a covered savings association if at least five years have elapsed since the termination.

III. Planning Considerations

Section 5A of HOLA should be beneficial for many federal savings associations that want greater flexibility to pursue a business strategy of increasing commercial or consumer lending without the limitations imposed by HOLA (including complying with the QTL test) and the additional burden and expense of a charter conversion. In this regard, it would have been a lot easier for federal savings associations to exercise national bank powers if Congress or the OCC just simplified the charter conversion process since the OCC currently regulates all federal savings associations. Federal savings associations should, however, consider the following before electing to operate as a covered savings association:

- Boards and management should understand the key differences between federal savings association and national bank powers and restrictions. Although a national bank may engage in a wider range of lending activities than a federal savings association, a covered savings association's subsidiary activities would be limited in ways that a federal savings association's subsidiary would not. For example, some activities that a federal savings association may conduct in a service corporation, such as acquiring real estate for development, would no longer be available to a covered savings association because such activities are not permissible for national banks.

- The federal savings association should identify its subsidiaries, assets and activities that do not conform to the requirements of a national bank and establish a plan to divest or cease such nonconforming investments or activities. Boards and management should consider the costs and potential financial harm to a federal savings association for divesting, conforming or discontinuing nonconforming subsidiaries, assets and activities before making an election.

- Notwithstanding an election under Section 5A of HOLA, a covered savings association operating in New York State would still be precluded from accepting public and municipal deposits. New York General Municipal Law restricts the deposits of local government funds to state-chartered commercial banks and national banks authorized to do business in the State of New York. Although a covered savings association would have national bank powers, it would still have a savings association charter and would not be considered a national bank for purposes of New York General Municipal Law.

- Management of each federal savings association that is interested in becoming a covered savings association should informally meet with the OCC before making an election, particularly if the federal savings association has non-conforming subsidiaries, assets and activities or is operating under an outstanding enforcement action or has unresolved examination matters requiring attention.

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