

---

## **LEGAL UPDATES AND NEWS**

---

### **OCC Issues Final Rule to Allow Certain Federal Savings Associations to Elect to Operate with National Bank Powers**

---

The Office of the Comptroller of the Currency (“OCC”) issued a final rule (the “Final Rule”) implementing Section 206 of the Economic Growth, Relief and Consumer Protection Act of 2018, which added a new Section 5A to the Home Owners’ Loan Act (“HOLA”). The Final Rule, which becomes effective July 1, 2019, permits a federal savings association with total consolidated assets of \$20 billion or less as of December 31, 2017 to elect to become a “covered savings association.” Such election will generally allow a federal savings association to operate with national bank powers without converting to a national bank charter, including not being required to meet the lending limitations applicable federal savings associations or satisfy the qualified thrift lender (“QTL”) test. A covered savings association, however, would become 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 that are not permissible for national banks. A summary of the Final Rule is described below.

#### **Holding Companies -- Not So Fast**

While the Final Rule is great news for federal savings associations, significant interpretive questions remain as to how it may be utilized by institutions in the holding company format (both stock or mutual holding companies). Specifically, the Final Rule does not address a requirement in HOLA that the subsidiary savings association of a savings and loan holding company meet the QTL test (or be subject to a host of operating restrictions and potentially be required to convert to a bank holding company). The preamble to the Final Rule recognizes this issue by noting that the OCC will continue to consult with the Federal Reserve on interpretative issues regarding the application of new Section 5A to savings and loan holding companies and states that institutions should direct any questions regarding such issues to the Federal Reserve Board. We have discussed this matter with Federal Reserve Board staff and they are currently reviewing the Final Rule and its possible effect on savings and loan holding companies. However, they have not provided further guidance on the issue. While it is possible for the Federal Reserve to take the position that a legislative fix is required to address this oversight, we hope it will be able to find a solution to this problem without requiring new legislation.

#### **Summary of the Final Rule**

##### **Who is eligible to elect become a covered savings association?**

A federal savings association in either mutual or stock form 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 will use an association’s Call Report submitted for December 31, 2017 to determine total consolidated assets, and the association can continue to operate as a covered savings association even if its total consolidated assets exceed \$20 billion after the election is made. Note that if a federal savings association’s total consolidated assets were \$20 billion or less on December 31, 2017, but increased above that threshold after that date, it may still elect to become a covered savings association.

The Final 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 to operate as a covered savings association. 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 the OCC. The notice must be signed by a duly authorized officer of the association and identify the association's assets, subsidiaries and activities that do not conform to applicable rules and regulations for national banks. The election would take effect automatically on the 60<sup>th</sup> day after the OCC receives the election notice.

A federal savings association may elect to become a covered savings association, regardless of its condition at the time of election. The proposed rule would have permitted the OCC to notify a federal savings association in writing that it was not eligible to make an election to become a covered savings association if the association did not meet certain criteria, such as being well capitalized, having a CAMELS rating of 2 or greater or not being subject to an enforcement action. These criteria were eliminated from the Final Rule to streamline the election process and increase the number of institutions that can elect to operate as covered savings associations. The OCC indicated that it will use existing supervisory and enforcement mechanisms to address any concerns arising from an association's election, regardless of the condition of the institution at the time of 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 may engage in any activity that is permissible for a similarly located national bank, subject to the same authorization, terms and conditions applicable to such a national bank. For example, a covered savings association is not subject to the QTL test and other lending restrictions under HOLA, including limits on aggregate loans secured by nonresidential real property, and certain affiliate transaction requirements applicable to a federal savings association but not a national bank.

***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 purposes: (1) of governance, including charter and bylaws, board of directors, shareholders, members and payment of dividends and (2) corporate changes, such as a merger, consolidation, dissolution, charter conversion, conversion from mutual to stock form, conservatorship and receivership. The Final Rule provides that certain federal savings association rules and regulations would continue to apply to a covered savings association, including regulations applicable only to mutual savings associations; and rules of practice and procedure, such as for adjudicative, investigative and formal examination proceedings.

The Final Rule, however, confirms that a covered savings association must comply with national bank rules and regulations with respect to subsidiaries, public welfare investment limits and branching restrictions, but will be able to continue to operate all branches in operation on the effective date of the

election. Regarding subsidiaries, 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 engage only 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 may grant up to four two-year extensions beyond the original two-year conformance period, which means that a covered savings association may not continue to hold a nonconforming asset or subsidiary or engage in a nonconforming activity for more than 10 years after the effective date of an election. Before granting an extension, the OCC must determine that: (1) the covered savings association made a good faith effort to divest, conform or discontinue the non-conforming subsidiary, asset or activity; (2) divestiture, conformance or discontinuance would have a material adverse financial effect on the covered savings association; and (3) retention or continuation of the non-conforming subsidiary, asset or activity is consistent with the safe and sound operation of the covered savings association.

**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 by submitting a notice to OCC. 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 a two-year conformance period (subject to the same rules regarding extensions described above). The federal savings association would also not be permitted to continue lending activities that would cause the savings association to fail 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.

**Planning Considerations**

Section 5A of HOLA should be beneficial for many federal savings associations that want greater flexibility to increase 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. Boards and management of federal savings associations, however, should consider, evaluate or do the following before electing to operate as a covered savings association:

- 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.

- Identify any 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. Assess the costs associated with 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.
- Meet informally with the OCC before making an election, particularly if a 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.
- The impact of making a covered savings association election on its stock or mutual holding company status. As noted above, HOLA was not amended to exempt subsidiary savings associations of federal stock and mutual holding companies from being QTLs, and the Federal Reserve has not yet provided any guidance on this issue. Hopefully, guidance will be forthcoming as federal savings association subsidiaries of holding companies apply for covered savings association status.

\* \* \* \* \*

[Luse Gorman, PC](#) is a Washington, D.C based law firm specializing in the representation of financial institutions. We advise clients located throughout the nation, ranging in size from small community-based financial institutions to multinational banks. This newsletter is being provided by Luse Gorman, PC for information purposes only and is not intended and should not be construed as legal advice. Please contact any of our attorneys below if you have any questions regarding the information contained in this newsletter.

<b>Eric Luse</b>	■ (202) 274-2002 <a href="mailto:eluse@luselaw.com">eluse@luselaw.com</a>
<b>John J. Gorman</b>	■ (202) 274-2001 <a href="mailto:jgorman@luselaw.com">jgorman@luselaw.com</a>
<b>Lawrence M.F. Spaccasi</b>	■ (202) 274-2037 <a href="mailto:lspaccasi@luselaw.com">lspaccasi@luselaw.com</a>
<b>Kip Weissman</b>	■ (202) 274-2029 <a href="mailto:kweissman@luselaw.com">kweissman@luselaw.com</a>
<b>Kent Krudys</b>	■ (202) 274-2019 <a href="mailto:kkrudys@luselaw.com">kkrudys@luselaw.com</a>
<b>Jeffrey Cardone</b>	■ (202) 274-2033 <a href="mailto:jcardone@luselaw.com">jcardone@luselaw.com</a>
<b>Gary Lax</b>	■ (202) 274-2031 <a href="mailto:glax@luselaw.com">glax@luselaw.com</a>
<b>Joseph Daly</b>	■ (202) 274-2034 <a href="mailto:jdaly@luselaw.com">jdaly@luselaw.com</a>