HAWAIIAN ELECTRIC INDUSTRIES, INC. · PO BOX 730 · HONOLULU, HI 96808-073

(14)

February 7, 2001

Via Facsimile and U.S. Mail
Fax: (202) 906-7755

Manager
Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G. Street, N.W.
Washington, DC 20552

RE: Comment on Docket No. 2000-91; Savings and Loan Holding Companies Notice of Significant Transactions or Activities and OTS Review of Capital Adequacy

Dear Ladies and Sirs:

We are writing in response to the captioned notice of proposed rulemaking and the invitation of the Office of Thrift Supervision ("OTS") to comment upon it.

For the reasons set forth herein, we strongly oppose adoption of the proposed regulation. In summary, those include the following: (1) there is no recognized or compelling risk requiring the intervention of new regulations for thrift holding companies; (2) the proposed regulations are unfair and confiscatory with respect to unitary thrift holding companies because they may prohibit activities that were expressly permitted at the time these companies were encouraged by federal agencies to acquire distressed thrifts; (3) the adoption of the proposed regulations will devalue the thrift charter, discourage the investment of new capital, encourage holding companies to dispose of their savings

institution subsidiaries and undercut the government's interest in having failing institutions acquired by well-capitalized entities; and (4) the proposed regulations constitute unwarranted and unnecessary regulatory intrusions upon the business judgments of holding companies and their subsidiaries.

I.

Background on the Commentators

American Savings Bank, F.S.B. ("ASB"), is a wholly-owned federal savings bank subsidiary of its intermediate parent, HEI Diversified, Inc., and its top-tier parent, Hawaiian Electric Industries, Inc. (collectively "HEI").

ASB is the third largest financial institution and the largest thrift in the State of Hawaii, with sixty-eight branches serving over half a million customers. As of the end of December 2000, ASB had assets of $6.0 billion and deposit liabilities of $3.6 billion. ASB, under its present federal thrift charter and previously as American Savings and Loan Association (Hawaii Division), has served the Hawaii community continuously since 1925. Through its retail emphasis and competitively-priced banking services and loans, ASB is a vigorous competitor to the two larger Hawaii commercial banks, Bank of Hawaii and First Hawaiian Bank.

HEI is a holding company with subsidiaries engaged in the electric utility, savings bank and power development businesses. HEI has been a registered savings and loan holding

company since 1988, and is therefore "grandfathered" under the Gramm-Leach-Bliley Act of 1999. See Home Owners' Loan Act ("HOLA"), Sec. 10; 12 U.S.C. § 1467(a)(9). HEI is a legal entity separate and distinct from its various subsidiaries. Its public utilities subsidiaries, Hawaiian Electric Company, Inc., Maui Electric Company, Limited, and Hawaii Electric Light Company, Inc., are highly regulated by the Public Utilities Commission of the State of Hawaii.

In the late 1980s, ASB's predecessor parent, American Savings and Loan Association, a Utah savings and loan, was in financial difficulty and a candidate for governmental takeover. In 1988, with the assent and strong encouragement of the Federal Home Loan Bank Board ("FHLBB"), HEI acquired ASB. As a condition of the acquisition, HEI executed a capital maintenance agreement, committing itself to infuse up to $65.1 million of capital to ASB. Over the years, HEI has invested over $195 million of capital in ASB to support ASB's growth. Today, the 1988 capital commitment has been reduced to its present level of $28.3 million.

II.

There is no Compelling Need for New Holding Company Regulations

The OTS is fully capable of addressing any safety and soundness risks to thrift subsidiaries posed by holding companies through current regulations.

In the "Supplementary Information" section of the proposal, two purported holding company "issues" were identified. First, the proposal asserts that savings associations "are subject to [holding company] decisions that are made with regard to the best interests of the corporate structure, often with little consideration of any potential positive or negative impact on the thrift standing alone." The proposal raised as concerns corporate affiliations "involv[ing] outsourcing of critical functions and cross-marketing of products."

Savings and loan holding companies and their affiliates are subject to comprehensive limitations on transactions with their subsidiary savings institutions, including transactions which involve the outsourcing of functions. Not only are affiliate transactions subject to the quantitative and qualitative restrictions of sections 23A and 23B of the Federal Reserve Act, but they are also subject to additional limitations on loans and investments in regard to affiliates that are set forth in 12 U.S.C. § 1468(a)(1). Moreover, the OTS is authorized to impose additional restrictions on any transaction between a savings association and any affiliate of the savings association that the OTS determines is necessary to protect the safety and soundness of the savings association. These regulatory requirements provide a comprehensive and effective means of ensuring that holding company decisions do not adversely impact thrift subsidiaries.

Furthermore, under section 10(p) of the HOLA, the OTS has the authority to limit affiliate transactions. Affiliate contracts are subject to regular examination by the OTS, and the OTS has the authority to set aside or require changes to affiliate contracts that do not meet regulatory requirements or that pose a safety and soundness concern.

As to the issue of the cross-marketing of products, the Gramm-Leach-Bliley Act and the regulations promulgated thereunder provide a comprehensive regulatory framework for addressing consumer privacy concerns. In addition, the OTS and other federal banking regulators already have adopted extensive and well-established regulations covering the marketing of deposit and loan products.

The second holding company issue identified by the proposal involves the holding company's capital needs. The proposal asserts that a variety of circumstances involving holding company decisions and operations can exert undue pressure on a thrift to meet the demands of the holding company's obligations or to fund its operations.

The proposal offers no specific examples or statistical evidence that holding company capital needs have created clear and present risks to thrift subsidiaries. The OTS has broad authority under its capital distribution regulations to monitor, evaluate and control the movement of capital from a thrift to its parent holding company. See OTS § 563.143. Hence, the present regulatory regime already provides the OTS the means to prevent a holding company from putting undue demands upon the thrift subsidiary to fund holding company capital needs. The OTS's concern in this regard appears to be based on the view that certain holding companies operate on a "consolidated basis" and that this, in turn, means that a holding company may make direct decisions regarding the types of business strategies that a thrift subsidiary will pursue without regard to the best interests of the thrift institution. We believe that unitary holding companies and their subsidiary thrifts are, in fact, very sensitive to the responsibility to operate the subsidiary thrift in a

prudent manner that protects the independent interests of the thrift. We do not believe that it is warranted or appropriate for the OTS to adopt a regulation based on the assumption that the directors and officers of a subsidiary savings institution are not aware of or responsive to their special obligations in regard to the operations of a federally insured savings institution notwithstanding their role in a holding company structure.

In our situation, HEI has been a ready and reliable source of capital for ASB – the exact opposite of the fear expressed in the proposal. As explained above, over the past twelve years, HEI has infused $195 million dollars of capital into ASB. Without HEI's support and access to the capital markets, ASB would not have been able to reach the levels of profitability, growth, and service to the public to which it has attained. Indeed, had HEI understood the extent to which new and unnecessary regulatory burdens would be placed upon it, it may not have taken the actions that it has.

Furthermore, under current regulations, the OTS receives sufficient holding company information. Relevant regulations that provide OTS current information on holding company activities include the requirement of audited financial reports for large thrifts and their holding companies, FIRREA Management letters, and the regular filing of H(b)-11 holding company reports. Moreover, OTS examiners regularly conduct a holding company examination of HEI.

III.

By These Proposed Regulations, the Federal Government Unfairly Reneges on Its Commitments to Unitary Thrift Holding Companies

During the 1980s, the thrift industry was in distress and the federal government actively solicited commercial businesses as potential buyers of these thrifts. Congress's exemption from the general restriction on savings and loan holding company activities for unitary holding companies, set forth in 12 U.S.C. § 1467a(c)(3), was an explicit recognition of the fact that these commercial businesses were, and in future years would continue to be, actively engaged in non-banking activities. The federal government induced commercial companies to acquire and invest capital in distressed thrifts with the understanding that such unitary holding companies and their non-thrift subsidiaries could continue their non-banking activities without restrictions.

This understanding was raised and acknowledged during the financial modernization debates leading to the enactment of the Gramm-Leach-Bliley Act. Senator Phil Gramm of Texas argued:

> During that period, we were desperate to try to get people to put money into troubled S&Ls to try to prevent the taxpayer from ending up paying billions of dollars in defaulted deposits.
>
> Most of these 22 thrifts were commercial companies that were enticed by the Office of Thrift Supervision—the Federal Home Loan Bank Board—to come in and buy troubled thrifts, to bring good management, and to bring in hard cash.

Commenting upon the "Johnson amendment's" restriction on the sale of unitary thrifts, Senator Gramm expressed the concern that a restriction upon the ability of unitary thrifts

to be acquired by commercial firms would depress the value of the holding company parents' substantial investments in once-troubled thrifts. This, he argued, would be in violation of the takings clause of the Constitution.[1] These same concerns are applicable to the proposed regulations, as they unfairly change for unitary holding companies the rules applicable to the ownership of their thrift subsidiaries.

Hawaiian Electric Industries would be directly impacted by these fairness concerns. In 1988, American Savings and Loan Association of Utah (the Hawaii division's parent) was operating under a supervisory agreement. When HEI was encouraged by the Federal Savings and Loan Insurance Corporation ("FSLIC") and the FHLBB to acquire ASB, there was no suggestion that the federal thrift regulator could limit HEI's future non-banking activities. The Regulatory Capital Maintenance/Dividend Agreement by and between FSLIC and HEI only required HEI to maintain the ASB's capital level and restricted HEI's ability to receive dividends from ASB. The Regulatory Capital Maintenance/Dividend Agreement placed no restrictions upon the activities of either HEI as a savings and loan holding company or upon the activities of its non-thrift subsidiaries. Had HEI known or suspected that the federal thrift regulator would restrict its future business activities, it would not have acquired ASB and invested millions of dollars in ASB's capitalization. The proposed regulations, if adopted, unfairly "changes the rules"

---

1 Senator Gramm's comments are found in the Congressional Record—Senate, for May 6, 1999, at S4833-34. Many federal courts have upheld the "takings" argument of thrift acquirers against the government in the FIRREA goodwill/capital maintenance lawsuits.

for HEI after it had made substantial commitments that ultimately benefited FSLIC and the federal government.

IV.

The Proposed Regulations Would Authorize a Regulatory Veto of Private Company Business Decisions

The proposed regulations would confer upon the OTS an unlimited, unchecked, and essentially unaccountable power to veto the business decisions of a thrift holding company and its non-thrift subsidiaries.

The proposal seemingly requires the OTS to act within a limited period after receiving notice – 30 days with an automatic right to request an additional 30 days for review, after which time, if no decision is made, the OTS is deemed to have no objection to the proposed activity. See proposed regulation § 584.150. However, this 60-day imperative for action is illusory because the first 30-day "clock" does not start until the OTS has deemed the notice to be complete. See proposed regulation § 584.150 ("You or your subsidiary may engage in the proposed transaction or activity thirty days *after OTS receives all required information* . . ."). When faced with a complex or unfamiliar activity or transaction, the OTS Regional Director, no matter how well-intentioned, will simply ask for more and more explanations and supplemental filings until he or she is satisfied that he or she understands the situation. Months might pass before the Regional Director simply deems the notice to be complete.

The OTS's authority to delay an activity or transaction for an unlimited period could adversely affect HEI and its non-thrift subsidiaries in several areas.

A. Facilities Contracts and Power Purchase Agreements

The core utility businesses are presently subject to the comprehensive review of the State of Hawaii's Public Utilities Commission ("PUC"). From time to time, the utilities enter into facilities leases and long-term power purchase agreements. Any untoward delay by the OTS could potentially result in the utilities losing these contracts notwithstanding their prior review and approval by the PUC.

B. Acquisitions and Sales

From time to time, HEI's non-thrift subsidiaries enter into agreements to acquire new businesses, or to expand or sell existing businesses. Examples of these types of transactions include agreements to build or operate power plants in foreign countries. Presumably, the OTS has no present expertise in these types of transactions. Were the OTS to delay its decision in order to become familiar with a pending transaction, the delay might cause the deal to be canceled by an impatient counter-party unsympathetic to the need of a banking regulator to review and to become comfortable with a non-banking transaction.

C. Financing

The utilities submit five-year budgets to the PUC, forecasting their financing needs and the timing, amount and terms of potential debt placements. Despite the utilities' best efforts, oftentimes financing plans must be changed quickly in response market conditions. Any failure to secure timely financing could adversely affect operations by reducing working capital and/or increasing financing costs. Again, the proposed regulations would require duplicative OTS review of these financing arrangements; the OTS will become, in essence, a secondary utility regulator without, however, the PUC's knowledge or expertise.

Furthermore, any delay in the OTS's approval of financing plans could adversely affect HEI and the utilities. HEI maintains a "shelf-registration" for several million dollars worth of medium-term notes. This shelf-registration permits HEI to respond quickly to changes in the financial markets and to lock in favorable rates when available. The proposal's notification requirement and waiting periods would delay the issuance of these medium term notes, possibly resulting in lost financing opportunities in a rising rate market.

An additional concern in this area is the fact that the proposed regulations do not define the types of transactions that would qualify as an incurrence of debt for purposes of potentially triggering a debt related notice. The absence of a clear definition has the potential to create significant confusion among both regulators and regulated entities and the prospect of widely varying implementations of the regulation.

In short, the power to delay is the power to disapprove. The proposed regulations would prevent holding companies from making quick and timely decisions, businesses would lose flexibility and opportunities, and holding companies would be unable to rely upon the business judgments of their boards of directors. Instead, the proposal interjects the OTS into the business decision-making process, giving the agency a *de facto* veto over any proposed transaction, and replacing sound business judgment with uncertain regulatory judgment in areas over which the regulator may have no expertise or familiarity. This regulatory intrusion into the business decisions of holding companies and their non-thrift subsidiaries is completely unwarranted and unauthorized by Congress under HOLA.[2] At a minimum, we recommend that the OTS structure any final regulation so that notices would not have to be given with respect to transactions involving a holding company or holding company affiliate that itself is subject to a significant level of supervision by another federal or state regulatory authority.

---

2 In addition, it is not wise for the OTS to create artificial financial standards that may be used or relied upon by the capital markets in ways that were unintended or unanticipated. For example, notwithstanding the OTS's suggestions to the contrary, we believe that a 10% tangible capital requirement for exemption from the applicability of certain holding company restrictions will become a *de facto* standard that capital markets, investors, creditors and others will apply. To the extent that such a standard may find its way into debentures, covenants and other financing terms that thrift holding companies are confronted with, the OTS should carefully evaluate all of the economic and financial impacts it may have.

V.

The Proposed Regulation Will Diminish the Attractiveness of the Thrift Charter And May Ultimately Lead to the Sale of Thrift Subsidiaries and Deprive Them of the Support Provided by Diversified Holding Company Parents

Several high-ranking federal banking officials have declared that thrift holding companies operating under the current regulatory regime pose no safety and soundness risk. According to Treasury Undersecretary John Hawke, "there is no history of problems attributable to the unitary holding company format." (Speech before the Association of American Law Schools, January 8, 1998).[3] OTS Director Ellen Seidman echoed this assessment, saying that, "So far, our experience with the relationship between a commercial or major financial entity and a subsidiary or affiliated thrift has been good, and devoid of any serious problems." (Speech before the Exchequer Club, January 21, 1998). Indeed, the OTS's own background papers have reached the same conclusion.[4]

We are unaware of any significant failures or other problems involving thrift holding companies or their thrift subsidiaries from January 1998 up until the present. We believe that the assessments made by Undersecretary Hawke and Director Seidman continue to

---

3 Mr. Hawke presently holds the office of the Comptroller of the Currency.

4 "As these figures show, the OTS experience with holding companies engaged in non-banking activities has been modest. Since the enactment of the savings and loan reform legislation in 1989 and the creation of OTS, unitary thrift holding companies have not as a class presented special supervisory problems." OTS, Historical Framework for Regulation of Activities of Unitary Savings and Loan Holding Companies, http://www.ots.treas.gov/docs/48035.html (Part II, 1999).

be just as germane today as when they were made – thrift holding companies simply do not pose a notable safety and soundness risk.

For all of the reasons stated above, we believe that the proposed regulations are unnecessary, unfair to unitary thrift holding companies, and are unwarranted regulatory intrusions upon business decisions.

Should the OTS nevertheless decide to adopt the proposed regulations over these objections and the objections raised by others, there is a strong likelihood that unitary thrift holding companies may sell or spin off their thrift subsidiaries. The thrift charter would become unattractive, investors would chose other financial entities for their capital, and there would be fewer institutions to serve consumers by carrying out the housing finance mission that Congress expressly encourages in HOLA.

Even more significant is the fact that the restrictions imposed by the proposed regulations are not in the best interests of the OTS or the FDIC. As the OTS well knows, it and its predecessor, the FHLBB, were actively soliciting interest in failed savings institutions in the 1988-1992 period, often trying to attract diverse companies with the requisite amount of capital, capacity and stature to acquire and operate failed institutions. To the extent that OTS transforms holding company status into an assurance of unending regulatory interference with normal business activities, those companies will not be there when the government next needs them. In this regard, we believe that the OTS should consult with investment bankers with expertise in acquisition issues and valuation matters to obtain

their insights as to the likely adverse impact of the Notice and Approval Requirement on the willingness of potential acquirors to purchase either troubled or healthy thrifts.

Sincerely,

Robert F. Mougeot
Financial Vice President, Treasurer and Chief Financial Officer
Hawaiian Electric Industries, Inc.

Stanley K. W. Chong
General Counsel and Vice President
American Savings Bank, F.S.B.