Fried, Frank, Harris, Shriver & Jacobson
1001 Pennsylvania Avenue, NW, Suite 800
Washington, DC 20004-2505
Tel: 202.639.7000
Fax: 202.639.7003 (4) (8)
www.ffhsj.com

15

VIA FACSIMILE AND HAND DELIVERY

Direct Phone: 202.639.7200

February 7, 2001

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

Attention: Docket No. 2000-91

Dear Sir or Madam:

We appreciate the opportunity to submit comments to the Office of Thrift Supervision ("OTS") in regard to its proposed rulemaking entitled "Savings and Loan Holding Companies Notice of Significant Transactions or Activities and OTS Review of Capital Adequacy" ("Proposal").[1] This letter is written on behalf of a client that is a unitary savings and holding company with grandfathered status under the Gramm-Leach-Bliley Act ("unitary holding company").[2]

The principal feature of the Proposal is to impose a regulatory requirement on a savings and loan holding company, subject to certain limited exceptions, to provide prior notice to OTS of its intention to engage in: (i) certain debt transactions, (ii) certain transactions that reduce capital, and (iii) certain asset acquisitions. Under the Proposal, OTS would have the authority to disapprove or condition a proposed activity or transaction that is the subject of a notice. Together this aspect of the Proposal is referred to as the "Notice and Approval Requirement."

1 65 Fed. Reg. 64,392 (proposed Oct. 27, 2000) (Docket No. 2000-91).

2 Pub. L. No. 106-102, § 401, 113 Stat. 1338, 1435 (1999) (codified at 12 U.S.C. § 1467a(c)(9)(C)).

We believe that under any reasonable analysis of section 10 of the Home Owners' Loan Act ("HOLA")[3] and the Administrative Procedure Act ("APA"),[4] it is clear that OTS: (i) lacks the statutory authority to impose the Notice and Approval Requirement on a unitary holding company; and (ii) even assuming OTS has the requisite statutory authority, the proposed Notice and Approval Requirement would be struck down as arbitrary and capricious as OTS clearly has not demonstrated why it is necessary, or how it addresses OTS's purported reasons for adopting the requirement.[5]

First, it is clear that the HOLA does not confer authority on OTS to promulgate the Notice and Approval Requirement. In this regard, we recognize that Congress has conferred broad authority on OTS to regulate and supervise savings institutions, particularly the federal savings institutions that it charters and as to which it has been said to exercise "cradle to . . . corporate grave" authority.[6] In contrast, Congress has given OTS only carefully prescribed authority over unitary holding companies. That authority allows OTS to exercise authority over the operations of unitary holding companies only in certain limited circumstances. As discussed in detail below, the authority Congress granted to OTS does not support OTS's position in the Proposal that it is authorized to promulgate and implement the Notice and Approval Requirement.

---

3 12 U.S.C. § 1467a.

4 5 U.S.C. §§ 551-559, 701-706.

5 Under the APA, a reviewing court shall

> (2) hold unlawful and set aside agency action, findings, and conclusions found to be -
>
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
>
> . . .
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.

Id. § 706(2)(A), (C).

Our comment letter does not address the discussion in the Proposal regarding the possibility that the OTS may seek to adopt a regulation regarding holding company capital requirements since the Proposal does not set forth the proposed provisions of such a regulation or the authority under which it would purport to be promulgated. *See* 5 U.S.C. § 553(b)(3) (mandating that notice of a proposed rule include "either the terms or substance of the proposed rule or a description of the subjects and issues involved"). In our view, OTS would have to initiate a separate rulemaking proceeding in order to adopt a regulation establishing holding company capital requirements. *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35-36 (D.C. Cir. 1977) ("an agency proposing informal rulemaking has an obligation to make its views known to the public in a concrete and focused form so as to make criticism or formulation of alternatives possible").

6 *See California v. Coast Federal Savings and Loan Association*, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

Second, we believe that apart from OTS's lack of statutory authority to promulgate the Notice and Approval Requirement, the Proposal fails to establish an adequate foundation for the actions it seeks to implement and the burdens it seeks to impose on unitary holding companies. In that regard, it would constitute arbitrary and capricious agency action. As discussed below, OTS's own statements and actions plainly contradict any claim in the proposal that the operation of unitary holding companies presents a meaningful threat to their subsidiary savings institutions. Furthermore, the threats that OTS describes are already directly addressed by applicable laws and regulations and are not, in fact, addressed by the Notice and Approval Requirement.

I. OTS Lacks the Statutory Authority to Promulgate the Notice and Approval Requirement

A. Analysis of the Notice and Approval Requirement Proposal

Under the APA, a reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be . . . in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."[7] The Proposal provides only a brief discussion of OTS's position regarding its authority to promulgate the Notice and Approval Requirement.[8] That discussion states that OTS bases the rulemaking on its extensive statutory authority over savings and loan holding companies under section 10 of the HOLA.[9] The Proposal goes on to state that OTS, for example, is authorized to issue regulations or orders, as are necessary and appropriate to carry out section 10 of the HOLA, and also has general statutory authority to prescribe regulations necessary to carry out all provisions of the HOLA.

Accordingly, for purposes of providing a legal foundation for the Notice and Approval Requirement, OTS relies exclusively on the authority granted to it by Congress under section 10 of the HOLA. Despite this reliance on section 10, the Proposal does not, however, cite any specific provision of section 10 (apart from the mere recitation of the authority in section 10(g)(1) to issue regulations[10]) that could be construed to give OTS the dramatic new authority it purports to implement through the Notice and Approval Requirement.

In fact, OTS's sole reference to specific provisions of section 10 comes in the form of a discussion of sections 10(g)(5) and 10(p). Rather than citing these sections as support for the

---

7 5 U.S.C. § 706(2)(C).

8 65 Fed. Reg. at 64,393.

9 12 U.S.C. § 1467a.

10 Section 10(g)(1) states that "[t]he Director is authorized to issue such regulations and orders as the Director deems necessary or appropriate to enable the Director to administer and carry out the purposes of this section, and to require compliance therewith and prevent evasions thereof." *Id.* § 1467a(g)(1).

Notice and Approval Requirement, OTS provides the following discussion of the relevance of these sections to the Proposal:

> OTS notes that sections 10(g)(5) and 10(p) of the HOLA expressly permit OTS to restrict the ability of savings and loan holding companies to continue to conduct certain activities. 12 U.S.C. 1467a(g)(5) and (p). In this regard, the focus of the proposed rule and sections 10(g)(5) and (p) are entirely different. The proposed notice is primarily preventive. It is designed to permit OTS to review proposed activities and to prevent a savings and loan holding company (or its affiliates) from undertaking new, risky activities. On the other hand, sections 10(g)(5) and 10(p) are remedial. These statutes are designed to allow OTS to require corrective action when established, ongoing activities threaten the safety and soundness of a subsidiary thrift.[11]

---

[11] 65 Fed. Reg. at 64,393 n.6.

Section 10(g)(5) states:

(5) Cease and desist orders
(A) Notwithstanding any other provision of this section, the Director may, whenever the Director has reasonable cause to believe that the continuation by a savings and loan holding company of any activity or of ownership or control of any of its noninsured subsidiaries constitutes a serious risk to the financial safety, soundness, or stability of a savings and loan holding company's subsidiary savings association and is inconsistent with the sound operation of a savings association or with the purposes of this section or section 1818 of this title, order the savings and loan holding company or any of its subsidiaries, after due notice and opportunity for hearing, to terminate such activities or to terminate (within 120 days or such longer period as the Director directs in unusual circumstances) its ownership or control of any such noninsured subsidiary either by sale or by distribution of the shares of the subsidiary to the shareholders of the savings and loan holding company. Such distribution shall be pro rata with respect to all of the shareholders of the distributing savings and loan holding company, and the holding company shall not make any charge to its shareholders arising out of such a distribution.

12 U.S.C. § 1467a(g)(5)(A).

Section 10(p)(1) states:

(p) Holding company activities constituting serious risk to subsidiary savings association
(1) Determination and imposition of restrictions
If the Director determines that there is reasonable cause to believe that the continuation by a savings and loan holding company of any activity constitutes a serious risk to the financial safety, soundness, or stability of a savings and loan holding company's subsidiary savings association, the Director may impose such restrictions as the Director determines to be necessary to address such risk. Such restrictions shall be issued in the form of a directive to the holding company and any of its subsidiaries, limiting--
(A) the payment of dividends by the savings association;

In our view, the foregoing paragraph succinctly presents the fundamental flaw in the Notice and Approval Requirement. Congress, in the exercise of its authority, decided what authority over unitary holding company operations it would give to OTS. As a result, OTS is able to point to *express* authority that it has been given by Congress under section 10 of the HOLA. That authority, as OTS recognizes, is limited. It is strictly remedial in form.

Congress, however, has not given OTS any express authority for OTS to act in a "preventive" manner with respect to holding company operations. The Proposal indicates that OTS believes that in the absence of congressional action, it has the authority to fill what it now believes to be a gap left by congressional inaction. In our view, this approach reflects a fundamental misunderstanding of the relative roles of Congress and OTS. It is Congress, not OTS, that establishes the parameters of OTS's authority over holding companies.

In the Proposal, OTS, in effect, concedes the following points regarding its authority with respect to the Notice and Approval Requirement:

- First, Congress in section 10 of the HOLA has expressly addressed the scope of authority over holding company operations by OTS.[12]

- Second, in doing so, Congress expressly conferred on OTS the *remedial* authority contained in sections 10(g)(5) and 10(p).[13]

- Third, Congress has *never* granted any express authority to OTS to take preventive action with respect to holding company operations.[14]

(B) transactions between the savings association, the holding company, and the subsidiaries or affiliates of either; and
(C) any activities of the savings association that might create a serious risk that the liabilities of the holding company and its other affiliates may be imposed on the savings association.
Such directive shall be effective as a cease and desist order that has become final.

12 U.S.C. § 1467a(p)(1).

12 *See* 65 Fed. Reg. at 64,393 (stating that "OTS bases this rulemaking authority on its extensive statutory authority over savings and loan holding companies under section 10 of the Home Owners' Loan Act (HOLA)").

13 *See id.* n.6.

14 *See id.*

- Fourth, OTS itself recognizes that the Notice and Approval Requirement is not remedial, but rather is preventive.[15]

In our view, OTS's reliance upon its rulemaking authority in section 10, to extend the statute beyond the limits of what Congress enacted, is the profile of a rulemaking proceeding in excess of an agency's statutory authority.[16] Indeed, under OTS's theory, there is almost no regulation that it could promulgate regarding holding companies that would run afoul of its statutory authority. As discussed further below, we believe that a court would conclude that the promulgation of the Notice and Approval Requirement is invalid on the basis that OTS exceeded the authority conferred to it under section 10 of the HOLA.

B. Authority Conferred On OTS Under Section 10 of the Home Owners' Loan Act

A fair review of the powers Congress granted to OTS under section 10 of the HOLA in regard to unitary holding companies, as described in Appendix A to this letter, demonstrates that Congress did not give OTS the type of plenary authority over unitary holding companies and their non-savings institution subsidiaries that it gave OTS over savings institutions. Section 10 does not contain any provision that grants OTS a general authority to intervene in the non-thrift business activities and operations of unitary holding companies. While Congress, in section 10, has given OTS the authority to require reports by unitary holding companies and to examine and investigate such holding companies, any authority under section 10 to affirmatively intervene in the operations of unitary holding companies is confined to sections 10(g)(5) and (p). As discussed above, the authority provided by those sections is strictly remedial in nature.

An understanding of how Congress limited the authority it gave to OTS over unitary holding company activities is enhanced by a review of certain actions taken by Congress in connection with the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA").[17] Section 10 was enacted as part of FIRREA. It largely consisted of the transfer of provisions of the prior Savings and Loan Holding Company Act, including the rulemaking authority that is now set forth in section 10(g)(1) and the cease and desist authority that is now set forth in section 10(g)(5).[18]

---

15 *See id.*

16 *See American Petroleum Inst. v. EPA*, 52 F.3d 1113, 1119 (D.C. Cir. 1995) (reviewing EPA regulation to determine whether its promulgation was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law").

17 Pub. L. No. 101-73, 103 Stat. 183 (1989).

18 This authority was previously codified at 12 U.S.C. § 1730a(h)(1), (5) (1988).

An important addition was made to section 10 as part of FIRREA. During the consideration of FIRREA, Congressman Leach on the floor of the House of Representatives offered a motion that included the substance of what ultimately became section 10(p). Section 10(p) authorizes OTS to limit: (i) the payment of dividends by a subsidiary savings association, (ii) transactions between the savings association and its affiliates, or (iii) any activities of the savings association that might create a risk that affiliate liabilities may be imposed on the savings association, where there is reasonable cause to believe that continuation by a holding company of an activity constitutes a serious risk to the financial safety, soundness, or stability of the subsidiary savings association. In offering his motion, Congressman Leach told the House that his section 10(p) proposal "gives the Federal thrift regulators stronger oversight power over thrift holding companies."[19] Congressman Leach's statement is in direct opposition to the position that OTS has taken in regard to its authority to promulgate the Notice and Approval Requirement.

Although OTS has argued that it has "extensive statutory authority over savings and loan holding companies under section 10" of the HOLA,[20] it is clear that Congressman Leach believed OTS (as successor to the Federal Home Loan Bank Board ("FHLBB")) required further statutory authorization before it could take the remedial actions set forth in Section 10(p), notwithstanding the rulemaking authority that Congress had already conferred on the FHLBB in regard to holding companies. Thus, the decision of Congress to enact section 10(p) must be read as a considered judgment to provide OTS with an incremental increase in its already existing cease and desist authority now contained in section 10(g)(5) to take remedial action where a specific threat posed by actual activities of a holding company to a subsidiary savings institution is demonstrated by OTS. At the same time, it flatly contradicts any claim that Congress had given the FHLBB or OTS a general authority beyond that expressed in law to intervene in the business activities and operations of unitary holding companies.

In fact, through FIRREA, Congress actually withdrew authority over holding companies that it had previously granted to the FHLBB and which OTS is now attempting to regain by an unauthorized rulemaking action. Prior to FIRREA, nondiversified holding companies were required to obtain FHLBB approval to incur debt in excess of certain limits.[21] In enacting section 10 of the HOLA in FIRREA, Congress eliminated any role for OTS to control debt incurred by any type of holding company.

There is, of course, nothing remarkable in stating that OTS has only limited authority to regulate the business activities and operations of unitary holding companies. In fact, until the Proposal was published, the absence of OTS authority to intervene, except in limited statutorily-

---

19 135 Cong. Rec. H 2797 (daily ed. June 15, 1989).

20 65 Fed. Reg. at 64,393.

21 12 U.S.C. § 1730a(g) (1988).

prescribed circumstances, in the activities and business operations of unitary holding companies, was consistent with OTS's own statements to Congress.[22] For example, in October 1997, then OTS Director Nicolas Retsinas in testimony before a House Banking Committee subcommittee stated as follows:

> Although SLHCs are not generally subject to activity restrictions, nor capital requirements, the interaction and relationships between the subsidiary thrift institution, the SLHC and its affiliates are monitored closely. In this manner, we attempt to ensure that a holding company (and its affiliates) will not adversely impact a subsidiary thrift. . . . The SLHC is also subject to examination and intervention in the event that its (or an affiliate's) operations appear to threaten a thrift's safety and soundness. *Otherwise, the SLHC generally is free of government intrusion into its operations.*[23]

Similarly, OTS Director Seidman in June 1998 testimony before the Senate Banking Committee has acknowledged the express intention of Congress to leave unitary holding companies free from OTS interference in their activities.

> Whereas Congress chose to restrict bank holding company ("BHC") activities and thereby enforce a separation between banking and commerce in the BHC structure, the focus in the SLHC context was to place limits on the subsidiary thrift. In exchange for permitting a unitary SLHC *to engage in any legitimate business activity*, the commercial lending activities of its subsidiary thrift are limited and the institution must maintain a focus on mortgage and other consumer lending activities . . . .[24]

---

22 *Cf. Railway Labor Executives' Ass'n v. National Mediation Bd.*, 29 F.3d 655, 669 (D.C. Cir. 1994) ("We find it telling that only in the last five years of its sixty-year history has the Board claimed that [the statute] affords it the authority to [take the proposed action]. The Board fails to point to anything in its pre-Merger Procedures history that so much as hints at the existence of such 'latent' authority. As such, the Merger Procedures are much more than a midstream change in course; they are a wholesale attempt to rewrite the statute and history.").

23 Prepared Statement of Nicolas Retsinas, Director, Office of Thrift Supervision, Before the Subcomm. on Financial Institutions and Consumer Credit of the House Comm. on Banking and Financial Services (Oct. 8, 1997) (emphasis added).

24 Prepared Statement of Ellen Seidman, Director, Office of Thrift Supervision, Before the Senate Comm. on Banking, Housing and Urban Affairs (June 25, 1998) (emphasis added).

C. Case Law Applicable to the Proposed Notice and Approval Requirement

The APA requires a reviewing court to set aside agency action that is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right." 5 U.S.C. § 706(2)(C). An administrative agency's power to promulgate regulations is limited to the authority statutorily delegated by Congress. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988); *Railway Labor Executives' Ass'n v. National Mediation Bd.*, 29 F.3d 655, 670-71 (D.C. Cir. 1994) (en banc). Challenges to an agency's interpretation of its authority under a statute are analyzed under the two-part test formulated by the Supreme Court in *Chevron U.S.A. Inc. v. Natural Resources Defense Counsel*, 467 U.S. 837, 842-43 (1984). Under the *Chevron* doctrine, a court reviewing an agency's interpretation of a statute first must determine "whether Congress has directly spoken to the precise question at issue." *Chevron*, 467 U.S. at 842-43. If Congress's intent is clear, "that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.*

If, however, a court determines that the statute is silent or ambiguous with respect to the precise issue, the court proceeds to the second step of the review, asking whether the agency's interpretation is based on a permissible construction of the statute. *Id.* at 843. Under this second step, the court may find either of two types of delegations. If Congress has explicitly left a gap for the agency to fill, there is an express delegation of authority to the agency to regulate. Courts must give such legislative regulations "controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Id.* at 844. If the delegation to an agency on a particular question is implicit rather than explicit, the court must accord considerable weight to the agency's construction of the statute, and it may not substitute its own construction of the statute for the agency's reasonable interpretation. *Id.* Although this review normally calls for a certain level of deference to an agency's interpretation, with respect to the precise question at issue here—whether Congress granted OTS the authority to issue the Notice and Approval Requirement—the case law discussed below indicates that OTS's Proposal oversteps its authority and would be struck down under the principles established by *Chevron*.

As discussed above, OTS argues that it has the statutory authority to promulgate the Notice and Approval Requirement based on section 10 of HOLA. OTS does not, however, cite any specific provision of section 10 that supports this authority, apart from its general authority to issue regulations that are "necessary and appropriate to carry out" the section. Indeed, OTS expressly distinguishes the specific provisions of section 10 that do, in fact, specify the limited authority OTS has over unitary holding company activities and operations. *See* 12 U.S.C. § 1467a(g)(5), (p). By OTS's own admission the "focus of the proposed rule and sections 10(g)(5) and (p) are entirely different."[25]

---

[25] 65 Fed. Reg. at 64,393 n.6.

Consequently, OTS appears to be trying to support its claim of implicit congressional authority to promulgate the Notice and Approval Requirement on two grounds: (i) because Congress has given it *some* power to regulate savings and loan holding companies and the general authority to promulgate regulations that are "necessary and proper" to effectuate that authority, it *must* have broader authority to act; and (ii) because Congress has not explicitly limited its authority to promulgate preventive measures, there must exist an implicit delegation to regulate in this way. Neither of these grounds will support the Proposal.

In *Railway Labor Executives' Association v. National Mediation Board*, the Court of Appeals for the D.C. Circuit rejected the arguments OTS appears to be making to support the Proposal. 29 F.3d 655 (D.C. Cir. 1994). At issue in *Railway Labor* was the extent of the authority Congress delegated to the National Mediation Board ("Board") to investigate and resolve representation disputes among a railway carrier's employees, pursuant to the Railway Labor Act. The Board had announced its intention to promulgate "revised procedures" under which representative proceedings could be initiated not just by a petition from a carrier's employee, as had previously been recognized, but also by a petition from a carrier itself, or on the Board's own initiative. It based these revised procedures on the theory that recent railroad mergers and acquisitions were likely to precipitate uncertainty as to the proper representation of employees. In other words, because the Board had certain recognized powers to investigate and resolve a representation dispute after receiving a petition by an employee concerned about confusion, the Board contended Congress also had granted it the power to take preventive action when it or a carrier concluded that there might be confusion among employees.

After reviewing the statute's plain language and legislative history, and the Board's previous interpretations and practice with regard to the statute, the D.C. Circuit determined that Congress gave the Board only very limited authority to investigate representation disputes. *Id.* at 658. Specifically, the court rejected the Board's contentions and found that Congress empowered the Board to initiate a representation investigation and resolve a dispute only upon the petition of one of the carrier's employees.[26] *Id.* at 670-71.

The D.C. Circuit characterized the Board's argument as amounting to the "bare suggestion that [the Board] possesses plenary authority to act within a given area simply because Congress has endowed [the Board] with some authority to act in that area." *Id.* at 670 (emphasis in original). In "categorically reject[ing]" the suggestion, the court stated that the "duty to act under certain carefully defined circumstances simply does not subsume the discretion to act under other, wholly different, circumstances, unless the statute bears such a reading." *Id.* at 671 (emphasis in original); *see also Ethyl Corp. v. EPA*, 51 F.3d 1053, 1060 & n.9 (D.C. Cir. 1995) (general grants of authority or broad statements of purpose do not trump the specific provisions

---

[26] While the Court in *Railway Labor* rejected the proposed procedures therein primarily on the basis of the Railway Labor Act itself, 45 U.S.C. § 152, that Court also expressly agreed that the procedures at issue violated the APA, in that the Board had exceeded its statutory authority in promulgating them. 29 F.3d at 659 n.1.

of a statute). Based on the language, structure, and legislative history of the Act, the *Railway Labor* court could not conclude that the limited power of the Board to resolve employee representation disputes in certain situations implied such power in every instance in which a question of representation arguably existed. *Railway Labor*, 29 F.3d at 671.

The *Railway Labor* court also expressly rejected the Board's argument that its interpretation of the statute should be given deference under step two of *Chevron* because Congress had not expressly prevented the Board from acting on its own on this point. Noting that agencies owe their capacity to act to the delegation of authority from the legislature, the court stated that

> To suggest, as the Board effectively does, that Chevron step two is implicated any time a statute does not expressly negate the existence of a claimed administrative power (i.e. when the statute is not written in "thou shalt not" terms), is both flatly unfaithful to the principles of administrative law outlined above, and refuted by precedent.

Id. (citing *Natural Res. Def. Council v. Reilly*, 983 F.2d 259, 266 (D.C. Cir. 1993); *accord American Petroleum Inst. v. EPA*, 52 F.3d 1113, 1120 (D.C. Cir. 1995) (striking down EPA regulations as beyond authority granted to EPA under the Clean Water Act) (citing *Railway Labor*, 29 F.3d at 671); *Ethyl Corp.*, 51 F.3d at 1060 (holding that EPA exceeded statutory authority under the Clean Air Act in considering public health effects on waiver applications when statute's only criteria was emission effects). If courts were always to presume that Congress intended to delegate power absent an express withholding of that power, the D.C. Circuit concluded that agencies would "enjoy virtually limitless hegemony, a result plainly out of keeping with Chevron and quite likely with the Constitution as well." *Railway Labor*, 29 F.3d at 671; *Ethyl Corp.*, 51 F.3d at 1060.[27]

---

[27] The absence of legal support for the Notice and Approval Requirement is further demonstrated by a memorandum issued by the Office of Legal Counsel of the Department of Justice that found that the federal banking agencies lacked the authority to issue regulations under the Community Reinvestment Act that would permit the agencies to take enforcement action against institutions that are found not to be in compliance with their obligations under banking agency regulations to meet the credit needs of their communities. Most relevantly, the memorandum rejects the argument that a general grant of rulemaking authority permits an administrative agency to issue regulations that go beyond the parameters of the express statutory authority that has been conferred on the agency.

> Agencies may only act pursuant to delegations of power that are explicit or can fairly be implied from the statutory scheme. See Railway Labor Executives Ass'n v. National Mediation Bd., 29 F.3d 655, 670-71 (D.C. Cir. 1994) (en banc).
>
> The CRA contains no express directive for the agencies to use any other modes of enforcement [apart from consideration of an applicant's CRA record in the application process], much less such coercive enforcement as

OTS's actions with regard to the proposed Notice and Approval Requirement are strikingly similar to the actions of the National Mediation Board that were struck down by the court in *Railway Labor*. In that case, the Board attempted to take preventive action (initiating investigations when the *Board* believed there was confusion over employee representation) despite the fact that its statutory authority contemplated only remedial powers (opening an investigation and resolving a dispute only upon the petition of an employee). OTS is proposing a similar course of action here. Moreover, OTS is relying upon the same theory unsuccessfully raised by the Board—the improper notion that a non-specific grant of authority to develop implementing regulations somehow justifies the exercise of new substantive authority in an area not covered by the governing statute.

Under section 10 of HOLA, Congress carefully delineated the authority OTS has over unitary holding companies. By the statute's plain language and the agency's own admission, this authority is remedial in form and not "preventive." As a result, for the reasons stated by the D.C. Circuit in *Railway Labor*, OTS does not have the authority to promulgate the Notice and Approval Requirement based on either (i) its limited powers to regulate unitary holding companies in certain strictly limited circumstances, or (ii) Congress's decision not to expressly withhold the claimed power.

> cease-and-desist orders and monetary penalties, and there is no basis for inferring such authority from any provision in the statute. The statute's only general grant of authority to the agencies is the authority to promulgate implementing regulations. We reject the argument that a delegation of broad enforcement authority can be inferred from the statute's delegation of authority to issue implementing regulations and the fact that the CRA does not explicitly state that the agencies may only sanction financial institutions through the application process. First of all, the authority to issue regulations is limited to "carry[ing] out the purposes" of the CRA, 12 U.S.C. § 2905, and those purposes are limited to requiring the agencies to "use [their] authority when examining financial institutions, to encourage such institutions to help meet the credit needs" of their communities, 12 U.S.C. § 2901(b) (emphasis added). More fundamentally, as the D.C. Circuit wrote recently, "[w]ere courts to presume a delegation of power absent an express withholding of such power, agencies would enjoy virtually limitless hegemony, a result plainly out of keeping with Chevron and quite likely with the Constitution as well." Railway Labor Executive Ass'n, 29 F.3d at 671 (emphasis in original).

Office of Legal Counsel Memorandum to Eugene A. Ludwig, Comptroller of the Currency (Dec. 15, 1994), at 4 (first bracketed material added; otherwise as in original).

II. The Notice and Approval Requirement Is Subject To Invalidation As An Arbitrary and Capricious Agency Action

In addition to OTS's lack of statutory authority to promulgate the Notice and Approval Requirement, we also believe OTS's proposed regulation would be struck down as arbitrary and capricious based upon an analysis of the rationale that OTS sets forth for the proposed regulation. As stated above, a reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). In this connection, although under the arbitrary and capricious standard of review "a court is not to substitute its judgment for that of the agency," the court must ensure that the agency has "examine[d] the relevant data and articulate[d] a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins.*, 463 U.S. 29, 43 (1983) (citing *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962)).

Expressly underlying OTS's Proposal is the concept that unitary holding company activities and operations pose a general threat to subsidiary savings institutions. While the Proposal suggests a number of potential scenarios where a holding company might adversely impact its subsidiary thrift, the Proposal does not meaningfully address the fact that existing statutes, regulations, and the fiduciary obligations of savings institution directors, officers, and employees already comprehensively address the types of concerns that are raised by OTS. Indeed, understanding the pervasive authority that OTS has over savings institution subsidiaries, it is unclear what activity a holding company can "cause" an institution to do that is not already regulated by OTS through its authority over savings institutions. Nor does the Proposal provide any meaningful empirical indication of the nature and the scope of the unaddressed problem that OTS seeks to combat with the Notice and Approval Requirement.[28] In fact, the Proposal refers to only two specific instances of supervisory problems that it links to holding company actions.[29] The first OTS concedes that it addressed by placing conditions on a branch purchase application, and the second, based on the facts set forth by OTS, turned on the decisions of the directors and officers of the savings institution, not the holding company, regarding the degree of risk that the institution was prepared to accept.

OTS's purported concerns regarding the threat posed by holding companies must be subject to close scrutiny in view of the testimony that OTS officials have given to Congress on the topic in recent years and Congress's clear withholding of the authority OTS attempts to bestow on itself by this proposal. In February 1999 testimony before the House Banking Committee, Director Seidman stated that: "[b]ased on our experience, there is no reason to

---

[28] In this regard, the OTS concedes that it does not know how often certain holding companies will engage in transactions subject to the Notice and Approval Requirement or how often the OTS will object to a transaction. *See* 65 Fed. Reg. at 64,398.

[29] *Id.* at 64,395-96.

believe that affiliations permitted in the unitary thrift holding company structure are inherently risky and should be constrained. In fact, there are numerous reasons to retain the structure in its current form."[30] Similarly in June 1998 testimony before the Senate Banking Committee, Director Seidman, in discussing the unitary holding company structure, observed that "[t]here is little evidence to suggest that, in the more than 30 years that it has been in existence, the unitary SLHC has created systemic problems . . . ."[31]

In July 1997 testimony before a House Commerce Committee subcommittee, then OTS Director Retsinas made the following statement:

> In our limited experience, we have found that affiliations between thrifts and commercial firms do not involve inherently greater risk to a thrift than affiliations between a thrift and a more traditional "financial services" company. In fact, since the implementation of FIRREA, it can be argued that the affiliation of thrifts with companies engaged in commercial activities has benefited thrifts more than it has their SLHC parents. In numerous instances, SLHCs with commercial interests have willingly added capital to a troubled thrift subsidiary. SLHCs that engage in diverse lines of business often have substantially greater financial resources than nondiversified companies. They have enhanced access to capital markets, diverse liquidity sources, and lower borrowing costs. SLHCs can also contribute business and managerial talent and expertise to a subsidiary thrift.[32]

Not only do we have the statements of OTS Directors to Congress clearly expressing the view that unitary holding companies have been a positive factor for the thrift industry, the available empirical evidence confirms that these companies have not been a source of supervisory problems to the thrift industry, but rather have provided significant benefits and support to their subsidiary savings institutions. These important points are captured in a statement by Senator Gorton during floor debate on the Gramm-Leach-Bliley Act.

---

30 Prepared Statement of Ellen Seidman, Director, Office of Thrift Supervision, Before the House Comm. on Banking and Financial Services (Feb. 12, 1999).

31 Prepared Statement of Ellen Seidman, Director, Office of Thrift Supervision, Before the Senate Comm. on Banking, Housing and Urban Affairs (June 25, 1998).

32 Prepared Testimony of Nicolas Retsinas, Director, Office of Thrift Supervision, Before the Subcomm. on Finance and Hazardous Materials of the House Comm. on Commerce (July 17, 1997).

> OTS has testified that commercial firms contributed more than $3 billion in capital to support thrift institutions in the 1980s.
>
> No safety and soundness issues have been presented by the unitary charter.
>
> In February 1999, the FDIC testified on the subject of financial modernization before the U.S. House Banking Committee. In its testimony, the FDIC argued that commercial companies have been a source of strength rather than weakness to the thrift industry and that limiting the non-financial activities of thrifts "would place limits on a vehicle that has enhanced financial modernization without causing significant safety-and-soundness problems."
>
> The combinations of thrift and commercial firms have compiled an exemplary safety and soundness record. During the height of the thrift crisis, the failure rate of commercially affiliated thrifts was approximately half that of other thrifts. Moreover, the federal thrift regulator has reported that only 0.3 percent of enforcement actions against thrifts and thrift holding companies from January 1, 1993 through June 30, 1997 were against holding companies engaged in non-banking activities. In short, the industry's experience with commercial affiliates has been the opposite of what the critics contend.[33]

In the Proposal, OTS 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."[34] The Proposal identified as specific concerns corporate affiliations "involv[ing] outsourcing of critical functions of the savings association and cross-marketing of products."[35] It is not, however, at all clear why the Notice and Approval Requirement is needed to address OTS concerns in these areas, or how, in fact, it would do so.

The transactions with affiliates requirements imposed by sections 10(d) and 11 of HOLA already provide a comprehensive and effective means of ensuring that interactions between a holding company or its affiliates and a subsidiary savings institution do not adversely impact the

---

[33] 145 Cong. Rec. S4833 (daily ed. May 6, 1999).

[34] 65 Fed. Reg. at 64.392.

[35] *Id.*

savings institution based on sections 23A and 23B of the Federal Reserve Act and the OTS's regulations thereunder.[36] Section 23B of the Federal Reserve Act requires that any "covered transaction," including the outsourcing of critical functions from a savings institution to a holding company, must be on terms and conditions to the savings institution that are at least market terms or better than market terms. These affiliate contracts are subject to regular examination and supervisory review by OTS. Furthermore, since the Notice and Approval Requirement would be triggered by increases in debt, reductions in capital, or asset acquisitions, it would not appear to bear any relation to OTS's concern about transactions between a subsidiary savings institution and its holding company affiliates.

Likewise, it is difficult to perceive how the Notice and Approval Requirements would address any concerns regarding cross-marketing of products since such activity would not trigger any notice filing requirements. Moreover, savings institutions already operate under a range of statutory and regulatory requirements in regard to cross-marketing of products, including the Interagency Statement on Retail Sales of Nondeposit Investment Products.

Furthermore, both of the foregoing concerns cited in the Proposal relate to actions that would directly involve savings institutions that would have to make decisions of their own in regard to such actions. Directors and officers of savings institutions are well aware of their obligations to ensure that their institution operates in compliance with applicable laws and regulations and in a safe and sound manner. The Proposal provides no basis for a conclusion that savings institutions' directors and officers would not properly discharge their obligations in situations that involve the institution's holding company or its affiliates. Indeed, it improperly presumes that they will not, and, therefore, regulatory intervention is required.

Another issue identified by the Proposal involves the holding company's funding needs. The Proposal asserts that "a holding company that makes risky investments that generate less than anticipated returns or result in losses [or that incurs excessive debt] can exert undue pressure on the thrift to meet the demands of its other obligations . . . [or to] look to the thrift to fund its operations."[37] In this area, the current OTS capital distribution regulations already provide ample means to control the flow of capital from the thrift to the holding company.[38] All thrift subsidiaries of savings and loan holding companies must file a notice with OTS before making a capital distribution, regardless of whether supervisory approval is required. There simply is no need to adopt the Notice and Approval Requirement to address capital distributions from a subsidiary savings institution to its parent holding company. Furthermore, OTS already has broad authority over savings institution activities and operations to monitor and address any concerns that it may have regarding the level of risk associated with such activities, or operations or changes in the relative degree of such risk.

---

[36] 12 C.F.R. §§ 563.41-.42.

[37] 65 Fed. Reg. at 64,392.

[38] 12 C.F.R. §§ 563.140-.146.

In short, on this record, we believe that OTS's adoption of the Proposal would constitute arbitrary and capricious regulatory action, which would subject the Notice and Approval Requirement to being struck down under the APA. As stated above, an agency rule will be set aside if the agency "has failed to provide a reasoned explanation, or where the record belies the agency's conclusion." *County of Los Angeles v. Shalala*, 192 F.3d 1005, 1021 (D.C. Cir. 1999), *cert. denied*, 120 S. Ct. 2197 (2000) (quoting *BellSouth Corp. v. FCC*, 162 F.3d 1215, 1222 (D.C. Cir. 1999)). OTS's Proposal fails both these tests. It clearly does not provide a reasoned explanation for the Notice and Approval Requirement. Moreover, in light of the recent congressional testimony of OTS officials described above, for OTS now to argue that unitary holding company activities and operations pose a general threat to subsidiary savings institutions is "counter to the evidence before the agency" and "is so implausible that it could not be ascribed to a difference in view of the product of agency expertise." *Id.* (noting possibility of arbitrary and capricious agency action based, in part, on Secretary of Health and Human Services's earlier statements that conflicted with the subsequent agency action and remanding to the Secretary for further proceedings) (quoting *State Farm*, 463 U.S. at 43).

Moreover, courts will carefully scrutinize an agency's departure from a longstanding policy implementing an agency's statutory mandate. In *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, the Supreme Court stated that "an agency changing its course by rescinding a rule is obligated to supply a reasoned analysis for the change beyond that which may be required when an agency does not act in the first instance." *State Farm*, 463 U.S. at 42. As a result, because OTS is now claiming statutory authority to act in a manner in which it has not acted before, a reviewing court will apply particular scrutiny to the Proposal.

III. Conclusion

In light of the foregoing, we urge you to withdraw the Proposal.

Sincerely,

Thomas P. Vartanian

Appendix A

Under section 10 of HOLA, Congress has granted OTS the following authority with respect to unitary holding companies:

Holding company registration, reporting, and examination. Section 10(b) requires registration with OTS as a savings and loan holding company, the filing of reports containing information regarding the operations of the holding company and its subsidiaries, and the maintenance of books and records as may be prescribed by OTS. The section also provides that a holding company and its subsidiaries are subject to examination by OTS.[1]

Unlimited unitary holding company activities. Section 10(c) authorizes a holding company that qualifies as a grandfathered unitary holding company to engage in whatever activities it chooses without limitation by section 10, subject to its subsidiary savings institution's compliance with the qualified thrift lender test set forth in section 10(m).[2] Although in the Gramm-Leach-Bliley Act of 1999, Congress prohibited the creation of new unitary savings and loan holding companies, it did nothing to restrict the unlimited activities permitted to grandfathered savings and loan holding companies.[3]

Restrictions on transactions between a savings institution and its holding company affiliates. Section 10(d) provides that transactions between a subsidiary savings association of a savings and loan holding company and any affiliate of such subsidiary shall be subject to limitations and prohibitions specified in 12 U.S.C. § 1468.[4]

OTS approval for holding company acquisitions of other holding companies or savings institutions. Section 10(e) requires a holding company to obtain OTS approval for certain acquisitions involving mergers or acquisitions of unaffiliated holding companies or savings institutions and places certain restrictions and limitations on such acquisitions.[5]

Notice to OTS of savings institution dividends. Section 10(f) provides that a subsidiary savings institution of a holding company must give OTS advance notice of its intention to declare a dividend.[6]

---

1 12 U.S.C. § 1467a(b).

2 *Id.* § 1467a(c), (m).

3 *See* Pub. L. No. 106-102, § 401, 113 Stat.1338, 1435 (1999) (codified at 12 U.S.C. § 1467a(c)(9)(C)).

4 12 U.S.C. § 1467a(d).

5 *Id.* § 1467a(e).

6 *Id.* § 1467a(f).

Issuance of regulations, conduct of investigations, and cease and desist orders. Section 10(g)(1) authorizes the Director of OTS to issue such regulations and orders as the Director deems necessary or appropriate to enable the Director to administer and carry out the purposes of this section and to require compliance therewith and prevent evasions thereof.[7] Sections 10(g)(2)-(4) authorize OTS to conduct investigations to determine whether a holding company is complying with section 10 and the regulations and orders thereunder and to seek an injunction from a federal court to enforce compliance therewith.[8] Section 10(g)(5) authorizes OTS to issue a cease and desist order, subject to notice and an opportunity for hearing, where it has reasonable cause to believe that the continuation by a holding company of any activity or of ownership or control of any of its noninsured subsidiaries constitutes a serious risk to the financial safety, soundness or stability of a holding company's subsidiary savings association and is inconsistent with the sound operation of a savings association or with the purposes of this section or 12 U.S.C. § 1818 and order the holding company or any of its noninsured subsidiaries to terminate such activity or terminate its ownership or control of any such noninsured subsidiary.[9]

Restricted or prohibited conduct or relationships. Section 10(h) prohibits or restricts certain relationships between a holding company and/or persons associated with the holding company and a mutual institution or another holding company. It also prohibits persons who have been convicted of certain offenses from serving in certain positions with a holding company without OTS approval.[10]

Penalties for violations. Section 10(i) provides for criminal and civil money penalties for persons and entities that violate section 10 or the regulations or orders issued thereunder.[11]

Judicial review. Section 10(j) provides for judicial review for any person aggrieved by an order issued by OTS under section 10.[12]

Applicability of antitying provisions. Section 10(n) makes a holding company subject to antitying provisions set forth elsewhere in the HOLA.[13]

Restrictions based on holding company activities. Section 10(p) provides that if the Director of OTS determines that there is reasonable cause to believe that the continuation by a holding company of any activity constitutes a serious risk to the financial safety, soundness or stability of the holding company's subsidiary savings association, the Director may impose such

---

7 *Id.* § 1467a(g)(1).

8 *Id.* § 1467a(g)(2)-(4).

9 *Id.* § 1467a(g)(5).

10 *Id.* § 1467a(h).

11 *Id.* § 1467a(i).

12 *Id.* § 1467a(j).

13 *Id.* § 1467a(n).

restrictions as the Director determines to be necessary to address such risk.[14] Such restrictions shall be issued in the form of a directive to the holding company and any of its subsidiaries, limiting: (i) the payment of dividends by the savings association; (ii) transactions between the savings association, the holding company, and the subsidiaries or either; and (iii) any activities of the savings association that might create a serious risk that the liabilities of the holding company and its affiliates may be imposed on the savings association. The section gives any party subject to such an order opportunities for agency and judicial review.[15]

Qualified stock issuances. Section 10(q) establishes requirements for an issuance of stock by a holding company or a subsidiary savings association to engage in a qualified stock issuance.[16]

Penalties relating to reports. Section 10(r) provides for penalties for the failure to submit required reports or for the submission of false or misleading reports.[17]

245065.7

14 *Id.* § 1467a(p).

15 *Id.*

16 *Id.* § 1467a(q).

17 *Id.* § 1467a(r).