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February 8, 2001

VIA HAND DELIVERY

Manager, Dissemination Branch
Information Management Services Division
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Re: Docket No. 2000-91, Notice of Proposed Rulemaking: Savings and Loan Holding Companies Notice of Significant Transactions or Activities and OTS Review of Capital Adequacy

Gentlemen and Ladies:

These comments are submitted to the Office of Thrift Supervision (the "OTS") on behalf of eight savings and loan holding companies and their non-thrift subsidiaries (the "commenting SLHCs"). The commenting SLHCs either are, or will be regulated under Section 10(c)(3) and 10(c)(9) of the Home Owners' Loan Act (the "HOLA") as if they are grandfathered unitary savings and loan holding companies. *See* 12 U.S.C. §§ 1467a(c)(3), (9)(A).[1] Several of the commenting SLHCs also are affiliated with companies that are "functionally regulated subsidiaries" within the meaning of Sections 112(b) and 113 of the Gramm-Leach-Bliley Act ("GLBA"), 12 U.S.C. §§ 1831v, 1848a. The commenting SLHCs submit this letter in response to the notice of proposed rulemaking ("NPR") published by the OTS in the Federal Register on October 27, 2000.[2]

[1] The commenting SLHCs consist of holding companies whose subsidiaries engage in retailing, manufacturing, securities, insurance or other financial activities. All of the commenting SLHCs controlled a savings association or had filed an application to control a savings association prior to May 4, 1999.

[2] *Notice of Proposed Rulemaking: Savings and Loan Holding Companies Notice of Significant Transactions or Activities and OTS Review of Capital Adequacy*, 65 Fed. Reg. 64,392 (Oct. 27, 2000). *See also* 65 Fed. Reg. 77,528 (Dec. 12, 2000) (OTS notice extending comment period with respect to the NPR until Feb. 9, 2001).

Overview

The NPR seeks comment on an OTS proposal to require covered SLHCs and their non-thrift subsidiaries to obtain prior OTS approval before engaging in or committing to engage in certain covered transactions (the "Notice and Approval Proposal") and on a proposal to codify the agency's stated practice of reviewing SLHC capital on a case-by-case basis and, when necessary, requiring SLHCs to increase their capital (the "Capital Proposal"). For the reasons discussed in detail below, the OTS should withdraw the NPR and terminate the instant rulemaking proceedings. *First*, the OTS lacks the authority under the HOLA to adopt the Notice and Approval Proposal. *Second*, application of the Notice and Approval Proposal to functionally regulated subsidiaries would violate Sections 112(b) and 113 of the GLBA, 12 U.S.C. §§ 1831v, 1848a. *Third*, the Notice and Approval Proposal has substantive flaws. *Fourth*, the OTS does not possess the power under the HOLA to regulate the capital of SLHCs, either on a case-by-case basis or by general rule. *Fifth*, the NPR does not provide a reasoned explanation for deviating from the OTS's prior interpretations, policies, and practices in these areas. As a result, adoption of final rules based upon the Notice and Approval Proposal or the Capital Proposal would be arbitrary, capricious, an abuse of discretion and otherwise not in accordance with law, as well as being in excess of statutory jurisdiction and authority. *See* 5 U.S.C. §§ 706(2)(A) and (B).

On its face, the Notice and Approval Proposal applies to a subset of the nation's SLHCs -- SLHCs that do not meet certain specified exemptive criteria. SLHCs that have consolidated tangible capital of 10% or greater following a transaction or whose subsidiary savings associations represent less than 20% of the SLHC's consolidated assets supposedly are not covered by the Notice and Approval Proposal. *See* Proposed Section 584.110(a), 65 Fed. Reg. at 64,400. On its face, the Proposal also applies only to classes of specified transactions – specifically, debt transactions that increase the amount of an SLHC's consolidated non-thrift liabilities by 5% or more where the SLHC's post-transaction consolidated non-thrift liabilities will be greater than or equal to 50% of consolidated tangible capital; asset acquisitions in which the SLHC acquires assets in excess of 15% of its consolidated assets; and transactions that reduce an SLHC's ratio of consolidated tangible capital to consolidated tangible assets by 10% or more. *See* Proposed Section 584.120(a), 65 Fed. Reg. at 64,400.

The Notice and Approval Proposal also has a broader application, however, as it authorizes Regional Directors to require *any* SLHC to file and obtain approval of covered transactions if the Regional Director has "concerns" about the SLHC's financial condition or the safety and soundness of its thrift subsidiary. *See* Proposed Section 584.120(b), 65 Fed. Reg. at 64,400. In addition, Regional Directors are authorized to require prior approval for *any* type of transaction if the Regional Director thinks the transaction "may pose a risk" to the financial safety, soundness, or stability of the subsidiary savings association. *See* Proposed Section 584.110(b), 65 Fed. Reg. at 64,400. Recent press reports and agency pronouncements suggest

that the OTS may intend to actively to exercise this supervisory authority over otherwise non-covered SLHCs and non-covered transactions.[3]

Although the OTS has characterized the Notice and Approval Proposal as an information gathering device designed to enhance communications between the regulated and their regulators, the plain language of the Proposal demonstrates that its reach is not so limited. The Notice and Approval Proposal forbids SLHCs to proceed with a proposed transaction or activity unless and until the OTS has acted upon the company's notice. *See* Proposed Sections 584.140 and 584.150, 65 Fed. Reg. at 64,401. It also authorizes a Regional Director to disapprove a transaction where the Director thinks that the transaction or activity "will pose a material risk" to the financial safety, soundness, or stability of the SLHC's subsidiary savings association.

As a separate matter, the NPR seeks comment on the Capital Proposal. The NPR does not identify, describe, or explain examples of situations in which the OTS has acted in keeping with this claimed practice, and we are aware of only one recent instance that might fit involving Sovereign Bancorp, Inc.[4] The NPR does not, however, identify the terms of any capital proposal the agency might adopt.

As explained below, we respectfully request that the OTS withdraw the NPR as it is beyond the scope of its authority and is otherwise fatally flawed.

Discussion

I. Prior Notice and Approval of Significant Transactions or Activities

A. The Notice and Approval Proposal is Contrary to Law Because the OTS Lacks the Authority to Adopt It

The HOLA does not explicitly or implicitly authorize the OTS to adopt the Notice and Approval Proposal. The NPR does not identify a single provision of the HOLA that could be construed to require SLHCs that are, or that are regulated as, unitary SLHCs to obtain OTS approval for transactions or activities of any sort.

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[3] *See* "Nonbank Thrift Owners to Face More Scrutiny," *American Banker* (Oct. 16, 2000). *See also Remarks Prepared for Ellen Seidman, Director, OTS, For the 11th Annual Seminar on International Finance,* Palace Hotel, Tokyo, Japan (Sept. 20, 2000); *Remarks of Ellen Seidman, Director OTS for Exchequer of Washington, D.C.* (Jan. 17, 2001) (OTS is revamping its supervisory processes to increase supervision of SLHCs resulting from the convergence of banking, securities and insurance industries).

[4] *See* OTS Order No. 2000-25 (Feb. 29, 2000), with respect to Sovereign Bancorp, Inc. ("Bancorp"). Such order approves Sovereign Bank's acquisition of certain assets and liabilities from Fleet National Bank, Fleet Bank – NH and BankBoston, N.A. and imposes certain requirements upon Bancorp.

Section 10(c) of the HOLA confirms the point. There, Congress explicitly requires multiple SLHCs to seek and obtain OTS approval before engaging in certain new activities. *See* 12 U.S.C. § 1467a(c)(4). Congress never has applied these requirements, however, to SLHCs that are, or that are regulated as, unitary SLHCs. *See* 12 U.S.C. §§ 1467a(c)(3), (9).

The reach of Section 10(c) is not the result of happenstance or inadvertence. To the contrary, it is part of the "historical framework" of SLHC regulation,[5] the product of carefully considered legislative policy judgments originally made more than thirty years ago and confirmed repeatedly ever since.

Congress reaffirmed these judgments just over a year ago. During the legislative process leading up to the passage of the GLBA, Congress considered proposals to eliminate the concept of unitary SLHCs altogether and to regulate unitary and multiple SLHCs in the same manner, including by subjecting unitary SLHCs to the notice and approval requirements of Section 10(c)(4).[6] Congress rejected these proposals. Instead, it chose to grandfather unitary SLHCs and to preserve the separate scheme of regulation, including the lack of any prior notice and approval requirements.

The extent to which the Notice and Approval Proposal is at odds with Congressional policy judgments also is demonstrated by the GLBA provisions governing financial holding companies. During the extensive deliberations over financial modernization legislation, securities firms and insurance companies repeatedly focused attention on the prior notice and approval requirements for new activities of bank holding companies contained in the Bank Holding Company Act of 1956, as amended (the "BHCA"). These industries urged Congress not to impose the requirements on financial holding companies and their non-bank subsidiaries because such restrictions would be inappropriate and unnecessary.[7] Congress responded favorably. It specifically amended the BHCA to permit financial holding companies to engage

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[5] *See Financial Services Modernization Act: Hearings on S.900 Before the Senate Comm. on Banking, Housing and Urban Affairs, 106th Cong., 1st Sess. 32* (1999) (statement of the Honorable Ellen S. Seidman, Director, OTS).

[6] *See e.g.*, S. Rep. No. 105-336, at 30 (1998) ("Some Committee members strongly hold the view that mixing banking and commerce poses serious risks to the safety and soundness of the financial system, distorts credit decisions by banks, and leads to undue concentrations of economic power. Since H.R. 10 generally maintains the separation of banking and commerce, *they felt strongly that the unitary holding company loophole to the separation of banking and commerce should be closed.*") (emphasis added).

[7] *See e.g., H.R. 10—The Financial Services Modernization Act of 1999: Hearings Before the House Comm. on Banking and Financial Services*, 106th Cong. 320 (1999) (statement of Roy J. Zuckerberg, Chairman, Securities Industry Association); *Financial Modernization—Part I: Hearings on H.R. 10 Before the House Comm. on Banking and Financial Services*, 105th Cong. 517 (1997) (statement of John G. Heimann, Chairman of Global Financial Institutions, Merrill Lynch & Co., Inc.); *H.R. 1062, The Financial Services Competitiveness Act of 1995, Glass-Steagall Reform, and Related Issues (Revised H.R. 18)—Part 4: Hearings Before the House Comm. on Banking and Financial Services*, 104th Cong. 207-08 (1995) (statement of John A. Thain, Goldman Sachs & Co.).

in new activities based solely upon an after-the-fact notice and with no agency approval. *See* 12 U.S.C. § 1843(l). By now imposing the very notice and approval requirements on companies that are, or that are regulated as, unitary SLHCs, the Notice and Approval Proposal conflicts with this legislative action.

The OTS's lack of authority is further exposed and confirmed by other key provisions of the HOLA and the federal banking laws. Like HOLA Section 10(c), these provisions demonstrate that when Congress intends to regulate the activities of holding companies or to require agency approval of holding company transactions or activities, Congress knows how to do so and does so expressly. They also show once again that Congress not only has not done so here, but specifically has rejected what the OTS now seeks to impose.

Of particular importance is former Section 408(g) of the National Housing Act (the "NHA"). This section required non-diversified SLHCs to obtain Federal Home Loan Bank Board ("FHLBB") approval before issuing, selling, renewing, or guaranteeing any debt that would increase the SLHC's total indebtedness to more than 15% of its consolidated net worth. When Congress incorporated the NHA into the HOLA as part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989,[8] however, Congress repealed and did not incorporate former NHA Section 408(g). Congress took this action because Congress determined that reviewing and approving holding company debt transactions was not a proper agency function, but was also burdensome and unnecessary as well.[9] Yet, reviewing and approving holding company debt transactions is precisely what the OTS now proposes once again to do. Given that the language of the provisions contained in the Notice and Approval Proposal regarding approval of debt transactions essentially mirrors the provisions of repealed Section 408(g) of the NHA, it appears that the OTS used the repealed provision of law as the

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[8] *See* Public L. No. 101 Pub. L. 73, 103 Stat. 183 (1989).

[9] In discussing the repeal of the NHA's debt approval provisions, Senator Karnes explained that:

> "The current debt control limits . . . are cumbersome and outmoded. They were enacted in 1967 at a time when the Bank Board had no cease and desist powers, civil and criminal enforcement authority, or power to remove S&L officers and directors. The Bank Board now has more efficient tools to deal with any abuses related to the incurrence of debt than it did in 1967. More important, however, is the fact that these restrictions make it extremely difficult for nondiversified S&L holding companies to raise funds at a favorable rate in a volatile market. The market is best suited to determine whether a holding company is credit worthy, not the Bank Board staff."

134 Cong. Rec. S956 (daily ed. Feb. 18, 1988) (Statement of Sen. Karnes). *See also* 1988 FHLBB Lexis 264 (Jan. 12, 1988) (similar FHLBB staff views).

basis in drafting this part of the Notice and Approval Proposal. Regulatory provisions implementing repealed laws, however, are without legal authority.[10]

Sections 10(p) and 10(g)(5) of the HOLA also are illuminating. *See* 12 U.S.C. §§ 1467a(p), (g)(5). These provisions specifically authorize the OTS to take action against or with respect to SLHCs and their non-thrift subsidiaries in specific circumstances.[11] These provisions neither apply in the present context nor authorize adoption of the Notice and Approval Proposal as the NPR concedes. *See* 65 *Fed. Reg.* at 64,393, n.6 (contrasting the remedial nature of Sections 10(p) and 10(g)(5) with the prophylactic nature of the NPR).

The prompt corrective action ("PCA") sections of the Federal Deposit Insurance Act (the "FDIA") further illustrate the point. *See* 12 U.S.C. § 1831*o*. These provisions affirmatively allow the banking agencies, under expressly identified and narrowly tailored circumstances, to take action against a holding company when necessary to protect an undercapitalized or significantly undercapitalized institution. *See* 12 U.S.C. § 1831*o*(f)(2)(H), (I).[12] But, these provisions also are solely remedial in nature in response to actual capital inadequacy at an insured depository institution and therefore cannot support the Notice and Approval Proposal, which is not triggered to undercapitalization of an insured institution and which is not remedial in nature.

The fundamental restructuring that the Notice and Approval Proposal would effect in the way Congress intended the OTS to regulate unitary SLHCs also highlights the absence of a statutory predicate for the Proposal. In the HOLA, Congress authorized agency monitoring of

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[10] *See generally Mississippi Poultry Ass'n, Inc. v. Madigan,* 131 F.3d 293 (5th Cir. 1993) (invalidating Food Safety and Inspection Service's efforts to continue to implement regulations which, in effect, had been repealed by the enactment of the Food, Agriculture, Conservation, and Trade Act of 1990).

[11] Section 10(g)(5) authorizes the issuance of cease and desist orders against a SLHC whenever the Director of the OTS has reasonable cause to become that the continuation by a SLHC of any activity or of ownership or control of its noninsured subsidiaries constitutes a serious risk to the financial safety, soundness or stability of a SLHC. Section 10(p) authorizes the Director of OTS to respond to a SLHC activity that poses a serious risk to the SLHC's savings association subsidiary by issuing a directive to the holding company and its subsidiaries limiting the payment of dividends by the savings association; transactions between the savings association, the holding company and subsidiaries or affiliates of either; or activities of the thrift that might create a serious risk that the liabilities of the holding company and its other affiliates may be imposed on the thrift; and limiting the payment of dividends by the thrift.

[12] Section 1831*o*(f)(2)(H) authorizes an appropriate Federal banking agency to prohibit a bank holding company from making a capital distribution without approval from the Federal Reserve. Section 1831o(f)(2)(I)(ii) authorizes an appropriate Federal banking agency to require a holding company to divest itself of or liquidate any affiliate other than an insured depository institution if the appropriate Federal banking agency for that company determines the affiliate is in danger of becoming insolvent or poses a significant risk to the institution or is likely to cause a significant dissipation of the institution's assets or earnings.

SLHC activities (through reports and examinations authorized under HOLA Sections 10(b)(2) and 10(b)(4)) to be followed, where necessary, by remedial administrative action (through cease and desist proceedings authorized under HOLA Section 10(g)). The Notice and Approval Proposal replaces this statutory plan with one that is based upon agency approval instead of agency monitoring and that operates through prophylactic prohibitions instead of remedial relief.

The only authority cited by the NPR to support the Notice and Approval Proposal is the agency's general rulemaking powers found in HOLA Sections 3(b)(2) and 10(g)(1), which allow the OTS to issue such regulations as are "necessary or appropriate" to administer Section 10 of the HOLA or necessary to carry out the HOLA generally.[13] *See* 12 U.S.C. §§ 1462a(b)(2), 1467a(g)(1). Regulations promulgated pursuant to such general rulemaking authority are valid, however, only to the extent that they are "reasonably related to the purposes of the enabling legislation." *See Mourning v. Family Publications Svc., Inc.*, 411 U.S. 356, 369 (1972) (quoting *Thorpe v. Housing Auth. of the City of Durham*, 393 U.S. 268, 280-81 (1969)).

The Notice and Approval Proposal does not meet this test.[14] As explained above, the Notice and Approval Proposal in effect rewrites the HOLA and fundamentally restructures its scheme for the regulation of entities that are, or that are regulated as, unitary SLHCs, all in contravention of the policy judgments Congress made more than three decades ago and again reaffirmed just a year ago as part of the GLBA. In the words of the Supreme Court, "[a]n agency's function is not, under our system of government, to arrogate that role to itself through administrative rulemaking proceedings that seek to rewrite language, history and purpose of a statutory provision. If the [Act] falls short of a providing safeguards desirable or necessary or necessary to protect the public interest, that is a problem for Congress, and not the [agency] to address." *Dimension Fin. Corp.*, 474 U.S. at 374; *see also FDA v. Brown & Williamson Tobacco,* 529 U.S. 120 (2000) (striking down FDA rules promulgated by FDA in reliance on the agency's general rulemaking authority under the federal Food, Drug, and Cosmetics Act to assert jurisdiction over tobacco products).[15]

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[13] *See* 65 Fed. Reg. at 64,393.

[14] *See Board of Governors v. Dimension Fin. Corp.*, 474 U.S. 361, 374 (1986); *accord Rappaport v. OTS*, 59 F.3d 212, 220 (D.C. Cir. 1995); *Wachtel v. OTS*, 982 F.2d 581, 585-96 (D.C. Cir. 1993); *Citicorp v. Board of Governors*, 936 F.2d 66, 76 (2d Cir. 1991); *MCorp Fin. Inc. v. Board of Governors*, 900 F.2d 852, 861-862 (5th Cir. 1990).

[15] *See also Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988) ("an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress."); *INS v. Chada*, 462 U.S. 919, 953, n.16 (1983) (agency action "is always subject to check by the terms of the legislation that authorized it; and if that authority is exceeded it is open to judicial review"); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212-14 (1976) (agency power is "not the power to make law. Rather, it is the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.") (quoting *Manhattan Gen. Equip. Co. v. Commissioner of Internal Revenue*, 297 U.S. 129, 134 (1936)).

B. The Notice and Approval Proposal Violates Recently Enacted Legislation Protecting Functionally-Regulated Subsidiaries of SLHCs

The recently enacted Sections 112(b) and 113 of the GLBA, 12 U.S.C. §§ 1831v, 1848a, generally forbid the OTS to take action with respect to functionally regulated subsidiaries of SLHCs except in certain narrowly defined circumstances.[16] Specifically, these provisions require that the OTS act on a case-by-case basis with respect to a functionally regulated subsidiary of a SLHC, and not by general rules such as the Notice and Approval Proposal. Moreover, such provisions preclude the OTS from imposing requirements on or otherwise restricting the activities of functionally regulated subsidiaries of SLHCs unless two conditions are met: (i) the OTS's action is necessary to prevent or redress an unsafe or unsound practice or a breach of fiduciary duty by the functionally regulated subsidiary that poses a material risk to the financial safety, soundness, or stability of an affiliated thrift (or to the domestic or international payment system), and (ii) the OTS finds that it is not reasonably possible to protect effectively against the material risk at issue through action directed at or against the affiliated thrift. *See* 12 U.S.C. § 1848a(a). Significantly, these provisions also prohibit the OTS from requiring an SLHC to require its functionally regulated subsidiary to engage in or to refrain from an activity or transaction, unless the OTS could take such action directly against the functionally regulated subsidiary in accordance with the two statutory conditions described above. *See* 12 U.S.C. § 1848a(b).

Adopting the Notice and Approval Proposal would violate Section 112(b) and 113 of the GLBA in a variety of ways. First, the Proposal improperly takes action with respect to functionally regulated subsidiaries of SLHCs by requiring prior approval of their transactions even though the statutory preconditions to such action are not satisfied. For example, nothing in the Proposal explains how a functionally regulated subsidiary engages in "an unsafe or unsound practice or breach of fiduciary duty that poses a material risk to the safety, soundness or stability" of the affiliated thrift simply by proposing to engage or engaging in a debt transaction, asset sale or other transaction covered by the rule.[17] Moreover, Congress' express limitation of OTS authority with respect to functionally regulated subsidiaries, except in cases of

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[16] A "functionally regulated subsidiary" is any company, except a depository institution or depository institution holding company, that is a broker or dealer registered under the Securities Exchange Act of 1934, a registered investment advisor, properly registered by or on behalf of either the Securities and Exchange Commission or any State, with respect to the investment advisory activities of such investment advisor and activities incident to such investment advisory activities, an investment company that is registered under the Investment Company Act of 1940, an insurance company, with respect to insurance activities of the insurance company and activities incident to such insurance activities, that is subject to supervision by a State insurance regulator; or an entity that is subject to regulation by the Commodity Futures Trading Commission, with respect to the commodities activities of such entities or activities incidental to such commodities activities. *See* 12 U.S.C. § 1844(c)(5).

[17] *See First Nat'l Bank of Bellaire v. OCC*, 697 F.2d 674 (5th Cir. 1983) (holding that a having certain level of capital is not, by definition, an unsafe or unsound practice).

individualized determinations of risk, cannot be read to authorize a sweeping prior approval process for the entire industry.

Nor does the Notice and Approval Proposal satisfy the second statutory condition established by Sections 112(b) and 113. The GLBA prohibits OTS regulation of the activities of functionally regulated subsidiaries unless the OTS "finds that it is not reasonably possible to protect effectively against the material risk at issue through action directed at or against" thrifts generally. 12 U.S.C. §§ 1831v(b), 1848a(2). The Proposal contains no analysis of any kind, however, explaining why the risks it intends to cover cannot be addressed through direct regulation of savings associations.

The provisions of the Notice and Approval Proposal authorizing Regional Directors to require prior approval for transactions of functionally regulated subsidiaries of otherwise exempt SLHCs also violate Sections 112(b) and 113. These provisions would permit a Regional Director to require an exempt SLHC to comply if the Regional Director "has concerns" relating to the SLHC's financial condition or the safety and soundness of its subsidiary thrift or that a transaction or activity "may pose a risk" to the safety, soundness, or stability of its subsidiary thrift. *See* Proposed Sections 584.110(b), 584.120(b), 65 Fed. Reg. at 64,400. These criteria, however, obviously fall far short of the statutory standards specified in Sections 112(b) and 113 of the GLBA.

The Notice and Approval Proposal's standards for OTS disapproval of transactions also violate Sections 112(b) and 113 of the GLBA. The Notice and Approval Proposal would permit a Regional Director to disapprove the covered transaction of a functionally regulated subsidiary whenever the Regional Director determines that the transaction "will pose a material risk to the financial safety, soundness or stability" of the SLHC's subsidiary thrift. *See* Proposal Section 584.140, 65 Fed. Reg. at 64,401. Sections 112(b) and 113, however, provide for OTS action only when the Director of the OTS determines that action is necessary to prevent or redress "an unsafe or unsound practice or breach of fiduciary duty" that poses a material risk to the financial safety, soundness or stability of the thrift and "it is not reasonably possible to protect effectively" against the material risk that the unsafe or unsound practice or breach of fiduciary duty presents through direct regulation of savings associations. *See* 12 U.S.C. §§ 1831v(a)(3), 1848a(a).

Finally, the fact that the Notice and Approval Proposal requires SLHCs, rather than functionally regulated subsidiaries, to file the required notices does not render the restrictions of Sections 112(b) and 113 of the GLBA inapplicable. As noted above, Sections 112(b) and 113 forbid an agency to take action directly against a functionally regulated subsidiary, but also forbid an agency from indirectly achieving the forbidden result by requiring a SLHC to require its functionally regulated subsidiary to engage or refrain from engaging in the conduct at issue. *See* 12 U.S.C. §§ 1831v(a), 1848a(b). Yet, the Notice and Approval Proposal takes indirect

action against the functionally regulated subsidiary in just this manner.[18] As both a legal and practical matter, a functionally regulated subsidiary would have no choice but to comply with the requirements imposed upon its parent, including a requirement to refrain from engaging or committing to engage in a proposed transaction until OTS approval has been obtained.

C. The Notice and Approval Proposal Is Fundamentally Flawed, Adversely Affecting SLHCs

Moreover, as a substantive matter, the Notice and Approval Proposal is flawed. In light of the lack of OTS authority to adopt the Notice and Approval Proposal, we will not undertake a detailed analysis here of the ways in which the Proposal is operationally untenable. Nonetheless, a brief mention of some of the most significant problems is worthwhile. For example:

- Unlike any other provision of law impacting SLHCs, the Notice and Approval Proposal requires that an SLHC seek OTS prior approval *before* it even "commits to engage in any transaction or activity" described in the Notice and Approval Proposal. *See* Proposed Section 584.120, 65 Fed. Reg. at 64,400. The uncertainty and delay inherent in this requirement -- especially given the absence of similar constraints upon financial holding companies and non-banking organizations -- inevitably will discourage third parties from dealing with SLHCs.

- The Notice and Approval Proposal also appears to require agency approval of any covered transaction, even one that takes place in the ordinary course of business. The need for a manufacturing, retailing, or other concern to obtain agency approval in order to acquire the inventory, parts, or assets it needs for its core business necessarily will disrupt its business operations.

- The proposed rolling twelve month period of Proposed Section 584.120(a), 65 Fed. Reg. at 64,400, will impose onerous compliance requirements and recordkeeping obligations upon SLHCs. These are especially significant in light of the discretionary authority granted to Regional Directors under Proposed Sections 584.110(b) and 584.120(b), 65 Fed. Reg. at 64,400, to require review at any time of any transaction by any SLHC. Complex SLHCs with international operations – which appear to be a target of the Proposals – will need to develop compliance systems on a world-wide basis. The

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[18] *See* 65 Fed. Reg. at 64,397 ("The proposed rule would apply to savings and loan holding companies *and subsidiaries of savings and loan holding companies* (other than savings association subsidiaries). A savings and loan holding company would be required to file a notice before it *or its non-thrift subsidiary* may engage in specified activities. While a subsidiary of a savings and loan holding company would not be required to file a notice, *OTS could, by disapproving a notice, prevent the subsidiary from engaging in certain proposed actions.*") (emphasis added).

Proposal imposes onerous recordkeeping burdens far in excess of the mere five hours the OTS has projected.

- The open-ended standard under which Regional Directors may disapprove transactions under Proposed Section 584.140, 65 Fed. Reg. at 64,400, provides no guidance as to how the regulation might apply to the various different transactions which the agency will face and also carries the potential for differential application among the various regions in light of the lack of standards for staff to apply in evaluating complex, non-banking transactions outside their traditional areas of expertise.

- The Notice and Approval Proposal is overbroad in its application to SLHCs of limited purpose savings associations, such that engage solely in trust or credit card operations, especially because Congress has expressly determined that holding companies that own *banks* that engage in the same activities are not subject to any holding company regulation. *See* 12 U.S.C. § 1841(c)(2)(D), (E).

The Notice and Approval Proposal should be withdrawn, given the OTS's lack of authority to promulgate the Notice and Approval Proposal and the significant problems inherent in implementing such proposal.[19]

II. Capital Proposal

The Capital Proposal requests comments on the OTS's desire to codify its stated policy of "reviewing the capital adequacy of savings and loan holding companies and, when necessary, requiring additional capital on a case-by-case basis." As a threshold matter, we note that the HOLA contains no provision that authorizes the OTS to engage in the practice of "requiring additional capital" for SLHCs, either on a case-by-case basis or by issuing rules of general applicability.[20]

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[19] Implementation of the Notice and Approval Proposal would also raise the specter of conflicts with the Takings and Due Process Clauses of the Fifth Amendment. Specifically, the U.S. Supreme Court has held that whether governmental action to restrict existing operational rights contravenes the Takings Clause turns on the "justice and fairness" of the circumstances presented, paying particular attention to the economic impact of the regulation, its interference with reasonable investment-backed expectations, and the character of government action. *Eastern Enterprises v. Apfel*, 118 S. Ct. 2131, 2146 (1998). Similarly, governmental action that is unreasonable or irrational contravenes the Due Process Clause. *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 458 (1993). Because the Notice and Approval Proposal would unreasonably impair the ability of an SLHC to engage in nonbank-related transactions, OTS action under color of the Notice and Approval Proposal would form the basis for claims under the Takings and Due Process Clauses.

[20] *See, e.g.*, OTS Enforcement Review Committee Resolution No. 89-127 at 2, in the Matter of Gary L. Akin, Sole Stockholder, Chairman and Former President of Texas Banc Savings, F.S.B. (Nov. 7, 1990); Brief of Appellant FDIC at 29, *In Re Conner Corp.*, No. 90-488 Civ.-5-BO (E.D.N.C. Sept. 28, 1990); *see also* Brief of RTC at 22, in

(continued)

The International Lending Supervision Act of 1983 (the "ILSA"), 12 U.S.C. §§ 3901 *et seq.*, confirms the point. Congress enacted the ILSA precisely to give the banking agencies authority to set capital levels for "banking institutions" subject to their jurisdiction, but ILSA does not apply here. A "banking institution," for purposes of the ILSA, is a depository institution; the term does not include depository institution holding companies.[21] Although the ILSA authorizes the Federal banking agencies to apply ILSA's provisions to "any affiliate of an insured bank" in order to promote uniform application of the ILSA or to prevent evasions thereof; *see* 12 U.S.C. § 3902(a)(2), that is not what the Capital Proposal contemplates.

For example, the Capital Proposal contains no suggestion that the OTS's proposed SLHC capital regulations are necessary in order to promote uniformity. To the contrary, the provisions impede uniformity because they are applied on a case-by-case basis. In addition, the ILSA requires the Federal banking agencies to "establish uniform systems to implement the authorities provided under this chapter." 12 U.S.C. § 3909(b). The OTS acknowledges, however, that the Federal Reserve – the only other holding company regulator – does not operate under the same system. Finally, the OTS cannot claim that its capital practices are necessary to prevent evasions of the ILSA because the record contains nothing that suggests that holding companies are engaging in transactions or any other activities in order to evade or circumvent thrift level capital requirements.

The opinion of the U.S. Court of Appeals for the Fifth Circuit in *MCorp v. Board of Governors*, 900 F.2d 852 (5th Cir. 1990), *aff'd in part and rev'd in part on other grounds*, 502 U.S. 32 (1991), further confirms that the OTS is not authorized to regulate holding company capital in the manner contemplated by the Capital Proposal. In *MCorp*, the Fifth Circuit struck down the Federal Reserve Board's attempt to enforce its "source of strength" policy, which asserted that the Federal Reserve had the authority to require bank holding companies to provide capital funds to their depository institution subsidiaries. The court held that the Federal Reserve lacks the authority under the ILSA, FDIA Section 8, the application provisions of BHCA Section 3, and its general rulemaking authority under Section 5 of the BHCA to take action against a bank holding company in order to promote the financial soundness of its subsidiary banks. *See MCorp*, 900 F.2d at 859-64. This result obviously should be the same when the OTS tries to act under the parallel provisions of the HOLA.[22]

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RTC v. Savers, No. 90-2037EA (8th Cir. Sept. 28, 1990), each, as cited in Brief of Respondents at 19 & nn. 51, 52, *Board of Governors of the Federal Reserve System v. MCorp.*, No. 90-913 (U.S. S Ct. Feb. 11, 1991).

[21] The ILSA defines a "banking institution" as an insured bank as defined in Section 3(h) of the FDIA, a subsidiary of an insured bank, an Edge Act corporation, an Agreement corporation, an agency or branch of a foreign bank, or a commercial lending corporation owned or controlled by one or more foreign banks. *Id.* at § 3902.

[22] The 5th Circuit decision in *MCorp* remains the law today. Indeed, in 1987, 1988, 1989, and 1991 both before and after *MCorp* Congress considered and declined to enact legislation imposing a specific source of strength requirement. *See e.g.*, H.R. 3799, 100th Cong. 1st Sess. (1987) (introduced only); S 25517, 100th Cong. 2nd Sess.
(continued)

FDIA's PCA and cross-guarantee provisions are further confirmation that Congress has never intended the OTS to regulate SLHC capital. Enacted in 1991, these provisions were designed to give the banking agencies the regulatory tools that they claimed were needed in light of the *MCorp* decision. The PCA provisions permits the banking agencies, under expressly identified and narrowly tailored circumstances, to take action against an SLHC when necessary to protect an undercapitalized or significantly undercapitalized thrift, such as requiring divestiture of the institution or the divestiture of a nondepository affiliate. *See* 12 U.S.C. § 1831*o*(f)(2), (H), (I). The Capital Proposal, however, does not contemplate the type of action authorized by those provisions, and the OTS does not rely on them in promulgating its proposed rule.[23]

The sole authority cited by the NPR in support of the OTS's claimed power to regulate SLHC capital is the agency's general rulemaking authority under HOLA Sections 3(b)(2) and 4(a)(2), 12 U.S.C. §§ 1462a(b)(2), 1463(a)(2), and its power under HOLA Section 10(g)(1) to prevent "evasions" of HOLA Section 10. These provisions, however, do not support the OTS's authority to adopt the Capital Proposal. As to the former, the HOLA's general rulemaking provisions do not authorize agency to rewrite the HOLA or to overrule Congress's considered legislative judgment. *See supra* p. 7. As to the latter, because HOLA Section 10 does not regulate, or authorize the OTS to regulate, SLHC capital, the Capital Proposal cannot stand as a measure designed to prevent an evasion of HOLA Section 10.

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(1988); H.R. 1992, 101st Cong., 1st Sess. (1989) (introduced only); H.R. 6, 102nd Cong. 1st Sess. (1991) (failed passage); and H.R. 192 102nd Cong. 1st Sess. (1991) (not reported out of committee). It did so following FDIC advice that a source of strength policy "will reduce market efficiency, limit the ability of banks to be viable competitors in the financial marketplace and limit the ability to obtain new capital for the banking agency." Federal Deposit Insurance Corporation, *Deposit Insurance for the Nineties, Meeting the Challenge* at 230 (1989). *See also* Federal Deposit Insurance Corporation, *Mandate for Change: Restructuring the Banking Industry* at 93-94 (Oct. 1987).

[23] Moreover, the prompt corrective action provisions are inconsistent with the premises of a source of strength doctrine (or any authority to impose capital requirement purportedly derived from the existence of a source of strength doctrine). Under the source of strength doctrine, a holding company could not walk away from its purported obligation to provide financial support to its subsidiary bank and there was no limitation on the holding company's liability in that regard. Under the PCA provisions, however, a holding company does have the ability to walk away from its obligation to support its subsidiary depository institution (in consideration for ceding control over the bank and any commonly-controlled depository institution) and, in the event the holding company elects to assume an obligation to support the subsidiary bank by guaranteeing the subsidiary's capital plan, the holding company's liability is capped at the lesser of 5% of the subsidiary's assets at the time it became undercapitalized or the amount that is necessary to bring the subsidiary into compliance with applicable capital standards.

III. OTS Also Has Not Satisfied Its Burden to Provide a Reasoned Explanation for the Shift in Agency Position the Proposals Represent

The Administrative Procedure Act requires an agency that deviates from its interpretation of a statute or its policies thereunder to provide a reasoned explanation for the change. *See, e.g., Motor Vehicles Mfrs. Ass'n of America* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983); *Atchison, T. & S.F.R. Co. v. Wichita Board of Trade*, 412 U.S. 800 (1973). For more than thirty years, the agencies administering the HOLA, as reflected both by their actions as well as their words, have interpreted the statute as permitting companies that are, or that are regulated as, unitary SLHCs to engage in any type of transaction or activity without agency approval and as permitting SLHCs to operate without agency regulation of their capital.[24] The OTS and the FHLBB also have recognized an obligation to avoid imposing unnecessary supervisory burdens on SLHCs,[25] especially through "obsolete" mechanisms such as prior approval of debt transactions,[26] and have long had a policy of refraining from regulating the non-banking business of SLHCs.[27] The NPR, however, does not acknowledge these longstanding positions or provide a reasoned explanation for abandoning them.

Nor does the NPR address or document a need for agency action in these areas now. The HOLA, other banking statutes and OTS regulations give the OTS a wide range of supervisory tools to use in monitoring the activities of traditional and non-traditional SLHCs and their savings association subsidiaries. These include Section 10(b) of the HOLA, which requires SLHCs to provide the OTS with reports requested by the OTS, such as the quarterly and annual reports OTS currently receives SLHCs under cover of Form HB-11, and the SLHC financial data to be provided to the OTS beginning in March 2001.[28] Moreover, thrifts are subject to the restrictions under Sections 23A and 23B of the Federal Reserve Act, 12 U.S.C. §§ 371c, 371c-1, with respect to transactions with their affiliates. Among other things, Section 23A of the Federal Reserve Act imposes strict limitations upon the extension of credit by a thrift to its affiliates and Section 23B requires that transactions between a thrift and its affiliates be on arms' length basis. The OTS augmented Sections 23A and 23B by imposing significant recordkeeping requirements on thrifts to document compliance with these provisions. *See* 12 C.F.R. §§ 563.41(e) and 563.42(e). In addition, a thrift currently may not issue a capital distribution to its SLHC without prior notice to the OTS, which may disapprove of the proposed distribution. *See* 12 C.F.R.

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[24] *See* "Holding Companies In The Thrift Industry Background Paper," OTS (1997).

[25] *See Testimony of Carolyn J. Buck, on Reducing Regulatory Burden, before the House Subcommittee on Financial Institutions and Consumer Credit,* (May 12, 1999).

[26] *See* 1988 FHLBB Lexis 264 (Jan. 12, 1988).

[27] *See Remarks of Ellen Seidman, Director OTS for Exchequer of Washington, D.C.* (Jan. 17, 2001).

[28] *See* 65 Fed. Reg. 48,049 (Aug. 4, 2000).

§ 563.143(b)(3). Just a little over a year ago, the OTS informed Congress that these tools provided a system of "sound regulatory oversight."[29] Just the year before that OTS informed Congress that its supervisory approach to SLHCs "worked well."[30] The NPR fails to explain why this is no longer the case.[31]

The Proposals also ignore the safety and soundness record of thrifts of non-traditional SLHCs. The OTS itself has concluded that SLHCs engaged in non-banking activities historically have been less likely to be subject to an OTS enforcement action.[32] While thrift holding companies with non-banking activities owned 5 percent of thrifts under OTS regulation at June 30, 1997, they accounted for only 0.3 percent of enforcement actions from January 1993 through the end of the second quarter of 1997.[33] Moreover, of the 14 thrift failures in the period 1992-1997, only five were owned by holding companies and only two of the holding companies were engaged in non-banking activities. And, even there, the OTS has affirmatively stated that the non-banking activities were not responsible for the failures.[34]

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[29] *See Financial Services Modernization Act: Hearings on S.900 Before the Senate Comm. on Banking, Housing and Urban Affairs, 106th Cong., 1st Sess. 32* (1999) (statement of the Honorable Ellen S. Seidman, Director, OTS).

[30] *See The Financial Services Act of 1988. Hearings on H.R. 10 Before the Senate Comm. on Banking, Housing and Urban Affairs, 105h Cong., 2nd Sess. 319* (1998) (statement of the Honorable Ellen S. Seidman, Director, OTS).

[31] In her recent remarks to the Exchequer Club of Washington, D.C., Director Seidman raised concerns that SLHCs having difficulties could place dividend demands on their thrift subsidiaries and impose pressure on thrift subsidiaries to "come up with additional earnings and dividends." The OTS has not indicated why current statutory and regulatory provisions including provisions that prevent a thrift from issuing a capital distribution to its parent holding company are inadequate to address such concerns. First, under Section 10(p) of the HOLA, the OTS has the authority to limit the payment of dividends from a savings association to its holding company if the OTS believes there is reasonable cause to believe that the continuation by a SLHC of any activity constitutes a serious risk to the safety, soundness, or stability of a savings association. *See* 12 U.S.C. § 1467a(p)(1)(A). Second, under PCA, capital distributions are prohibited if such distribution would result in the thrift being undercapitalized, significantly undercapitalized or critically undercapitalized. *See* 12 U.S.C. § 1831o. Third, savings associations are required to provide prior notice to the OTS of any dividends to their SLHCs. 12 C.F.R. § 563.143(c), and OTS already has the authority to disapprove a capital distribution for various reasons. *See* 12 C.F.R. § 563.146. Given this extensive authority to preclude inappropriate capital distributions, additional regulatory authority appears to be unnecessary.

[32] *See* "Holding Companies in the Thrift Industry Background Paper," OTS (1997).

[33] *Id.*

[34] *Id.*

Conclusion

For all the reasons set forth above, the Notice and Approval Proposal and the Capital Proposal should be withdrawn and the instant rulemaking proceedings should be terminated.

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If you have any questions regarding the foregoing, please contact any of the undersigned:

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