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Financial Reform: Savings Associations or "Thrifts"

The degree to which the regulatory regime facing federal savings associations—also called "thrifts"—and banks should differ is a prominent policy issue in the 115th Congress. For example, S. 2155 and H.R. 10 propose to allow certain federal thrifts to effectively opt in to the national bank regulatory regime. This In Focus provides background on federal savings associations and examines policy issues and proposals related to these institutions.

Background

Savings associations—or "thrifts"—are institutions that, like banks and other depositories, accept deposits that are federally insured and make loans. Both banks and thrifts can be primarily subject to a state or federal regulatory regime depending on who they choose as a chartering authority. However, the two types of institutions hold different charters, meaning they are allowed to perform different activities and are subject to different regulations.

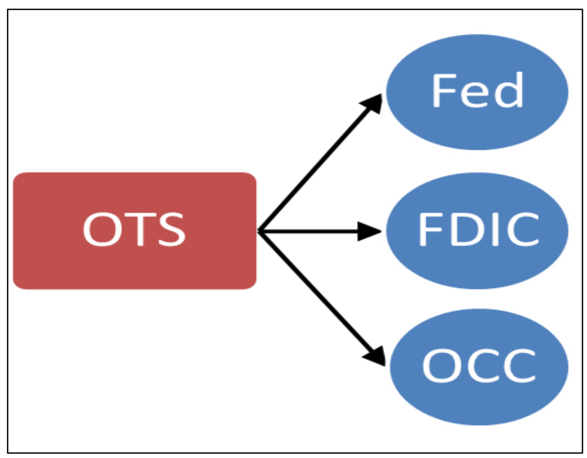
The federal thrift charter was established during the Great Depression by the Home Owners' Loan Act (P.L. 73-43) with the intent of increasing the availability of mortgages. To achieve this, the charter required thrifts to focus on home mortgage lending. Thus, thrifts generally have faced limits on certain other types of lending. Over time, the federal charter has been expanded to allow federal thrifts to offer many products similar to those offered by national banks, narrowing the differences between the two. Nevertheless, differences remain. For example, federal thrifts are limited in the amount of commercial and non-residential real estate loans they can hold, whereas national banks do not face the same restrictions.

Savings associations played a role in two recent financial crises—the savings and loan (S&L) crisis of the 1980s and 1990s and the 2007-2009 financial crisis—and in both cases thrift regulation was changed pursuant to subsequent legislation. From 1986 to 1995, more than 1,000 thrifts failed (with failures occurring at both federal- and state-chartered thrifts, including at both savings associations and S&L associations), at a cost to taxpayers of approximately $124 billion, according to a Federal Deposit Insurance Corporation (FDIC) analysis. Numerous economic and regulatory developments preceding the S&L crisis have been cited as possible causes. Notably, some argued that the Federal Home Loan Board—the primary federal thrift regulator and an independent agency—had become too lax in its supervision and regulation of thrifts. In response to the S&L crisis, Congress passed the Financial Institutions Reform and Recovery and Enforcement Act (P.L. 101-73), which (among other things) established the Office of Thrift Supervision (OTS) as a bureau of the Treasury Department, and transferred regulatory authority over thrifts to OTS.

OTS was still the primary thrift regulator at the onset of the 2007-2009 financial crisis, and the institutions it oversaw included thrift holding companies (THCs)—parent holding companies that owned at least one thrift and (in certain cases) many other nondepository subsidiaries. Although depositories of all types failed in the crisis, some observers were particularly critical of perceived shortcomings in OTS supervision of large THCs. Some distressed THCs—e.g., AIG (mainly an insurance firm), Lehman Brothers (mainly a securities firm), and Washington Mutual (mainly a depository)—were arguably among the most destabilizing sources of systemic risk.

Title III of the Dodd-Frank Act (DFA; P.L. 111-203) eliminated the OTS and reassigned the primary regulation of thrifts to the banking agencies. The Federal Reserve (the Fed) acquired authority over THCs, the FDIC over state thrifts, and the Office of the Comptroller of the Currency (OCC) over federal thrifts, as shown in **Figure 1**. This eliminated what was often perceived as a flawed regulator, and many hoped that consolidation would lead to more consistent regulation, supervision, and enforcement across charters.

Figure 1. Dodd-Frank Changes to Thrift Regulation



Source: CRS.

Notes: Blue = existing, red = eliminated. See text for details.

Policy Issues

A broad, long-standing issue underlying debates over thrift regulation is to what degree the government should offer different charters (with different benefits, responsibilities, and regulators) to banks and thrifts that engage in similar deposit taking and loan making, and whether the difference between the charters should be narrowed.

On one hand, a system of differentiated charters could give institutions with different business models and ownership arrangements the ability to have regulation tailored to suit their business needs and risks. Reducing regulatory differentiation could put a group of depositories at a competitive disadvantage relative to others if (1) different groups of depositories are currently subject to appropriately designed regulatory frameworks and (2) the new, more homogenous regulatory framework would be more burdensome on one group relative to others.

On the other hand, a differentiated system could provide an opportunity for institutions to strategically choose a charter type based on what they perceive would be the most lenient regulatory regime. In addition, regulators—which are funded at least in part by fees they charge the institutions they regulate—may have an incentive to offer a more relaxed regulatory treatment.

An important consideration in optimizing the degree of differentiation is determining the degree to which the business models of different depository types differ. If they differ significantly, differentiated charters could create substantive benefits. To the extent this is the case, proposals that reduce the differences in charters reduce the benefits of maintaining separate charters. In contrast, if banks and thrifts are in essence similar businesses, differentiated charters may be inefficient and unnecessary.

Legislative Alternatives

Option to Operate as a Bank. Section 206 of S. 2155 would allow certain federal savings associations with less than $15 billion in assets to elect to operate with the same rights as national banks (while still being treated as thrifts for purposes of certain regulations, including those related to corporate governance, consolidations, and mergers) without having to change charters. This would remove certain lending limits thrifts face on certain loan types, including consumer, business, and commercial real estate loans. H.R. 1426 and Section 551 of H.R. 10 would allow for the same election, without a size limit.

A federal thrift may want to alter its business model (perhaps by expanding in a certain loan type), but so doing would violate limitations faced by thrifts, but not national banks. Currently, implementing such a change would require converting to a national bank charter. The conversion process may act as a safeguard against certain institutions imprudently changing their risk profile, but can be costly, time consuming, and may necessitate a change in ownership structure.

If a federal thrift can opt to be treated as a national bank without changing charters, some thrifts may be able to alter their business models more quickly and at less cost. Supporters argue that this would provide thrifts flexibility to adapt to changing economic conditions. Furthermore, they argue that the change would not pose a safety and soundness risk because federal thrifts are regulated by the same regulator—the OCC—as national banks. In addition, the bills would provide the OCC with authority to issue necessary safety and soundness regulations.

Opponents of the proposals have argued this is an inappropriate expansion of thrifts' permitted activities that, if applied only to thrifts could put other depositories—such as credit unions—at a disadvantage. In addition, they argue that creating another regulatory option that shares characteristics with both aspects of national bank and thrift requirements could potentially create an opportunity for institutions to cherry pick aspects of each regulatory regime that results in inappropriately lenient regulation.

Large Thrift Holding Companies. Depositories can be (but are not always) subsidiaries of a parent holding company that may own other nondepository financial subsidiaries. Holding companies may incorporate as bank holding companies (BHCs) or THCs, depending on the charter of the depositories. Similar to BHCs, THCs have subsidiaries that accept deposits and make loans; can own nonbank subsidiaries; and are regulated by the Fed.

One area in which the two types of organizations differ is the application of certain *enhanced prudential regulations* pursuant to the DFA. In response to the 2007-2009 crisis and with the aim of addressing financial stability and "too big to fail" institutions, the DFA created a new prudential regulatory regime that applies to all BHCs with more than $50 billion in assets and to certain other financial institutions. Under this regime, the Federal Reserve is required to apply a number of safety and soundness requirements to large banks that are more stringent than those applied to smaller banks.

Although a number of these enhanced regulations have been implemented for BHCs, to date they have not been applied to THCs with $50 billion or more in assets. As of June 2017, official regulatory data report six THCs that have more than $50 billion in assets, with some having more than $200 billion. These include firms in the securities or insurance industries that have limited deposit and lending operations.

However, implementation of DFA regulations is ongoing and prefatory material accompanying a 2014 regulation noted that the Fed "may apply additional prudential requirements to certain [THCs] that are similar to the enhanced prudential standards if it determines that such standards are consistent with the safety and soundness of such companies." In addition, individual THCs could be subjected to enhanced regulation by a Financial Stability Oversight Council *nonbank systemically important financial institution* designation. No THC has been designated to date, however.

Congress might consider whether there is sufficient difference between the complexity and interconnectedness of large THCs compared with their BHC peers to warrant THC omission from the enhanced regulatory regime. If Congress finds the two types of institutions pose similar risks, it could approve legislation directing the Fed to subject large THCs to the regime. Conversely, if Congress finds they are different, it could explicitly exempt THCs.

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