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May 23, 2011

Board of Governors of the Federal Reserve System
c/o Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

BY EMAIL: regs.comments@federalreserve.gov

Re: Docket No. OP-1416

Members of the Board:

On behalf of Sandler O'Neill + Partners, L.P., I am commenting on the Board's *Notice of Intent to Apply Certain Supervisory Guidance to Savings and Loan Holding Companies*, issued April 15, 2011 for comment by May 23, 2011.

Sandler O'Neill is a full-service investment-banking firm focused on the financial services sector.[1] Our clients include a wide variety of financial firms, among them almost 1,000 banks and thrifts and their holding companies. Sandler O'Neill frequently comments on supervisory and other issues important to our clients.

Overview

Pursuant to Title III of the Dodd-Frank Act, on July 21, 2011 (the "transfer date") supervisory responsibility for savings and loan holding companies ("SLHCs") will be transferred to the Board from the Office of Thrift Supervision. As with bank holding companies ("BHCs"), the Board's supervisory objective for SLHCs will be to ensure their effective supervision as sources of strength for their subsidiary depository institutions.

In its notice of intent to apply its BHC consolidated supervision program to SLHCs, the Board states its belief that SLHCs need not take preparatory action and should not experience "undue burden on an ongoing basis." More specifically:

> The Board intends to integrate each SLHC into existing programs that align institutions with various supervisory portfolios (e.g., community banking organizations, regional banking organizations, and large banking organizations) based on their size and complexity. Each portfolio has a supervisory program tailored to the type of institution supervised.

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[1] For further information on Sandler O'Neill + Partners, L.P., see http://www.sandleroneill.com/; author contact information: jlongino@sandleroneill.com or 212-466-7936.

Nevertheless, the Board has requested comment on all aspects of its approach, including "any unique characteristics, risks, or specific activities of SLHCs," as well as the impact of Basel III capital limitations and exclusions and transition periods.

After the transfer date, the Board will issue formal guidance or proposed rules, as appropriate, taking into consideration comments on its notice. Pending final guidance and rules, the Board "anticipates that it will assess SLHC capital using supervisory quantitative and qualitative methods similar to those currently employed by the OTS."

Discussion

We wish to highlight for the Board three issues: (i) provisions of Dodd-Frank that conflict with Basel III, (ii) the lack of an exemption for small SLHCs from Dodd-Frank's minimum capital requirements, and (iii) SLHC reliance on trust preferred securities as capital instruments.

(i) Conflicts Between Dodd-Frank and Basel III

In our review, we see several areas where the provisions of Dodd-Frank conflict with those of Basel III, particularly as applied to SLHCs. Although we are not lawyers, we believe that generally recognized principles of statutory and regulatory construction argue for resolving conflicts between the Dodd-Frank Act and Basel III in favor of Dodd-Frank. In brief, because the provisions of Dodd-Frank are statutory expressions of congressional intent specific to banking organizations in the United States, they should trump conflicting Basel III guidance.

We believe the consequences for SLHCs of this conflict-resolution construct to be as follows:

- All SLHCs remain exempt from consolidated capital requirements until July 21, 2015 (five years after Dodd-Frank enactment), except for such individual minimum capital requirements as the Board may impose in appropriate supervisory circumstances.
- Thereafter, SLHCs (and BHCs) with less than $15 billion in consolidated assets at December 31, 2009 and all companies that were mutual holding companies at May 19, 2010, will be able to include in consolidated Tier 1 capital trust preferred securities issued before May 19, 2010, as permitted by the Board's capital regulations.
- Sometime in 2015, to be determined by the Board's implementing rules, trust preferred securities issued by SLHCs (and BHCs) with $15 billion or more in consolidated assets at December 31, 2009 will be fully excluded from consolidated Tier 1 capital, notwithstanding Basel III's longer phase-out.
- TARP or CPP equity or debt instruments issued by SLHCs (and BHCs) prior to October 4, 2010 will continue to count as consolidated Tier 1 capital, notwithstanding the termination of Basel III grandfathering in 2018.

We note that the U.S. Congress may wish to reconsider the phase-out of trust preferred securities from Tier 1 capital over Dodd-Frank's 3 years compared to Basel III's 10 years in light of any competitive disadvantage it might create for banking organizations in the United States.

(ii) Dodd-Frank's Nonexemption of Small SLHCs

As the Board itself observes in its notice, although section 171 of Dodd-Frank exempts small BHCs (less than $500 million in consolidated assets) from its minimum capital requirements, it does not similarly exempt small SLHCs. Specifically, the minimum capital requirements of section 171 do not apply to small BHCs that are subject to the Board's Small Bank Holding Company Policy Statement as in effect May 19, 2010. Small SLHCs obviously are not subject to that policy statement, and so by the literal terms of section 171 are not exempt from its consolidated capital requirements.

Although section 171 defers application of its capital requirements to all SLHCs for five years, as noted above, the nonexemption of small SLHCs from consolidated capital requirements is nevertheless a problem that merits prompt resolution in the interests of regulatory and operational certainty for small SLHCs. Particularly is this so in light of the extent of their reliance on trust preferred securities as capital instruments, as discussed below.

In the absence of prompt correction of what we believe is legislative oversight, small SLHCs would have to convert their subsidiary depositories to bank charters to retain their exemption from minimum capital requirements. Charter change should be a solution of last resort because there are 219 SLHCs reporting consolidated assets less than $500 million each and aggregate assets of $42 billion (SNL Financial data as of 12/31/10).

We note that the 111th Congress considered and rejected abolition of the Federal thrift charter during the legislative process that culminated in the Dodd-Frank Act. We therefore urge the Board, through prompt supervisory interpretation, to give effect to the clear congressional intent in section 171 to exempt all small depository institution holding companies from consolidated capital requirements.

(iii) SLHC Reliance on Trust Preferred Securities

The utilization by SLHCs of trust preferred securities as capital instruments is an important reason that conflicts between Basel III and Dodd-Frank be resolved in favor of the latter and that Dodd-Frank's inadvertent nonexemption of small SLHCs from consolidated capital requirements be rectified promptly through regulatory interpretation.

Our review of the extent of this use identified a total of 79 SLHCs with outstanding trust preferred securities, for 25 of which such securities exceeded 25% of pro forma

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consolidated Tier 1 capital.[2] The smaller the SLHC, the greater its reliance on trust preferred securities tended to be.

Only 5 SLHCs had consolidated assets of $15 billion or more, none with trust preferred securities exceeding 25% of pro forma consolidated Tier 1 capital. Of the 47 SLHCs with consolidated assets of $500 million or more but less than $15 billion, 9 had trust preferred securities exceeding 25% of pro forma consolidated Tier 1 capital. Of the 27 SLHCs with consolidated assets of less than $500 million, 16 had trust preferred securities exceeding 25% of pro forma consolidated Tier 1 capital.

Thus, the greater reliance of smaller SLHCs on trust preferred securities heightens the importance of resolving in favor of Dodd-Frank conflicts between it and Basel III and of clarifying promptly that small SLHCs are exempt from consolidated Tier 1 capital requirements.

Very truly yours,

Joseph Longino

Joseph Longino
Principal

cc: The Honorable John E. Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552

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[2] SNL Financial data as of 12/31/10. The lesser quantity and quality of SLHC data reflect both its relative unimportance arising from the lack of consolidated capital requirements and the large number of SLHCs that are not public companies. Because for much of their history thrifts were mutual institutions, they had no holding companies and diversified instead through service-corporation subsidiaries. During the thrift crisis of the 1980s, SLHCs became more common, but largely as a means of raising equity or debt to recapitalize their subsidiary thrifts rather than as a means of diversifying their operations. Thus, compared to BHCs, SLHCs tend to be shell corporations whose balance sheets consist primarily of investment in thrift subsidiary plus whatever capital instruments they have issued.