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Arguments for Keeping Thrifts May Be Fading

Two advantages could be eliminated; third under criticism

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WASHINGTON — Though the banking industry has a strong chance of defeating the Obama administration's call to eliminate the thrift charter, its arguments for defending it appear weaker than ever.

Two of the primary reasons for preserving the charter — stronger preemption powers and broader interstate branching rights — appear headed for the chopping block, and the third — a focus on mortgage lending — is now increasingly suspect. Many observers doubt the wisdom of keeping a charter that focuses primarily on real estate lending, arguing that thrifts caused the savings and loan crisis and helped fuel the current crisis.

"Why do you need it?" said Chuck Muckenfuss, a partner at Gibson, Dunn & Crutcher LLP. "It has certain restrictions in it, and so why not just make it one better charter in which you can do whatever you want to do? That's pretty compelling."

At issue is the Obama administration's regulatory reform proposal, which calls for the elimination of the thrift charter and its regulator, the Office of Thrift Supervision. Though most observers see the agency's elimination as a given, the banking industry is ready to fight tooth and nail to preserve the thrift charter itself.

To that end, bankers have a powerful ally in House Financial Services Committee Chairman Barney Frank, who said in an interview that problems in the thrift charter can be addressed by merging the OTS with the Office of the Comptroller of the Currency and strengthening regulatory oversight. "It is true that the thrift charter has been abused, because people have used a thrift charter to do all kinds of other things, but I think it's a mistake to abolish it altogether," Frank said. "There is a sort of housing and community savings emphasis there. What we should do instead is to amend the law creating a thrift charter so it can't be used as a fig leaf to go into other things. If people want to run a thrift as a thrift, I would keep that charter."

A dedicated charter focused on real estate lending remains the most compelling argument for keeping the charter. The charter "benefits consumers by ensuring that thrift institutions provide home mortgages and other consumer retail lending services, thereby meeting America's financial services needs," John Bowman, the OTS' acting director, said in a statement to *American Banker*.

But many have begun to argue that having a concentration in an area that was once thought risk-free but that has proven otherwise in the current crisis is a mistake. The focus on real estate lending left thrifts more vulnerable in the savings and loan crisis and the recent housing crisis because they were not able to diversify as much as commercial banks.

"The concentration in housing lending, like any other required concentration, can introduce additional risk," said David Nason, a former Treasury official who helped craft the Bush administration's regulatory blueprint released last year. That proposal also would have eliminated the thrift charter.

Some observers contend that focusing on regulation of thrifts is missing the point. The industry has twice had a regulator dedicated to its oversight — the Federal Home Loan Bank Board and the OTS — and both times it missed key problems. "Do you want a regulator with a unique specialty on mortgage lending?" said Mark Calabria, director of financial regulations studies at the Cato Institute. "You could have a regulator with that expertise, but they can still miss the ball."

Ellen Seidman, a former OTS director, also questions whether there is a more effective way to promote real estate lending than through a specialized charter.

"If we go about supporting residential lending, it's not at all clear that pushing institutions into an overall reliance on real estate lending is how we ought to be supporting homeownership in the United States," said Seidman, now the director of the Financial Services and Education Project at the New America Foundation. "We need to think about how unsubsidized residential real estate lending at the originator level for both single and multifamily — what degree of support do we want to give this, how supportive should this be, can we do it purely as a private function? I think that is a debate we need to have. The thrift charter may be a way of having that debate."

Recent data also suggests that commercial banks are increasingly doing more mortgage lending. Of the top 20 largest residential mortgage loan portfolios as of March 31, only three were held by thrifts. And as of June 11, thrifts had $631 billion of assets in mortgage loans, compared to $1.227 trillion in mortgage assets held by commercial banks.

The data raises a question that has dogged the thrift industry during the past decade: are thrifts any different from banks anymore? Before the savings and loan crisis, the answer was a definitive yes, but in recent years the differences have become blurred.

"What's happened over time is the thrifts have become more like banks, and the banks, in the sense that they are making mortgage loans, have become more like thrifts," said Bob Clarke, a senior partner at Bracewell & Giuliani LLP and a former comptroller of the currency.

The growing similarities between the two are a key reason the Obama and Bush administration suggested eliminating the thrift charter. They say a specialized mortgage charter is no longer necessary. "The historical distinctions between the bank charter and the thrift charter have long ago dissipated," said Michael Barr, Treasury assistant secretary for financial institutions. "What remains doesn't make any sense. … There's no continuing meaningful justification for having a separate charter with the opportunity to arbitrage between a bank charter and a thrift charter."

Barr argued that keeping a separate charter allowed institutions to shop for a more lenient regulator. While all commercial bank holding companies are regulated by the Fed, thrift holding companies are overseen by the OTS. "Our system of bank regulation was filled with loopholes," Barr said. "We need to say anybody who owns a bank is a bank holding company and is going to get meaningful significant supervision as a consolidated entity at the holding company level by the person in charge of doing that, which in our proposal is the Federal Reserve, and all the other games people have played in the past are over."

Other companies are also filling the role that thrifts traditionally did. "The administration states that the government-sponsored enterprises are doing a lot of securitization for housing lending, which has lessened the need for a charter dedicated to housing," said Nason, who is now at Promontory Financial Group.

Many thrift charter supporters point to two remaining differences from the national bank charter: greater preemption and branching powers. While national bank preemption is under fire from state regulators and the court system, thrift preemption has largely gone unchallenged because it has rested on more solid legal footing.

But the Obama plan would eliminate both those advantages even if the charter itself does not go away. The administration has proposed effectively doing away with preemption for all banks and thrifts, and so far appears to have significant support in Congress for such a move (which the banking industry also opposes).

Thrift branching powers, meanwhile, which include the ability for de novos to branch across state lines, are likely to be granted to all institutions. The Obama plan argued for removing any restrictions on interstate branching, and that provision appears to have a very likely chance of enactment.

Without preemption and interstate branching, it's unclear why the industry would want to keep the thrift charter, observers said.

"It looks to me like if they are trying to preserve the benefits of the thrift charter in the new charter then there isn't much of a benefit in preserving it," said Clarke.

But the banking industry and many thrift executives argue the administration has it wrong. Curtis Hage, chairman, president and chief executive of the $1.17 billion-asset Home Federal Bank in Sioux Falls, S.D., said that even though banks have increasingly engaged in mortgage lending, they are just following thrifts' lead.

"The reason more banks are making loans is simply there are more banks than thrifts today but they are doing it within the framework and system and structure the thrift industry has created," Hage said. "I don't know if bankers have in their philosophy to keep developing the home mortgage market. They are doing it as a competitive response."

Hage also argued that eliminating the thrift charter did not solve any immediate problems.

"If there is an inherent problem in mortgage finance that will reside with whoever does mortgage finance, even if you move it to the banking charter," he said.

Kevin Jacques, associate professor of finance at Baldwin-Wallace College, agreed that even if the thrift charter was eliminated, it would not make much difference.

"If you wipe out the thrift charter, you will see former thrifts say, 'My expertise is in home lending, so I'm not going to change how I do business,' " Jacques said. "Most thrifts are not going to change how they do business if you take the thrift charter away."

Diane Casey-Landry, the chief operating officer of the American Bankers Association, says the administration is fighting the last crisis, not this one.

"It's the remnant of the savings and loan crisis and viewed as the low-hanging fruit and not recognizing that the thrifts that survived didn't cause the crisis," she said.

But thrift failures have helped propel the housing downturn. Since last year, 9 thrifts have failed, including the largest savings and loans. Washington Mutual Inc., IndyMac and BankUnited were all large thrifts undone by the crisis, while others, like Countrywide Financial, were purchased before they could collapse.

Some said that issue can be addressed by merging the OCC and OTS, as Obama has proposed. "Let's create one strong entity," Jacques said. "At the end of the day, the biggest issue isn't the charter itself, it's the fact that the OTS is a weak supervisory agency."

But others said there is little point in eliminating the OTS without taking away the charter.

"The charter and OTS go hand in hand," said Kip Weissman, a partner at Luse Gorman. "Keeping the charter and putting it into the bank regulator is pretty close to window dressing."

Then there are practical issues the administration has not addressed. If the thrift charter were eliminated, it is unclear what would become of the 247 federally chartered mutuals, which would theoretically need to convert to a commercial banking charter.

"There is no way to convert a mutual charter into a bank unless you create a whole nother charter," said Chip MacDonald, a partner at Jones Day.

Forcing large insurance companies and other nonbanks that own thrifts to convert or divest could raise additional problems.

"What you are doing is you are going to cut off the ability of these people to do sales and do financing in the system," MacDonald said. "Many of the institutions that have a thrift aren't eligible to be a bank holding company."

One thing is clear: if the administration wants to eliminate the thrift charter, it has some heavy lifting to do. With Frank already opposed to that part of the plan, and most other lawmakers silent, observers said it would take a concerted push by Obama to make it happen. "I wouldn't underestimate the thrift industry and housing industry lobbying against this," said Calabria, a former top aide to Sen. Richard Shelby, R-Ala. "The politics don't favor it."