1991

The Office of Thrift Supervision

Robert Cooper

Recommended Citation
Available at: http://ir.lawnet.fordham.edu/flr/vol59/iss6/14
THE OFFICE OF THRIFT SUPERVISION

INTRODUCTION

By enacting the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), Congress created the Office of Thrift Supervision ("OTS") to replace the Federal Home Loan Bank Board ("FHLBB"). Dissatisfied with the state of the thrift industry as regulated by the FHLBB, Congress created the OTS exclusively for the purpose of regulating the thrift industry, and expected the strong hand of the OTS to provide stability for the thrifts. In order to carry out its mission, the OTS is vested with broad powers. These powers enable the OTS to impose specific requirements upon the thrifts to ensure their safe operation and to minimize the threat to the thrift industry's deposit insurance fund. Furthermore, the OTS' enforcement powers allow it to prevent non-complying thrifts from continuing to violate these standards.

Part I of this Note examines the FHLBB, the predecessor of the OTS, and describes how Congress intended the OTS to remedy some of the ills giving rise to the savings and loan ("S&L") crisis. These causes include the inadequate supervision of the thrift industry and the apparent conflict of interest between the FHLBB and the Federal Savings & Loan Insurance Corporation ("FSLIC"). Part II presents an overview of the OTS, describing its duties, powers and day-to-day operations—and examines some of the litigation in which the OTS is currently involved. This Note concludes that, its detractors notwithstanding, the OTS remains a necessary regulatory body that can continue to supervise the thrift industry effectively.

I. THE REGULATORY STRUCTURE PRIOR TO THE OTS

A. The Federal Home Loan Bank Board

1. Formation of the FHLBB

In 1932, Congress formed the FHLBB as an agency of the federal government by enacting the Federal Home Loan Bank Act ("FHLBA").

---

2. See infra note 44 and accompanying text.
3. See infra note 48 and accompanying text.
4. See infra notes 47-48 and accompanying text.
5. See infra notes 56-88 and accompanying text.
6. See infra notes 89-123 and accompanying text.
7. See infra notes 12-29 and accompanying text.
8. See infra notes 30-42 and accompanying text.
9. See infra notes 43-150 and accompanying text.
10. See infra notes 151-171 and accompanying text.
11. See infra note 172 and accompanying text.
The FHLBB consisted of a three-member panel appointed by the President with the approval of the Senate. These members served four-year terms, with one member designated by the President as chairman.

Congress authorized the FHLBB to regulate all S&Ls that made long-term home mortgage loans and were members of the Federal Home Loan Bank System. Additionally, with the Home Owners' Loan Act of 1933 ("HOLA"), Congress authorized the FHLBB to charter and regulate federal thrifts through a system consisting of twelve regional Federal Home Loan Banks. The statute mandated that the Federal Home Loan Banks be owned by FSLIC-insured thrift institutions, with each thrift being required to own stock in its regional bank. Thus, each Federal Home Loan Bank served as a central credit facility as well as a secondary liquidity source.

2. Powers of the FHLBB

The FHLBB's regulatory powers were similar to but less far-reaching than those now possessed by the OTS. The FHLBB could organize, incorporate, examine, operate, and regulate federal savings and loan associations. The FHLBB also supervised and regulated the twelve Federal Home Loan Banks that provided credit and other services to the

15. See id.
18. See id. § 1423 (1988). These regional banks were located in Atlanta, Boston, Chicago, Cincinnati, Dallas, Des Moines, Indianapolis, New York, Pittsburgh, San Francisco, Seattle and Topeka. See Adams & Peck, The Federal Home Banks and the Home Finance System, 43 Bus. Law. 833, 833 (1988). The Federal Home Loan Banks were established for two main purposes—first, to provide member thrifts with below-market loans to further the housing-finance mission, see H.R. Rep. No. 54, 101st Cong., 1st Sess., pt. 1, at 453, reprinted in 1989 U.S. Code & Admin. News 86, 149 [hereinafter House Report], and second, to supervise and examine the member thrifts. The president of each district served as the main supervisory agent and had the power to decide on applications from member thrifts and to enforce federal laws and regulations. See id.
19. See id.
20. See 12 U.S.C. § 1426(a) (1988). The number of shares a thrift institution was required to buy was based on the level of investment the thrift held in residential mortgages and on the thrift's Federal Home Loan Bank advances. See id. § 1426(c)(1)-(2) (1988).
22. See Regulation of Savings Associations, supra note 16, at 1028. For a discussion of the OTS' regulatory powers, see infra notes 56-100 and accompanying text.
23. See 12 U.S.C. § 1464(a) (1988). The FHLBB lacked authority over state-chartered savings associations, however. The regulations and authority of these state-chartered savings associations was most often determined by state law. See Regulation of Savings Associations, supra note 16, at 1018.
S&Ls. The FHLBB had authority, for example, to issue cease-and-desist orders against associations that engaged in unsound or unsafe business practices, and could also place an institution in conservatorship or receivership.

Through its role as administrator of the FSLIC, the FHLBB insured deposits in FSLIC-insured thrifts. Congress empowered the FSLIC to insure accounts placed in both federal savings associations and some federal savings banks. The FSLIC also insured accounts of savings and loans, building and loans and homestead associations operated under state law. Thus, through the FSLIC, the FHLBB had some regulatory authority over those state institutions that were insured by the FSLIC.

B. The Savings and Loan Crisis

The FHLBB was abolished in the wake of the S&L crisis. While the reasons for the crisis are many and varied, this section will focus on those causes related to the operations of the FHLBB.

Many believe that the S&L crisis resulted at least in part from inadequate supervision of thrifts. In keeping with the Reagan Administration’s policy of diminishing government intrusion, the Treasury Department and the thrift regulators convinced Congress in the early 1980’s to scale back government regulation of the S&L industry, thus reducing the number of savings and loan examiners to an inadequate level. This lack of supervision, coupled with the deregulation of thrift


27. The FHLBB could also appoint the FSLIC as conservator or receiver of a federal savings association. See 12 U.S.C. § 1729(b)(1) (1988). As conservator or receiver, the FSLIC could take control of an association’s assets and operations, merge the association with another insured association, or organize a new federal association to take over the assets of the seized association. See id. § 1729(b) (1)(A). The FSLIC could choose whichever option it deemed to be in the best interest of the seized institution and the FSLIC. See id.; see also Note, The FDIC’s Enhanced Powers Over Savings Associations: Does FIRREA Make it “SAIF”? in Annual Survey of Financial Institutions and Regulation, The S&L Debacle: Death and Transfiguration, 59 Fordham L. Rev. S381 (1991) (discussing FSLIC’s successor, SAIF).


32. See id.
investment activities,\textsuperscript{33} led to an increase in "fraudulent and risky activities."\textsuperscript{34} Many institutions subsequently suffered great financial losses while regulators appeared to be unaware that problems existed.\textsuperscript{35}

Another cause of the S&L crisis stemmed from the dual missions of the FHLBB. The FHLBB, the chief regulator of savings and loan associations, "perceived its role as that of an industry promoter."\textsuperscript{36} The Board also administered the FSLIC, however, and therefore was charged with protecting the industry's deposit insurance fund.\textsuperscript{37} This potential conflict of interest within the FHLBB—its role as an industry promoter versus its role as an industry insurer—inevitably led to problems.\textsuperscript{38} In fact, witnesses testifying before the House Banking Committee asserted that the Board's main priority was to promote the thrift industry\textsuperscript{39} at the expense of the "captive deposit insurance fund."\textsuperscript{40} These witnesses pointed to the Board's relaxation of capital standards as well as to a scarcity of enforcement actions against thrift owners as evidence of their claims.\textsuperscript{41} The FHLBB, it seems, may have been more interested in promoting the industry than in protecting the insurance fund.\textsuperscript{42} This conflict was a major force leading to the decline of the FHLBB and giving rise to the newly designed OTS.

II. A SELECTIVE OVERVIEW OF THE OTS

A. Formation and Structure of the OTS

President Bush signed FIRREA into law on August 9, 1989.\textsuperscript{43} Pursuant to FIRREA, the FHLBB was disbanded at the close of business on October 7, 1989, and the OTS was officially established on October 8, 1989.\textsuperscript{44} One of the main purposes of establishing the OTS was to sepa-


\textsuperscript{36} Id.

\textsuperscript{37} See id.


\textsuperscript{39} See id.

\textsuperscript{40} Id.

\textsuperscript{41} See id.

\textsuperscript{42} See id. The FHLBB's relaxation of capital standards and failure to use its enforcement powers against thrift associations supports this theory. See id.

\textsuperscript{43} See Malloy, Nothing to Fear but FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation, 50 Ohio St. L. J. 1117, 1133 (1989).

\textsuperscript{44} See FIRREA, § 401(a)(2), 103 Stat. at 354 (to be codified at 12 U.S.C. § 1437(a)(2)).
rate the credit, insurance and regulatory functions\textsuperscript{45} that had previously all been under the control of the FHLBB.\textsuperscript{46} Congress was painfully aware that concentrating these functions may have led to conflicts of interest that contributed to the S&L crisis.\textsuperscript{47} Its goal was to create an agency with enhanced enforcement powers that would concentrate solely on regulating the industry.\textsuperscript{48}

Organizationally, the OTS is an agency within the Department of the Treasury,\textsuperscript{49} headed by a Director under the general oversight of the Secretary of the Treasury.\textsuperscript{50} The Secretary may not, however, intervene in matters before the Director unless so permitted by law.\textsuperscript{51}

The Director of the OTS is appointed by the President with the approval of the Senate.\textsuperscript{52} Although the Director may serve only one five-year term, he may remain at the post after his term has expired until a successor has been appointed.\textsuperscript{53} Except for those powers that were ex-


\textsuperscript{46} See id.


\textsuperscript{49} See FIRREA, § 301(3)(a), 103 Stat. at 278 (to be codified at 12 U.S.C. § 1462a(a)).

\textsuperscript{50} See id. § 301(3)(b)(1), 103 Stat. at 278 (to be codified at 12 U.S.C. § 1462a(b)(1)). The Director is required to report annually to Congress, detailing any changes he has made or may make regarding the OTS' district offices, including "the geographic allocation of the office's resources and personnel used to carry out examination and supervision functions." Id. § 301(3)(f), 103 Stat. at 279 (to be codified at 12 U.S.C. § 1462a(f)).

Congressional budget analysts have criticized the OTS for failing to provide timely updates on the condition of the thrift industry. See Cope, Dearth of Numbers from OTS Makes Thrift Picture Hazy, Am. Banker, July 16, 1990, at 8, col. 1. From March 1990 through July 1990, the OTS failed to publish any statistics from monthly thrift financial reports. See id. This lack of information makes it difficult to determine the success of the rescue efforts or to assess the financial needs of the Resolution Trust Corporation ("RTC"). See id. For a discussion of RTC, see Note, The Resolution Trust Corporation: Waste Management and The S&L Crisis, in Annual Survey of Financial Institutions and Regulation, The S&L Crisis: Death and Transfiguration, 59 Fordham L. Rev. S339 (1991). Lack of information also hinders efforts to increase the strength of the thrift industry because investors need information to determine the health of certain savings associations before they will invest in thrifts. See Cope, supra, at 8, col. 1.

\textsuperscript{51} See FIRREA, § 301(3)(b)(3), 103 Stat. at 278 (to be codified at 12 U.S.C. § 1462a(b)(3)).

\textsuperscript{52} See id. § 301(3)(c)(1), 103 Stat. at 278 (to be codified at 12 U.S.C. § 1462a(c)(1)). The Director must be a citizen of the United States. See id.

\textsuperscript{53} See id. § 301(3)(c)(4), 103 Stat. at 278 (to be codified at 12 U.S.C. § 1462a(c)(4)). The statute also provided that, upon creation of the OTS and abolition of the FHLBB, the then chairman of the FHLBB, M. Danny Wall, would continue as the Director of the OTS until his term expired. See id. § 301(3)(c)(5), 103 Stat. at 278 (to be codified at 12 U.S.C. § 1462a(c)(5)). In November 1989, however, Mr. Wall resigned. See 8 Annual Review of Banking Law 1989, at 15.
pressly transferred to other agencies or repealed by FIRREA, the Director retains the powers granted to the chairman of the FHLBB.

B. The OTS' Regulatory Powers

The OTS has many varied powers and duties, all of which are aimed at ensuring a strong, viable thrift industry. This section will examine the OTS' most important and useful powers and will compare these powers to similar powers that had been available to the FHLBB.

1. Capital Requirements

One of the OTS' most important regulatory powers is its ability to enforce minimum capital standards for savings associations. In contrast, before the enactment of FIRREA, the FHLBB set whatever minimum capital requirements it deemed appropriate, based on the circumstances of individual savings associations.

The OTS can similarly prescribe minimum regulatory capital standards that apply industry-wide, and can require more stringent capital standards for particular thrift institutions if their condition warrants stronger compliance. These requirements force savings associations to maintain an adequate level of capital under three standards: a risk-based capital standard, a leverage capital standard, and a tangible capital standard.

---

54. See FIRREA, § 301(3)(e), 103 Stat. at 278-9 (to be codified at 12 U.S.C. § 1462a(e)).
55. See supra notes 23-29 and accompanying text.
56. See Regulation of Savings Associations, supra note 16, at 1034, 1036. Congress enacted the capital standards to discourage thrifts from investing in risky activities; a thrift had to comply with higher capital standards before engaging in such activities. See House Report, supra note 18, at 429, reprinted in 1989 U.S. Code Cong. & Admin. News 86, 225. Additionally, Congress believed that capital standards acted like deductibles in insurance policies, and therefore less of the deposit insurance fund was at risk. See id. Finally, Congress believed that because more of the thrift owners' money was at risk, the owners would be more careful. See id.
58. See id. § 1464(s)(2) (1988).
59. See FIRREA, § 301(5)(s)(2), 103 Stat. at 303 (to be codified at 12 U.S.C. § 1464(s)(2)). These standards are set as a percentage of total assets. See id.
60. See id. § 301(5)(s)(4), 103 Stat. at 302 (to be codified at 12 U.S.C. § 1464(s)(4)).
61. See id. § 301(5)(t)(1)(A), 103 Stat. at 303-4 (to be codified at 12 U.S.C. § 1464(t)(1)(A)). For a more detailed discussion of the minimum capital standards, and for a description of the three standards, see Anthony Providenti's section of survey. FIR-
If a thrift fails to meet minimum capital requirements, the OTS requires the thrift to submit a capital plan proposing a strategy for reaching the minimum requirements. If the OTS rejects a thrift's plan or if a thrift fails to comply with an approved plan, the OTS may treat this as an unsafe or unsound practice, and therefore may find grounds to seize the thrift.

The OTS has been strictly enforcing these new capital requirements and has been extremely selective in approving capital plans. As of March 27, 1990, the OTS had ruled on 172 capital plans. Of these, only forty-nine were approved. The 123 thrifts that had their plans rejected were expected to be turned over to the Resolution Trust Corporation ("RTC") or face other enforcement or supervisory action.

Thrift operators have strongly denounced the OTS for its strict en-

REA requires the OTS to enforce minimum capital standards at least as stringent as those of the Comptroller of the Currency, the regulator for national banks. See FIRREA, § 301(5)(1)(C), 103 Stat. at 304 (to be codified at 12 U.S.C. § 1464(1)(1)(C)). Risk-based capital standards may exceed those standards of national banks to reflect interest rate risks or other possible risks. See id. § 301(5)(1)(C), 103 Stat. at 304 (to be codified at 12 U.S.C. § 1464(1)(1)(C)). A thrift must maintain the leverage standard of capital at not less than three percent of total assets, and tangible capital at a level of 1.5% or more of total assets. See id. § 301(5)(1)(1)(A)-(B), 103 Stat. at 304 (to be codified at 12 U.S.C. § 1464(1)(1)(A)-(B)).

62. See id. § 301(5)(1)(6)(A)(ii)(III), 103 Stat. at 307 (to be codified at 12 U.S.C. § 1464(1)(6)(A)(ii)(III)). The OTS has the additional power to limit the asset growth of any savings association that fails the minimum capital requirements prior to January 1, 1991 by issuing a capital directive. See id. § 301(5)(1)(6)(A)(ii), 103 Stat. at 307-08 (to be codified at 12 U.S.C. § 1464(1)(6)(A)(ii)). The capital directive will restrict payment of dividends and compensation as the Director deems appropriate. See id. at 308. The OTS has the discretion to limit the sanctions on any thrift that fails to meet the capital requirements, but the asset growth limitation must still apply. The OTS will approve a capital exemption only if: (1) it poses no significant risk to the thrift; (2) the management of the thrift is competent; (3) the savings association is for the most part in compliance with all applicable statutes, orders, regulations, directives and supervisory agreements; and (4) the institution's management has not engaged in practices that have jeopardized the safety or soundness of the institution. See id. § 301(5)(1)(7)(C)(i)-(IV), 103 Stat. at 309 (to be codified at 12 U.S.C. § 1464(1)(7)(C)(i)-(IV)).

63. See id. § 301(5)(7)(E), 103 Stat. at 309 (to be codified at 12 U.S.C. § 1464(1)(7)(E)).

64. See infra note 102 and accompanying text.


67. See id.


69. See Statement of Salvatore R. Martoche, supra note 66, at 486.
 enforcement of these standards. Critics of OTS, who claim that harsh capital standards will ultimately close some savings associations that would otherwise survive, believe that the continued imposition of these standards will ultimately increase the amount paid by taxpayers as a result of the S&L crisis. These critics, including thrift operators themselves, contend that before seizing troubled associations, the OTS should allow associations that have not submitted acceptable capital plans a last shot at raising their levels of capital.

The OTS counters that strong restrictions must be imposed to minimize the costs to taxpayers. The OTS claims that many of the institutions that critics allege would survive with less stringent capital restrictions are, in reality, terminally sick institutions that would ultimately collapse at a later date. By closing the thrifts now, the OTS argues, higher future costs are averted. Additionally, the OTS asserts that those thrifts that do not have a reasonable chance of survival should be removed from the industry. The prolonged survival of weaker institutions is problematic because weaker institutions would likely offer higher interest rates in order to attract deposits. These higher rates, in turn, would result in higher overall funding costs to the industry, thereby impairing the strength of sound thrifts.

2. The Qualified Thrift Lender Test

In addition to imposing capital requirements, the OTS requires thrifts to maintain a minimum percentage of their assets in qualified thrift investments—specifically, in home finance and related activities. The Qualified Thrift Lender Test (“QTL test”), as set out under the administration of the FHLBB, required a thrift to maintain an average of at least sixty percent of tangible assets in qualified thrift investments in three

---

71. See id.
72. See id.
73. See id. Critics also believe that the strict enforcement policy has more to do with political pressure on the OTS than with sound regulatory policy. See id.
74. See id.
75. See id.
76. See Statement of Salvatore R. Martoche, supra note 66, at 487.
77. See id.
78. See id. The OTS has also developed a “Capital Enhancement Program” to help savings associations raise capital and avoid being placed into conservatorship. See id. at 488. Employees in the OTS’ twelve district offices attempt to bring investors together with savings associations that need external capital financing. See id. The employees also work closely with the thrifts to develop effective marketing strategies and materials. See id.
79. See FIRREA, § 301(10)(m)(1)(A)-(B), 103 Stat. at 331-2 (to be codified at 12 U.S.C. § 1467a(m)(1)(A)-(B)).
80. Tangible assets are defined as the total assets of an insured association less goodwill and any other intangible assets. See 12 C.F.R. § 583.27 (1989).
out of four quarters annually and in two out of every three years.\textsuperscript{81} The OTS will use this test until July 1, 1991, at which time the OTS will increase the requirement to seventy percent of portfolio assets\textsuperscript{82} on a constant basis.\textsuperscript{83} Additionally, an association will be required to satisfy the seventy percent minimum by a weekly or daily average for a two-year period beginning July 1, 1991 and for each two-year period thereafter.\textsuperscript{84}

As of August 9, 1990, new investments or activities of a thrift institution that fails the QTL test will be limited to those allowable for national banks and savings associations alike.\textsuperscript{85} Such a thrift will also be prohibited from establishing new branches in areas where national banks are prohibited from establishing new branches.\textsuperscript{86} Further, it will be denied advances from any Federal Home Loan Bank and required to pay dividends in accordance with rules and regulations for national banks.\textsuperscript{87} Finally, a thrift failing the QTL test must repay any outstanding advances owed to any Federal Home Loan Bank as quickly and safely as possible, and, three years after failing the QTL test, will be required to divest itself of all investments and activities not authorized for both banks and savings associations.\textsuperscript{88}

3. Cease-and-Desist Power

FIRREA has significantly expanded the OTS' enforcement powers.\textsuperscript{89} For example, the OTS may issue cease-and-desist orders against any shareholder, consultant, or joint venture partner who participates in the

\textsuperscript{81}See 12 U.S.C. § 1730a(o)(1) (1988) (repealed by FIRREA § 407). Additionally, under the control of the FHLBB, a thrift failing the QTL was still permitted to receive advances from a Federal Home Loan Bank. These advances, however, were limited to the percentage of qualified thrift investments held by the institution. See id. § 1430(e)(1) (1988). Therefore, if a thrift held 50% of its tangible assets in qualified thrift investments, the thrift could receive 50% of the advances the association would have been entitled to had the QTL test been met.

\textsuperscript{82}'The term 'portfolio assets' means, with respect to any savings association, the total assets of the savings association, less the sum of: (i) goodwill and other intangible assets; (ii) the value of property used by the savings association to conduct its business; and (iii) liquid assets of the type required to be maintained under section 6 of the Home Owners Loan Act, in an amount not exceeding the amount equal to 10% of the savings association's total assets.' See FIRREA, § 303(a), 103 Stat. at 343-4 (to be codified at 12 U.S.C. § 1467a(m)(4)(B)).

\textsuperscript{83}See id. § 303(a), 103 Stat. at 343-4 (to be codified at 12 U.S.C. § 1467a(m)(1)(A)-(B)).

\textsuperscript{84}See id. § 303(a), 103 Stat. at 344 (to be codified at 12 U.S.C. § 1467a(m)(1)(B)).

\textsuperscript{85}See id. § 301(10)(m)(3)(B)(i)(I), 103 Stat. at 332 (to be codified at 12 U.S.C. § 1467a(m)(3)(B) (i)(I)).

\textsuperscript{86}See id. § 301(10)(m)(3)(B)(i)(II), 103 Stat. at 332 (to be codified at 12 U.S.C. § 1467a(m)(3)(B) (i)(II)).

\textsuperscript{87}See id. § 301(10)(m)(3)(B)(i)(III)-(IV), 103 Stat. at 333 (to be codified at 12 U.S.C. § 1467a(m) (3)(B)(i)(III)-(IV)).

\textsuperscript{88}See id. § 301(10)(m)(3)(B)(i)(III)-(IV), 103 Stat. at 333 (to be codified at 12 U.S.C. § 1467a(m) (3)(B)(i)(III)-(IV)).

\textsuperscript{89}See Regulation of Savings Associations, supra note 16, at 1028.
It may also issue a cease-and-desist order against any independent contractor—such as an accountant, attorney, or appraiser—who knowingly or recklessly participates in any violation of a law or regulation, breach of a fiduciary duty, or unsafe or unsound practice that has caused (or likely will cause) more than a minimal financial loss or that will have a significant adverse effect upon the thrift.

The OTS is authorized to take any enforcement action against any affiliated individual, even if that individual has resigned, been fired, or has otherwise removed. The OTS may bring an action against the party up to six years after the person has severed ties with the thrift. By contrast, the FHLBB was only permitted to bring enforcement actions against individuals who were still connected with the savings association.

The OTS is also authorized to issue temporary cease-and-desist orders. This authority was greatly enhanced relative to similar powers of the FHLBB. FIRREA has reduced the burden of proof required for issuing a temporary cease-and-desist order. The OTS must find that the violation is likely to cause a significant dissipation of assets. The FHLBB was required to show that the unsafe or unsound practice was likely to cause insolvency or a substantial—as opposed to significant—dissipation of assets, or was likely to seriously weaken the condition of the thrift.

C. Conservatorship Powers

The OTS' greatest regulatory power is its authority to seize federal and state-chartered savings associations and place them under conservatorship.

90. See FIRREA, § 902(a)(1), 103 Stat. at 450 (to be codified at 12 U.S.C. § 1818(b)).
91. See id. § 204(f), 103 Stat. at 193 (to be codified at 12 U.S.C. § 1813). Although the FHLBB had the power to issue cease-and-desist orders, the categories of individual persons subject to the FHLBB's power were much more limited. See 12 U.S.C. § 1464(d)(2)(A) (1988) (repealed by FIRREA § 407).
92. Once the cease-and-desist order has been issued, the OTS may require the institution or the affiliated party to remedy the unsafe or unsound practice or condition by: (i) making restitution, reimbursement or indemnification against loss if the association or affiliated party was unjustly enriched, or if the violation involved a reckless disregard for the law, regulation, or prior order of the OTS; (ii) restricting the growth of the thrift; (iii) disposing of any loan or asset involved; (iv) rescinding agreements or contracts; (v) rescinding employment of qualified employees or officers; or (vi) taking any action the OTS deems proper. See FIRREA, § 902(a)(1), 103 Stat. at 450 (to be codified at 12 U.S.C. § 1818(b)).
93. See id. § 905(a), 103 Stat. at 459 (to be codified at 12 U.S.C. § 1818(i)).
94. See id.
96. See FIRREA, § 902(a)(2), 103 Stat. at 451 (to be codified at 12 U.S.C. § 1818(e)).
97. See id.
98. See id.
The OTS may, without notice or a hearing, seize a federal savings association if any of a number of conditions is met. Additionally, the OTS may seize a federal savings association if, by resolution of the thrift's board of directors or its members, the thrift consents to the seizure. The OTS is also authorized to seize a federal thrift that loses its membership in any Federal Home Loan Bank or whose accounts cease to be insured by the Federal Deposit Insurance Corporation ("FDIC").

The OTS may seize a state thrift only upon the decision of a state banking official that one or more of the reasons specified for seizure exist. There are, however, two situations in which the OTS may proceed


102. See id. § 301(5)(d)(2)(A), 103 Stat. at 290 (to be codified at 12 U.S.C. § 1464(d)(2)(A)). These conditions include: (i) insolvency, such that the assets of the association are less than its obligations to its creditors and others, including its members; (ii) a substantial dissipation of assets or earnings due to any violation of law or regulations or to any unsafe or unsound practice or practices; (iii) an unsafe or unsound condition for the transaction of business, including having substantially insufficient capital; (iv) willful violation of a cease-and-desist order that has become final; (v) concealment of books, papers, records, or assets of the savings association or refusal to submit books, papers, records, or affairs of the association for inspection to any examiner or to any lawful agent of the Director; (vi) a likelihood that the association will not be able to meet the demands of its depositors or pay its obligations in the normal course of business; (vii) the association’s insolvency or likely insolvency otherwise seriously prejudice the interests of its depositors. See id. at 290-91.

Although the OTS has the authority to seize a federal savings association unilaterally and without notice, the thrift has a right to bring an action within thirty days in a United States district court requesting that the OTS remove the appointed conservator or receiver. See id. § 301(5)(d)(2)(E), 103 Stat. at 292 (to be codified at 12 U.S.C. § 1464(d) (2)(E)); infra notes 151-171 and accompanying text.


105. See id. § 301(5)(d)(2)(D)(i), 103 Stat. at 292 (to be codified at 12 U.S.C. § 1464(d)(2)(D)(i)). The grounds for seizure of a state-chartered thrift by the OTS are as follows:

(i) insolvency, such that the assets of the association are less than its obligations to its creditors and others, including its members; (ii) a substantial dissipation of assets or earnings due to any violation of law or regulations or to any unsafe or unsound practice or practices; (iii) an unsafe or unsound condition to transact business, including having substantially insufficient capital; (iv) the association is not likely to be able to meet the demands of its depositors or pay its obligations in the normal course of business; (v) the savings association has incurred or is likely to incur losses that will deplete all or substantially all of its capital and there is no reasonable prospect for the replenishment of the capital of the association without Federal assistance; or (vi) a violation of law or regulations or an unsafe or unsound practice or condition that is likely to cause insolvency or substantial dissipation of assets or earnings, or is likely to weaken the condition of the association or otherwise seriously prejudice the interests of its depositors.
without state approval: 1) where the OTS notifies the state that valid reasons exist to seize a specific thrift and the state fails to respond within thirty days;\textsuperscript{106} and 2) where the state does respond, the OTS may none-theless seize the thrift upon an OTS answer to the state response.\textsuperscript{107}

A thrift seized by the OTS is handed over to the RTC. Pursuant to FIRREA, the RTC will manage and resolve\textsuperscript{108} all thrifts seized between January 1, 1989 and August 9, 1992.\textsuperscript{109} The RTC is also authorized to dispose of a seized thrift’s assets.\textsuperscript{110} Any thrift seized prior to January 1, 1989 is managed and resolved by the FSLIC Resolution Fund, which is under the control of the FDIC.\textsuperscript{111} Thrift failures that occur after August 9, 1992 will be resolved by the FDIC.\textsuperscript{112}

Under an agreement with the RTC, the OTS has the authority to look for buyers for a thrift before seizing it.\textsuperscript{113} This procedure avoids placing many thrifts in the hands of the RTC and thus allows thrifts to be sold intact to private individuals while still attractive to potential buyers.\textsuperscript{114} The plan allows for a savings association to be sold intact to private individuals rather than allowing it to deteriorate under the RTC’s control.\textsuperscript{115}

The OTS has come under strong criticism for seizing institutions and placing them under RTC control.\textsuperscript{116} Analysts have criticized the OTS for placing thrifts in the hands of the RTC when buyers have not yet been found or sought.\textsuperscript{117} Observers believe the OTS has been placing...
thrifts under RTC control quickly to remove itself from the thrift crisis and allow itself to cut staff and give more attention to viable thrifts.\textsuperscript{118} The OTS' former chief economist, James Barth, has criticized the OTS for dumping savings associations on the RTC with full knowledge that "when the red ink spills, the RTC will get most of the blame."\textsuperscript{119} Accordingly, critics maintain that the OTS' present policy of rapidly placing many thrifts into the hands of the RTC is creating chaos and may actually drive up the cost of the thrift bailout.\textsuperscript{120} These critics believe that placing many thrifts into prolonged RTC conservatorship despoils such thrifts and significantly lowers their ultimate selling price.\textsuperscript{121} While the OTS has responded to these charges by claiming that it has placed into conservatorship only those thrifts that need to be so placed,\textsuperscript{122} critics have countered that, in reality, many of the seized thrifts did not yet fit the takeover criteria.\textsuperscript{123}

\section*{D. Day-to-Day Operations of the OTS}

\subsection*{1. Limitations on One-Borrower Lending}

FIRREA generally caps lending to one borrower at fifteen percent of the thrift's unimpaired capital.\textsuperscript{124} FIRREA does, however, provide for an exemption allowing thrifts to lend up to thirty percent of unimpaired capital subject to a complicated approval process.\textsuperscript{125} The OTS has temporarily relaxed these limits, however.\textsuperscript{126} A temporary regulation allows thrifts that meet the fully-phased-in capital requirements of 1995\textsuperscript{121} to lend as much as sixty percent of unimpaired capital to a single borrower if the money is to be used for domestic residential construction.\textsuperscript{128}

Savings associations may receive the exemption merely by notifying

\begin{thebibliography}{99}
\bibitem{118} See id.
\bibitem{119} Id.
\bibitem{120} See id. at 1, col. 1.
\bibitem{121} See id.
\bibitem{122} See Klinkerman, supra note 116, at 1, col. 1.
\bibitem{123} See id. Critics have pointed to the takeovers of Southwest Savings Association, Santa Barbara Savings & Loan Association, and Home Owners Savings Bank as proof that many seizures have been unnecessary. Each of these savings associations had between $3.6 billion and $6.5 billion in assets when seized. See id.
\bibitem{124} See Cope, OTS Will Relax Limitations on Single Borrowers, Banking Week, June 11, 1990, at 1, col. 4. Unimpaired capital includes the amount of unimpaired common stock and perpetual preferred stock outstanding. See 12 C.F.R. § 3.100(a) (1989).
\bibitem{125} See FIRREA, § 301(5)(u)(2), 103 Stat. at 310-1 (to be codified at 12 U.S.C. § 1464(u)(2)).
\bibitem{126} See Cope, supra note 124, at 1, col. 4.
\bibitem{128} See 12 C.F.R. § 563.93(g)(1)(i) (1991). The 60% figure will drop to 30% at the start of 1991 and will then return to 15% by December 31, 1991. See id. § 563.93(g)(5) (1991).
\end{thebibliography}
the OTS. Prior to the issuance of this temporary regulation, there was some discussion among OTS lawyers on whether this liberal exemption was ultra vires. Therefore, they sought and received Treasury Department approval of the temporary regulation. With this approval, the OTS believes that FIRREA permits this temporary exemption.

The OTS has faced criticism for amending these restrictions, with some critics calling for even fewer restrictions and others denouncing the new regulation as too liberal. Critics calling for fewer restrictions propose that the OTS permit a certain number of thrifts that do not meet current capital standards to benefit from the relaxation of the limits. Under this proposal, any well-run, profitable thrift could take advantage of the relaxed limitations. The critics who have denounced the new regulation as being too liberal, however, claim that the loosening of restrictions will lead to "a new wave of risky lending." While it is possible that this liberal exemption could lead to an increase in risky lending, this appears doubtful. The OTS has broad regulatory powers, and so long as it continues to act as a diligent policeman, the loosening of the restrictions will not lead to an increase in risky lending; rather, only a decrease in the OTS' supervision of thrifts will lead to renewed risky lending.

2. Payment of Dividends

The OTS has developed a plan whereby it would allow undercapitalized thrifts to pay out small dividends to investors on a case-by-case basis, thereby helping struggling thrifts to attract investors. The new rule also places restrictions on dividends that can be paid by institutions that meet current capital standards but fall short of the fully-phased-in requirements of 1995. These thrifts may issue dividends of between

129. See Cope, supra note 124, at 11, col. 1.
130. See id.
132. See Cope, supra note 124, at 11, col. 1.
133. See Garsson, OTS' Easing of Loan Limit Seen as Feeble, Am. Banker, July 11, 1990, at 1, col. 1. Many of the critics calling for looser restrictions believe that the revised limit will do little if anything to help struggling thrifts because, for the most part, they will not qualify for such reduced restrictions. See id.
Other critics assert that the Department of Treasury insisted on a limited regulation such as the one that has been developed, see Cope, supra note 126, at 11, col. 2, and that the OTS is merely a second-rate regulator, a puppet of the Department of Treasury and the Office of the Comptroller of the Currency. See Garsson, at 20, col. 4.
135. See Cope, supra note 124, at 1, 11, col. 1.
136. See id.
137. See Cope, supra note 134, at 8, col. 2.
139. See id.
140. See id.
twenty-five percent and seventy-five percent of net income, depending on how close the thrift is to the 1995 capital requirements.  

3. OTS' Operating Costs

To lower its operating costs, the OTS has devised a plan to streamline its operations. The plan calls for five of its twelve district offices to become regional offices that would manage the other districts. The remaining district offices would then be pared back. Each region would be run by a manager who would direct policy and who would have the authority to place field examiners where they are most needed. Additionally, antifraud and enforcement squads would operate from the regional offices, as would interest-rate risk and capital-market officers.  

Complete implementation of this restructuring plan is not expected until, at the earliest, the end of 1991. The restructuring should ease the costs to the thrift industry, which finances the operation of the OTS. In the second quarter of 1990 alone, the thrift industry contributed $54.2 million in revenues to the OTS.  

E. Litigation Involving the OTS  

1. Lincoln Savings & Loan v. OTS

The Lincoln Savings & Loan litigation arose when the FHLBB placed Lincoln Savings first in conservatorship and then under receivership. The FHLBB appointed a conservator for Lincoln because it determined that the thrift was in an unsafe and unsound condition and consequently

---

141. See id.  
142. See Cope, supra note 134, at 8, col. 2.  
143. See id. The twelve district offices, as initially created, were located in Atlanta, Boston, Chicago, Cincinnati, Dallas, Des Moines, Indianapolis, Jersey City, Pittsburgh, San Francisco, Seattle and Topeka. See id. Under the proposal, the district offices in Atlanta, Chicago, Dallas, Jersey City and San Francisco would become regional offices. See id. The Jersey City regional office would control Boston and Pittsburgh. The Chicago office would control Cincinnati and Indianapolis, while Dallas would control Des Moines and Topeka. San Francisco would control only the Seattle district, and Atlanta, while being raised to a regional office, would not control any additional districts. See id.  
144. See id.  
145. See id.  
146. See id.  
147. See id.  
148. See id.  
150. See Cope, supra note 134, at 8.  
152. See id. at 902-03. As the successor of the FHLBB, the OTS replaced the FHLBB as the defendant in this case. See id. at 902. The plaintiffs were the American Continental Corporation and its wholly owned subsidiary, Lincoln Savings and Loan Association. See id.

had incurred a substantial dissipation of assets. The plaintiffs contended that they had operated Lincoln on a sound financial basis at all times and that the FHLBB acted in an arbitrary and capricious manner by appointing a conservator.

The plaintiffs argued that the defendant’s actions had to be viewed by the court under a de novo standard. The court, however, in upholding the FHLBB’s decision, applied a standard of review affording judicial deference to the FHLBB’s judgement. Under this standard, the court would have to find the actions of the FHLBB or the OTS arbitrary and capricious in order to remove the conservator or receiver.

The court also stated that this deferential level of review was necessary for the effective regulation of the S&L industry. The ruling in this case appears to maintain the standard of review traditionally applied to FHLBB actions. Therefore, although the ruling did not expand the OTS’ powers, it left intact the OTS’ already broad seizure powers.

2. Franklin Savings Association v. OTS

The Franklin Savings Association litigation arose out of the OTS’ appointment of a conservator for Franklin Savings Association. The first issue addressed by the court was what evidence could be considered in determining whether the OTS’ seizure was justified. FIRREA calls for judicial review “upon the merits,” and the OTS argued that “upon the merits” meant that the court could review only the administrative record, which was compiled by the OTS itself. Franklin argued, however, that outside evidence received by the court must be considered.

The court interpreted “upon the merits” to mean that the court would continue to apply an “arbitrary and capricious” standard of review, thus requiring the court to uphold the OTS’ decisions if there was a rea-

153. See id. at 903.
154. See id. at 904.
155. See id.
156. See id.
157. See id. at 905.
158. See id. According to the court, the FHLBB or the OTS need show only a reasonable factual basis for its belief that at least one of the grounds for seizure existed. See id. Under this holding, it seems likely that courts will consistently rule in favor of the OTS because the review by the court is controlled by the administrative record as established by the OTS. Therefore, it will be difficult for a thrift challenging an OTS seizure to provide enough evidence to show that the OTS acted arbitrarily and capriciously. The action of the OTS would need to be of such magnitude that the court could spot it in the review of the OTS-created administrative record.
159. See id.
161. See id. at 1096.
162. See id.
163. See id.
164. See id.
165. See id.
sonable basis for the action. On its face, this standard seems to coincide with the type of review set out in Lincoln. The Franklin court, however, decided that the record on which the review would be considered should be expanded to include evidence outside the administrative record. The court was quick to add that this holding did not change the OTS' power to place a thrift in conservatorship ex parte and without notice, but that after such ex parte seizure, the seized institution must eventually be permitted to present its side of the evidence.

Under this new interpretation, the district court held that the OTS' determination that Franklin was engaging in unsound and unsafe practices was arbitrary and capricious. The court considered evidence, presented by Franklin, that the federal regulators who examined the thrift lacked sufficient training to analyze its operations and therefore had no reasonable basis for determining that Franklin's methods were a threat to the safety of the institution.

Therefore, although the court still required plaintiffs to show that the OTS' actions were arbitrary and capricious, the Franklin court made it easier for plaintiffs to meet the standard. By allowing a seized thrift to introduce evidence outside the administrative record presented by the OTS, the court looked at actual allegations that the OTS acted arbitrarily and capriciously. Previously, where only the administrative record as established by the OTS or FHLBB was considered, it was much more difficult for the court to find arbitrary and capricious behavior. The level of arbitrary and capricious activities by the agencies would therefore have had to be at such a level as to be clearly evident.

Additionally, Franklin is important because it may serve to make the OTS more wary when considering whether to seize a thrift. The OTS will need to determine whether a seized thrift will have valid evidence proving the OTS' actions to be improper. Although Franklin did not formally reduce the OTS' powers to seize an institution, it appears likely that this will be the result if Franklin is followed.

CONCLUSION

Under FIRREA, the OTS has been granted broad authority. Because the OTS has come under strong criticism, how the OTS uses this power effectively will decide not only the future of the thrift industry, but quite possibly the future of the OTS itself. There has already been legislation...
proposed to abolish the OTS and combine it with the Office of the Comptroller of Currency. In the future, it may become prudent to provide for a centralized agency that controls both thrifts and commercial banks. In the short run, however, it is important that legislators afford the OTS an opportunity to carry out its mandate and that regulators monitor its future effectiveness in restructuring the thrift industry.

Robert Cooper