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Depository Institution Charter Conversions

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The financial services industry in this country is fortunate to have choices when it comes to the nature and oversight of bank and thrift charters. While Alexander Hamilton founded the first federally-chartered “Bank of the United States” in the late 1700s, and the “Second Bank of the United States” was formed in the early 1800s (primarily to finance the federal debts of the War of 1812), historically banks were primarily creatures of state law and chartered at the state level. In the “dual charter” system that has been in place since the time of the Civil War, banks and thrifts can choose between federal and state charters, and have the ability to convert from one charter to the other subject to certain legal and regulatory requirements and procedures. That dual charter system provides important options to depository institutions.

One of the many key responsibilities of bank boards is to ascertain whether, given the options available, the charter under which their institution operates is the right charter for the institution and provides the appropriate opportunities and oversight for its business model and future business plans. As part of that exercise, the largest state-chartered bank in Ohio, which operates in a multi-state environment, recently announced its intention to convert to a federal bank charter. Likewise, a number of Ohio-based financial institutions have converted from federal charters to Ohio state charters in recent years. A number of considerations drove the boards of these institutions to determine that a change was appropriate for their particular institution, and the options available through the dual-chartering system provides important options and alternatives for boards to choose which system is best for their institution.

As a result, the ability to convert from one charter to another provides boards with important flexibility to determine what is best for their institution and to follow that path. The process of conversion is relatively straightforward, and each of the chartering agencies have rules that provide guidance for consideration.

Board Considerations

Board due diligence in considering charter options is critical, and creating a record of that consideration is likewise critical in establishing and documenting the board's process and rationale. A long- and short-term cost/benefit analysis is part of that consideration. Boards looking at which charter provides the appropriate oversight and opportunities for their institution going forward tend to consider such things as future growth (if that is part of their overall business plan) including product and geographic expansion, opportunities for products and services, parity opportunities to provide competitive products and services, accessibility of the regulator and examination staffs, continuity of examination staff, agency and examiner familiarity with the institution and the markets served by the institution, and cost of supervision (assessments). It is also inevitable that the board will compare historic experience with its current regulator in the process, and care must be taken not to base the decision on any single examination or examiner team. "Charter shopping" is not a good practice, and in fact Dodd-Frank expressly prohibits charter conversions for institutions that are presently experiencing certain regulatory difficulties.

As part of the board's due diligence, it should consult with appropriate professionals to gain insight as to the differences between the charters and the impact of a change on the business and prospects of the institution as well as the procedural aspects of a conversion.

Meeting with Regulators

Should the board elect to explore the possibility of a charter conversion, meetings between executive management (and perhaps representatives of the board) and senior target regulatory authorities are helpful as part of the board's due diligence process. Both state and federal agency representatives are more than willing to explore conversion opportunities, and to meet on a confidential basis with institutions exploring that possibility. The meetings are a good way to get a sense of the agency environment, and for supervisory agency personnel to get a good sense of the institution. It can provide not only valuable information concerning the target agency and its regulatory approach and structure, but serves as a valuable "gut check" for both the agency and the institution as to certain intangibles regarding the "fit."

Agency Oversight Considerations

Depository institutions are licensed or "chartered" by either the state or federal government to engage in the business of accepting deposits from the public and engaging in the business of banking. They are also, as a result, subject to oversight and periodic examination by the chartering agency and, in the case of state-chartered institutions, their "primary federal regulator."

All depository institutions have a "primary federal regulator." For national banks and federal thrifts that agency is the Office of the Comptroller of the Currency (OCC). State institutions also have a "primary federal regulator" even though they are licensed by a particular state. For Federal Reserve member institutions that is the Federal Reserve Board (FRB), and for non-member state institutions that is the Federal Deposit Insurance Corporation (FDIC). One of the typical operating considerations for charter selection can be the examination oversight process. National banks and federal thrifts are licensed, and examined, by the OCC. State banks and thrifts are licensed by the particular state, but are also examined by either the FRB or the FDIC depending on the FRB "member" status. While examinations are typically rotated between the state and federal agencies for state-chartered institutions, some institutions view

having two examining agencies as more burdensome than one.

Boards should resist the temptation to base a conversion decision on the most recent experience with an examination. While “relationship” issues can and often do impact the decision, those issues should be discussed first with the relevant agency in order to ascertain the basis for the issue. The board should be open and honest with its current regulator, and make that agency aware of its concerns (if that is the case) and plans. Sometimes it can happen that relationships (personal and/or business) can erode to a point where a change may be appropriate, however care must be taken to make certain that a strong and supportable business justification exists for whatever change is under consideration before proceeding. Changes based primarily on personality conflicts should be avoided if possible.

For institutions with holding companies, the impact of chartering as a bank or as a thrift institution will impact the nature of the holding company as a “bank” holding company or a “savings and loan” holding company, both of which are licensed and examined by the FRB. Changing will have an impact on the nature of the holding company and will thus involve FRB application and approval. Chartering as a thrift will likewise impose QTL restrictions that impact the nature and diversity of the institution’s balance sheet.

Boards exploring chartering options may in fact discover that where they are presently is the best option for the institution.

The Next Steps

Following due diligence and assuming a decision is made to seek a charter conversion, the board must create a careful record of its considerations and actions in minutes that reflect the board’s due diligence and why the board feels that the proposed conversion is in the best long-term interests of the institution and its constituency. Once that decision is made, if there is no parent holding company that holds 100% of the stock of the bank or thrift, the next consideration is how to approach obtaining approval by the shareholders of the institution for the charter conversion. In those instances the board typically approves setting a special shareholder meeting to consider and act upon the proposal.

Receiving chartering agency approval is also required for a conversion, and conversion to a state charter will also require action with either the FDIC (for non-member candidates) or the FRB (for member candidates). If a holding company is in fact involved, discussions should likewise be held with FRB representatives regarding the pending proposal and depending on whether the charter conversion involves conversion from a bank to a thrift, or vice versa, an application to convert the holding company may or may not be involved.

Care must also be taken to review any contracts, equity and/or debt issues, and other third-party considerations with respect to any relevant notices or consents that may be required in the conversion process. Likewise, expenses and any shareholder and customer impact involved with the conversion process should also be reviewed by the board in its deliberations.

In any and all instances, care should be taken to maintain very open lines of communication with the regulatory agencies involved. Not only are their decisions as to acceptance critical, but they can and do provide important guidance and direction during the agency conversion application process.

The Formal Process

Conversions require application and/or notice to the appropriate agencies, and discussions early and often with those agencies are critical to a successful process. Regulatory application processes can run contemporaneously with the process of soliciting shareholder approvals, and will very likely entail an “entrance examination” by the receiving agency. Applicants should check with agency personnel insofar as procedures and application forms can and do change.

One important aspect of the regulatory application process is the institution’s business plan. That plan, as submitted, will become an important part of the consideration by the receiving agency as to the conversion decision, and in the case of converting thrift organizations presently acts as a form of commitment that will be reflected in conditions in the approval order by the FDIC that require post-conversion notice to the FDIC of proposed material deviations from that plan for a 3-year period following conversion. That factor has been a concern to certain thrifts in the conversion process, simply based on the unknowns involved. Most have no present plan to make material changes to their business plan and so while it may not be a relevant concern it still presents a post-conversion consideration. It is very important to continue an open dialogue with agency personnel throughout the conversion application process.

Timing

Timing for the conversion regulatory application process can and does vary, but a conservative time period is somewhere around six months from application to approval. Running the shareholder approval process contemporaneously with the regulatory application process can provide some overall timing relief, however it is important from a reputation risk perspective to be certain that the applicant does not anticipate any regulatory issues prior to proceeding with the solicitation of shareholder approval.

Assessment timing is also a significant expense consideration for converting institutions. Depending on the date assessments are determined and billed, applicants may avoid significant additional expense by consummating by a specific date. Assessment timing issues play an important role in conversion timing considerations.

Expenses

The conversion process entails a number of one-time expenses relating to the process and the operations of the converting institution. Professional expenses relating to the regulatory and shareholder processes are a one-time expense and document and marketing expenses are another one-time expense.

Name Considerations

One of the tangible and intangible issues with consideration of a conversion relates to the name of the converted institution and its impact on not only signage and documentation, but customer relations.

Eliminating the term “National” from some institutions that have operated under that term for over a hundred years can cause significant angst in the decision process.

National banks converting to state-chartered institutions will in fact not be able to continue use of the term “National” in their name. Conversely, state institutions converting to a national bank charter will use “National” in their name. Interestingly, federal thrifts that convert to state charters may continue to use the term “Federal” in their name, thereby eliminating both tangible expense issues regarding documentation and signage as well as customer issues. However, federal thrifts that describe themselves as a “federally-chartered institution” or similar descriptions in documents and/or signage will in fact need to make appropriate revisions despite being able to retain their formal names.

Conclusions

Chartering agencies provide not only the license to take deposits and to conduct a banking business, but become a long-term partner with institutions on the examination side. The relationship with the chartering agency is an important one, and there are in fact clear differences between the agencies. As boards explore which charter is the best for their institution, it is important to create a record of the board’s due diligence and rationale for making a change or staying where they are. The long-term best interests of the institution are paramount, and the conclusion may be to stay put rather than change. If the decision is to in fact make a change, then moving forward quickly and expeditiously, particularly in light of assessment timing issues and uncertainty regarding application and shareholder approval timing, is important in mitigating the expense and disruption issues involved in the conversion process.

Institutions exploring chartering options that are clearly doing so for the best interests of the institution and its stakeholders (which can take many forms and be both tangible and intangible), and which are not “troubled” and “regulator shopping,” will find the receiving agencies very approachable, open and helpful in the process.