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Small Banks Shift Charters to Avoid U.S. as Regulator

By JESSICA SILVER-GREENBERG

A small community bank in New Hampshire found a demand from its regulator last month just too much.

Monadnock Community Bank in Peterborough was ordered to do a thorough review of how it collected payments on its delinquent loans, said William Pierce, the chief executive. That meant diverting three of its 18 employees to comb through reams of mortgages.

“We’ve had two [foreclosures](#) in the last four years, and yet here we had to do it anyway because our regulator only knows how to deal with the behemoth banks,” said Mr. Pierce, referring to the regulator, the [Office of the Comptroller of the Currency](#).

Frustrated, Mr. Pierce agreed to sell his institution, which has \$82 million in assets and a charter as a [savings and loan](#) association, to the GFA Federal Credit Union in Gardner, Mass., a credit union overseen by the National Credit Union Association — not the comptroller’s office.

An increasing number of the nation’s more than 600 savings and loan associations are fleeing the comptroller’s office as they navigate a shifting regulatory landscape. The Dodd-Frank financial reform law closed their longtime regulator, the Office of Thrift Supervision, and moved them to the comptroller. A few of these institutions are trying to become credit unions, and many others are choosing state oversight. Nationally, 35 have applied to switch from national to state charters since July 2011.

While the banks say that they are looking for a regulatory agency that understands them, some

former industry experts have expressed concern that the financial institutions are regulator shopping.

The Office of Thrift Supervision was a notoriously easy supervisor, said James Gilkeson, a former regulator at the comptroller's office. "Going to state and credit union regulators is clearly a search for the next best thing," he said.

Banks are displaying a familiar pattern, Mr. Gilkeson said. After each financial crisis, lawmakers try to buttress regulation by closing a weak supervisor and consolidating oversight under a stronger central agency. Then many banks, faced with a new regulator, try to find more lenient supervision. In the late 1980s, because of the savings and loan crisis, the Federal Home Loan Bank Board was closed and the new Office of Thrift Supervision, he said, was going to be the "big muscle."

The latest migration is getting bank regulators' attention. "We are dealing with a false perception that the O.C.C. doesn't understand community banks," said Jennifer Kelly, senior deputy comptroller for midsize bank supervision in the office.

The agency says it is committed to local regulation. As an example, it points to its team of 207 midsize or community bank examiners in Texas alone.

Still, New York has seen an uptick in applications from nationally chartered banks that want to be overseen by the state, according to Benjamin M. Lawsky, the New York superintendent of financial services.

Community bankers vociferously deny that they are hunting for lax regulators. What they want, they say, is a regulator more in touch with the issues faced by the nation's smaller banks, which are different from the ones faced by their larger national counterparts. "The O.C.C. basically punishes the community banks as if we committed the sins of risky lending that the biggest banks did," Mr. Pierce said.

No one disputes that regulators allowed banks to distribute risky loans to subprime borrowers, among other dubious practices, leading up to the financial crisis. But some community bankers say that the tighter regulation that has resulted has gone too far and should be focused more on

the nation's largest banks. Even though their capital requirements are different from those of the biggest banks, the smaller banks say that requirements for loan-loss reserves, for example, are depleting them of capital that could be otherwise used for loans.

Despite their complaints, small banks were not immune from the financial crisis. This year, 16 community banks, which have up to \$10 billion in assets, have failed. The pace of bank failures is slowing, though. Last year, 92 community banks failed.

To get a new regulator, banks have two options under state and federal banking laws. They can become a credit union — either through a charter conversion or through an acquisition, as Mr. Pierce's bank did — or they can convert to a state charter.

Gary Easterling, the chief executive of the United Federal Credit Union, which bought Griffith Savings Bank in Indiana in January, said that community banks considered credit unions to be more of a peer than the nation's largest banks.

Dime Savings Bank in Brooklyn chose to convert from a federal to a state charter last month. So did Midstate Federal Savings & Loan Association in Baltimore. Frost Bank in San Antonio traded its century-old national charter for a state one in February. "Dodd-Frank is a dump-truck bill with many unintended consequences," said Richard Evans, the chief executive of Frost. "We need a local regulator, especially as regulatory demands grow."

Still, some worry that the flight from the federal comptroller is the kind of regulatory arbitrage that the Dodd-Frank bill was meant to prevent, and they point out that state supervisors are historically weak.

"This looks like the banks are trying to avoid tough regulation by heading to the states," said Amit Seru, a professor of business at the University of Chicago whose research comparing state and federal regulators was published in January.

Along with economists at the Federal Reserve Bank in Chicago, Professor Seru found that state regulators consistently went easier on banks than their federal counterparts.

The call for a more "locally focused regulator," Mr. Gilkeson said, is actually code for wanting a regulator who is more accommodating. "I think that the banks feel small and unable to lobby

the O.C.C.”

With a state charter, banks primarily report to the state banking supervisor, with some additional oversight from the Federal Deposit Insurance Corporation and the Federal Reserve System. Inspection costs generally fall when banks make that conversion.

Verus Bank in Derby, Kan., handed in its federal charter for a state one last year, and the change will save \$30,000 a year in fees alone, said Kyle Russell, the bank’s president.

If a bank switches to a credit union charter, it may save in another way: on taxes. Credit unions are exempt from taxes because of their nonprofit status. They were originally created to serve distinct communities of people, like union workers.

“It’s definitely an added benefit,” said Mr. Easterling of the United Federal Credit Union.

This year, only Thrivent Financial Bank in Appleton, Wis., has applied for a credit union charter, said John Zimmerman, a spokesman for the credit union association. But that may be just the beginning.

Doug Faucette, a lawyer who leads the banking and transaction group of Locke Lord Bissell & Liddell, said that he had fielded a flurry of calls since the summer from community banks interested in converting their charters to credit unions.