Office of Thrift Supervision
Department of the Treasury

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6000

December 2, 1994

[redacted]

Re: Contribution of Holding Company Stock to Thrift Subsidiary to Facilitate an Acquisition

Dear [redacted]:

This letter responds to your request, submitted on behalf of [redacted] (the "Association"), for confirmation that the Office of Thrift Supervision ("OTS") will not take enforcement action against the Association or its holding company under §§ 5(c) or 11(a) of the Home Owners' Loan Act ("HOLA") if the Association acquires a mortgage banking company (the "Target") in the manner described below.

Based on the information submitted, we have decided to grant the Associations's no-action request, provided the acquisition is consummated in accordance with your representations.

I. Background

The Association, which is controlled by [redacted], a savings and loan holding company (the "Holding Company"), intends to establish a phantom corporate subsidiary to merge with the Target. The shareholders of the Target will receive shares of the Holding Company in exchange for tender of their shares. Following the acquisition, the resulting mortgage banking company will be a subsidiary of the Association until its assets and liabilities can be transferred to the Association.

The Target has outstanding grants of certain options to third party option holders to purchase additional shares of Target stock. As part of the acquisition, the Holding Company will transfer approximately $3 million of its own voting stock to the option holders as compensation for the difference in value between the exercise price of the options and the share price in the Acquisition. The Target options will then be extinguished.

In order to take advantage of favorable federal income tax treatment for the transaction, the Holding Company proposes to transfer its voting stock to the Target's option holders by first contributing the stock to the Association, which will in turn immediately convey the stock to the option holders in order

to consummate the transaction. You have informed us that it is critical that payment of the Holding Company shares to the option holders (but not the shareholders) be made through the Association to preserve the tax-free nature of the reorganization for the Target shareholders. This benefit is significant to the Holding Company and, indirectly, the Association, insofar as the tax benefit accruing to the Target shareholders permits the Holding Company to negotiate more favorable terms for the acquisition of the Target.

The contribution of the Holding Company stock to the Association and the resulting transfer of the stock to the Target option holders will occur instantaneously at the consummation of the acquisition. Accordingly, the Association will hold the Holding Company's stock only for a brief moment prior to its transfer to the option holders. The Association will not pay any compensation to, or assume any liabilities of, the Holding Company in exchange for the Holding Company's contribution of its stock.

II. Discussion

You have asked us to take a no-action position with respect to the proposed transaction under HOLA §§ 5(c) and 11(a).

A. HOLA § 11

The rules governing transactions between savings associations and their affiliates are set forth in HOLA § 11,[1] which in turn incorporates §§ 23A and 23B of the Federal Reserve Act ("FRA").[2] The OTS has promulgated implementing regulations at 12 C.F.R. §§ 563.41 and 563.42. These provisions establish a regulatory scheme under which certain transactions between savings associations and their affiliates are absolutely prohibited, others are permitted but subject to certain quantitative and qualitative limits, and yet others are permitted without restriction. There are two aspects of the acquisition proposed by the Association that require analysis under these transactions with affiliates ("TWA") provisions.

First, there is the transfer of Holding Company stock from the Holding Company to the Association. HOLA § 11(a)(1)(B) flatly prohibits savings associations from purchasing or investing in securities issued by an affiliate, other than a subsidiary. Thus, if the transfer of stock from the Holding Company to the Association were structured as a purchase and sale, it would be prohibited. Instead, however, the Holding

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1 12 U.S.C.A. § 1468 (West Supp. 1994).

2 12 U.S.C.A. §§ 371c and 371c-1 (West 1989).

Company's stock will be contributed, not sold, to the Association. No compensation will be paid, and no liabilities will be assumed, by the Association. Thus, the proposed transfer is not prohibited by HOLA § 11(a).

Nor is the proposed transfer from the Holding Company to the Association subject to the quantitative and qualitative limitations of FRA §§ 23A and 23B. Pure asset contributions from affiliates to savings associations are not identified on the list of transactions covered by FRA §§ 23A and 23B.

The second aspect of the Association's proposed acquisition that requires TWA analysis is the transfer of Holding Company stock from the Association to the Target's option holders. This aspect of the transaction does constitute a purchase and sale, since Holding Company stock will be transferred to the option holders in exchange for surrender of their option rights. However, FRA § 23A and 12 C.F.R. § 563.41 apply only to purchases of assets from affiliates and you represent that none of the option holders are affiliates of the Association. Thus, FRA § 23A and 12 C.F.R. § 563.41 have no application to the transfer of stock from the Association to the option holders.

As for FRA § 23B, this provision applies to "any transaction . . . with a third party . . . if an affiliate is a participant in such transaction."[3] Since the Holding Company is an affiliate of the Association and is a party to the acquisition of the Target, the transfer of Holding Company stock from the Association to the option holders could, technically, be subject to FRA § 23B. The primary purpose of § 23B, however, is to protect savings associations from paying greater than fair value in acquiring assets or services from affiliates, thereby depleting their resources. In the present transaction, the Holding Company -- not the Association -- is the true source of the consideration being paid to the option holders. Under these circumstances, we do not believe there is any reason to object to the transaction under § 23B.

Accordingly, the OTS will not take action against the Association under the TWA provisions if the transaction goes forward as proposed.

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[3] 12 U.S.C.A. § 371c-1(a)(2)(E) (West 1989).

B. HOLA § 5(c)

HOLA § 5(c)[4] does not expressly authorize federal savings associations to invest in the stock of their parent companies. Because the Association is only holding the stock for a brief moment on a pass-through basis, however, we do not view this as the type of transaction that was intended to be regulated by HOLA § 5(c). See OTS Op. by Williams (June 7, 1990)(concluding that OTS would not raise a legal objection to a proposed transaction on the basis of HOLA § 5(c)(4)(B), which requires a service corporation of a federal savings association to be organized under the laws of the state in which the federal association's home office is located, given that the service corporation there proposed was merely organized to facilitate a larger transaction and would then disappear). The purpose of HOLA § 5(c) is to control portfolio risk and ensure that savings associations concentrate on housing-related investments. Neither of these purposes is implicated by a riskless, momentary holding of stock contributed by the Holding Company.

Accordingly, the OTS will not take enforcement action against the Association for violation of either HOLA § 5(c) or HOLA § 11 if the Association undertakes the proposed acquisition. In reaching this conclusion, we have relied on the factual representations contained in your September 19, 1994, letter and in subsequent conversations with you, as summarized herein. Our conclusion depends on the accuracy and completeness of those representations. Any material change in circumstances from those described might require a different conclusion. Moreover, this conclusion should not be relied upon for any other transaction.

It is also important to note that our conclusion pertains only to enforcement actions based on HOLA § 5(c) or HOLA § 11. The Association is responsible for ensuring that the acquisition is safe and sound under all the facts as they exist at the time of the acquisition and that the acquisition conforms to all other applicable laws and regulations. This letter does not preclude enforcement action for failure to satisfy these standards.

If you have further questions about this response, please call Laurie Nicoli, Counsel (Banking and Finance), at (202) 906-7452.

Very truly yours,

Carolyn B. Lieberman
Chief Counsel

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[4] 12 U.S.C.A. § 1464(c) (West Supp. 1994).