

OFFICE OF THRIFT SUPERVISION

Order Approving Application To Establish An Operating Subsidiary

Order No.: 2004-33
Date: June 15, 2004
Docket No. 08475

NetBank, Alpharetta, Georgia (Savings Bank), a federal stock savings bank, has filed an application with the Office of Thrift Supervision (OTS), pursuant to 12 U.S.C. § 1828(m) and 12 C.F.R. § 559.11, requesting approval to establish an operating subsidiary. The Savings Bank proposes to acquire Meritage Mortgage Corporation (Meritage) from NetBank, Inc. (Holding Company), the Savings Bank's holding company, and hold Meritage as a first-tier operating subsidiary.

Background

The Savings Bank, a Savings Association Insurance Fund-insured federal stock savings bank, is a wholly owned, direct subsidiary of the Holding Company. As of March 31, 2004, the Savings Bank had total assets of \$4.00 billion, total liabilities of \$3.77 billion, and total equity capital of \$328.2 million. As of such date, the Savings Bank was well capitalized, under OTS regulations.

Meritage originates non-conforming, mostly sub-prime first and second mortgage loans. Meritage operates in 46 states and the District of Columbia.

The Proposed Transaction

In the proposed transaction, the Holding Company will contribute all of the common stock of Meritage to the Savings Bank. As a result, Meritage will become a wholly owned first-tier operating subsidiary of the Savings Bank.

Operating Subsidiary Application

Generally, a federal savings association may invest in an operating subsidiary only if: (1) the subsidiary engages only in activities permissible for federal associations to engage in directly; (2) the federal association owns, directly or indirectly, more than 50 percent of the voting shares of the operating subsidiary; and (3) no person or entity other than the federal association exercises operating control over the operating subsidiary.¹ In addition, OTS may, at any time, limit a savings association's investment in operating subsidiaries, or may limit or

¹ 12 C.F.R. § 559.2, 559.3(c)(1), and (e)(1) (2004).

refuse to permit any activities of an operating subsidiary, for supervisory, legal, or safety and soundness reasons.²

With regard to the requirement that the subsidiary may engage only in activities permissible for federal associations to engage in directly, Meritage will continue to engage in mortgage loan origination activities, which are permissible for federal savings associations.

With regard to the requirement that the federal association own, directly or indirectly, more than 50 percent of the voting shares of the operating subsidiary, the application indicates that the Savings Bank will hold all of the common stock of Meritage. With regard to the requirement that no person or entity other than the federal association exercise operating control over the operating subsidiary, the application indicates that no other party will have operating control over Meritage.

OTS has carefully considered the supervisory considerations presented by the application. Based on the application, OTS' regulatory experience with the Savings Bank and the Holding Company, and the commitments provided in the application, OTS concludes that it has no supervisory objections to the proposed transaction, provided the conditions set forth below are satisfied.

Transactions With Affiliates Notice

Because the proposed transfer of the stock of the Meritage to the Savings Bank is a covered transaction pursuant to § 23A of the Federal Reserve Act and 12 C.F.R. § 563.41, which incorporates certain provisions of the Federal Reserve Board's Regulation W, 12 C.F.R. Part 223, the application provides notice to OTS that the proposed transaction will satisfy the internal corporate reorganization exemption requirements of 12 C.F.R. § 223.41(d) and will therefore be exempt from the quantitative limits set forth at 12 C.F.R. §§ 223.11 and 223.12 and the collateral requirements set forth at 12 C.F.R. § 223.14.

The notice indicates that the proposed transaction satisfies the seven requirements for claiming the exemption, which are set forth at 12 C.F.R. § 223.4(d)(1)-(d)(7). The proposed transaction is part of an internal corporate reorganization of the Holding Company and involves the transfer of all of the shares of Meritage, which is currently an affiliate, to the Savings Bank. The Savings Bank has provided written notice to OTS, before consummation of the proposed transaction, and has provided a description of the proposed business activities of Meritage and the proposed date of the transaction. The Holding Company has committed to make quarterly cash contributions to the Savings Bank for two years, equal to the book value plus any write-downs on assets that become low quality during the quarter. The Savings Bank's board of directors has reviewed and approved the proposed transaction.

² 12 C.F.R. § 559.1(a) (2004).

Furthermore, based on the materials provided with the application and other materials available to OTS, OTS concludes that the value of the proposed transaction represents less than 10 percent of the Savings Bank's capital stock and surplus. The Savings Bank has not previously claimed the corporate reorganization exemption. Finally, based on its regulatory experience with the Holding Company, and the Savings Bank, OTS concludes that these entities are well-capitalized and well-managed and would remain well-capitalized and well-managed upon consummation of the proposed transaction. Based on the foregoing, OTS concludes that the proposed transaction satisfies the requirements for the internal corporate reorganization exemption, under 12 C.F.R. § 563.41 and § 223.41(d).

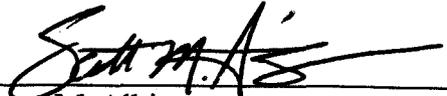
Conclusions

Based on the considerations set forth above, OTS concludes that the application meets the applicable approval criteria, provided that the following conditions are imposed. Accordingly, the application is hereby approved, provided that the following conditions are complied with in a manner satisfactory to the OTS Southeast Regional Director, or his designee (Regional Director):

1. The Savings Bank and the other parties to the transaction must receive all required regulatory approvals and submit copies of all such approvals to the Regional Director prior to consummation of the proposed transaction;
2. The proposed transaction must be consummated within six months from the date of this Order;
3. On the business day prior to the date of consummation of the proposed transaction, the chief financial officers of the Savings Bank and the Holding Company must certify in writing to the Regional Director that no material adverse changes have occurred with respect to the financial condition or operations of the Holding Company, the Savings Bank, and Meritage, respectively, as disclosed in the application. If additional information having a material adverse bearing on any feature of the application is brought to the attention of the Savings Bank, Meritage, the Holding Company, or OTS since the date of the financial information submitted with the application, the transaction must not be consummated, unless the information is presented to the Regional Director, and the Regional Director provides written non-objection to consummation of the transaction;
4. The Savings Bank must advise the Regional Director in writing within 5 calendar days after the effective date of the proposed transaction: (a) of the effective date of the proposed transaction; and (b) that the transaction was consummated in accordance with all applicable laws and regulations, the application, and this Order; and
5. Meritage must not deviate materially from any of the activities, facts, representations or commitments described in the application, except with the prior written non-objection of the Regional Director.

Any time specified herein may be extended by the Regional Director, for good cause, for up to 120 calendar days.

By Order of the Director of the Office of Thrift Supervision, or his designee, effective June 15, 2004.



Scott M. Albinson
Managing Director
Office of Examinations, Supervision and
Consumer Protection