



Office of Thrift Supervision

Department of the Treasury

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

Chief Counsel

April 15, 1998

[

]

Re: H-(e)l Application filed by [
] (the "Holding Company")

Dear [],

This is in response to your letter dated March 19, 1998, in which you request that we advise you that we will not recommend enforcement action under section 11(a) of the Home Owners' Loan Act¹ ("HOLA") or section 563.41(a)(3) of OTS regulations² if the Holding Company and its wholly owned subsidiary, [] (the "Bank"), or their successors, engage in repurchase and reverse repurchase agreements within the framework set forth in your letter. The Holding Company has been engaging in these types of transactions with the Bank, which has applied to convert to a federal savings bank ("New FSB"), and proposes to continue this practice with New FSB.

On the basis of the facts presented in your request, and in materials submitted as part of the related holding company application, we would not recommend enforcement action should the Holding Company and New FSB enter into the types of repurchase and reverse repurchase agreements described in your letter,³ provided that (1) all of the agreements are collateralized by Treasury securities, (2) the reverse repurchase agreements will each be subject to an agreement to repurchase the Treasury securities on the next business day after the reverse repurchase agreement has been entered into, and (3) at all times, the aggregate outstanding amount of repurchase agreements will exceed the aggregate amount of reverse repurchase agreements, i.e. New FSB will be in a net debtor position with the Holding Company.

¹ 12 U.S.C. § 1468(a).

² 12 C.F.R. § 563.41(a)(3).

³ For purposes of this letter, a repurchase agreement is a sale of securities by a bank or thrift, subject to an agreement to repurchase the securities at some future date. A reverse repurchase agreement occurs when the bank or thrift is the purchaser of the securities and the seller agrees to a subsequent repurchase.

Background

The Holding Company, a [] corporation, is []. The Bank is an []-chartered commercial bank and a direct wholly-owned subsidiary of the Holding Company. Contemporaneously with the Bank's application to convert to a thrift, the Holding Company has applied for approval to own all of the shares of New FSB after the conversion. The Holding Company has used the Bank, and proposes to use New FSB, as a cash management vehicle. To carry out this function, the New FSB will enter into repurchase and reverse repurchase agreements with the Holding Company.

Under the repurchase agreements, New FSB will sell United States Treasury securities to the Holding Company, subject to an agreement to repurchase the securities after a pre-determined period, usually several years. Using reverse repurchase agreements, New FSB will also purchase United States Treasury securities from the Holding Company, subject to an agreement to repurchase on an overnight (or next business day) basis. The Holding Company will use the overnight purchases by New FSB to manage its available cash.

The securities that will be the subject of the reverse repurchase agreements will always be United States Treasury securities, the repurchase of the Treasury securities by the Holding Company will always occur by the next business day, and the amount of repurchase agreements, where the Holding Company is the purchaser, will always exceed the amount of reverse repurchase agreements, where New FSB will be the purchaser, so that at all times New FSB will be a net debtor to the Holding Company

Several federal statutes regulate the extent to which thrifts may engage in transactions with their affiliates. Section 11(a)(1) of the HOLA applies the provisions of sections 23A and 23B of the Federal Reserve Act ("FRA") to every savings association to the same extent as if the thrift were a member of the Federal Reserve System. Section 23A places quantitative and qualitative limits on certain transactions with affiliates, while section 23B requires that affiliated transactions be conducted on an arms-length basis. Section 11(a)(1) also imposes several restrictions on a savings association's transactions with affiliates in addition to the restrictions imposed by sections 23A and 23B of the FRA. Specifically, section 11(a)(1)(A) states that "no loan or other extension of credit may be made to any affiliate unless that affiliate is engaged only in activities described in section 10(c)(2)(F)(i) of the HOLA." As defined by 12 C.F.R. § 584.2-2, these activities include activities approved for bank holding companies by regulation, 12 C.F.R. § 225.25, or by case-by-case order of the Federal Reserve Board, 12 C.F.R. § 225.23. Thus a thrift may not under section 11(a)(1)(A) make a loan or other extension of credit to an affiliate engaged in non-bank holding company activities.

Whether or not this provision bars New FSB from entering into reverse repurchase agreements with the Holding Company is the focus of your request for “no action” relief.

Discussion

Because the Holding Company is clearly engaged in non-banking activities, the ability of New FSB to enter into reverse repurchase agreements with the Holding Company turns on whether such agreements are to be considered loans or other extensions of credit for the purposes of the section 11(a)(1)(A) prohibition.

Congress enacted the section 11(a)(1)(A) prohibition in recognition of the fact that affiliates of savings associations can engage in a far greater range of activities than affiliates of banks, and thus can expose the savings association to greater risks. These risks are not fully addressed by sections 23A and 23B of the FRA. Section 11(a)(1)(A) addresses these risks by ensuring that a savings association (1) does not serve, via an extension of credit, as a source of funds for the activities of a non-banking affiliate, and (2) is not exposed to the risks of default by an affiliate that is engaged in non bank holding company activities. Section 11(a)(1)(A) does not, however, define “loan or other extension of credit.” Thus, the face of the statute does not compel a legal conclusion that reverse repurchase agreements are, or are not, prohibited.⁴ Accordingly, the OTS has substantial discretion in making this determination.

As a general matter, reverse repurchase agreements with non-banking affiliates do bear many of the economic characteristics of a loan or extension of credit to such affiliates, and potentially pose the risks associated with those types of transactions. Reverse repurchase agreements have been considered loans for purposes of other statutory and regulatory provisions (QTL, LTOB, Regulation O), although agreements involving Treasury securities have generally been exempted from treatment as loans.

However, the reverse repurchase agreements the Bank has entered into are part of a structured set of transactions in which the Bank remains a net debtor to the Holding Company, which essentially avoids the use of insured deposits as a source of funds for a non-banking affiliate. The collateral used, short term United States Treasury securities, together with the Bank’s ability to dispose of the securities in case of default,⁵ substantially eliminates the risk to the Bank and, going forward, New FSB.

⁴ We recognize that the definition of “covered transactions” under section 23A(b)(7) of the FRA lists “a purchase of assets, including assets subject to an agreement to repurchase” separately from “a loan or extension of credit.” See 12 U.S.C. 371c(b)(7)(A), (C). The fact that a reverse repurchase agreement is considered to be an asset purchase, rather than an extension of credit under 23A of the FRA, however, is not controlling here.

⁵ The bankruptcy code permits the holder of securities subject to an agreement to repurchase to liquidate the securities without being subject to an automatic stay or similar delays or prohibitions.

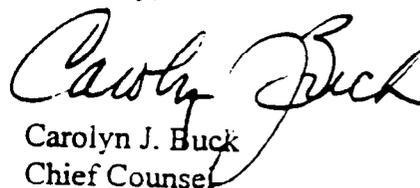
Conclusion

Accordingly, on the basis of the facts presented in your request, and in related materials, we will not recommend enforcement action should New FSB and the Holding Company enter into repurchase and reverse repurchase agreements, provided that (1) all of the agreements are collateralized by Treasury securities, (2) the reverse repurchase agreements will each be subject to an agreement to repurchase the Treasury securities on the next business day after the reverse repurchase agreement has been entered into, and (3) at all times, the aggregate outstanding amount of repurchase agreements will exceed the aggregate amount of reverse repurchase agreements, whereby New FSB always remains a net debtor.

In reaching the foregoing conclusion, we have relied on the factual representations contained in the materials presented to us. Our conclusions depend upon the accuracy and completeness of those representations. Any material change in facts or circumstances from those set forth in your submission could result in conclusions different from those expressed herein. Moreover, our conclusions represent our position on an enforcement action in this particular case. Accordingly, this letter may not be used as a precedent by any other parties.

We trust that the foregoing has been responsive to your request. Any questions regarding this matter should be directed to Eric E. Berg, Counsel (Banking & Finance), Business Transactions Division, at (202)906-6464, or Kevin A. Corcoran, Assistant Chief Counsel for Business Transactions, at (202)906-6962.

Sincerely,


Carolyn J. Buck
Chief Counsel

cc: [] Regional Director
 [] Regional Counsel