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New Transactions With Affiliates and Insider Lending Rules for Thrifts

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Summary: Pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) all savings institution transactions with affiliates are subject to the provisions of new Section 11 of the Home Owners' Loan Act (HOLA), whether or not the institution is a subsidiary of a holding company. The provisions of Sections 23A, 23B, and 22(h) of the Federal Reserve Act (FRA), with variations unique to savings institutions, are also adopted.

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Thrift Bulletin 31-8

I. Section 11 of the Home Owners' Loan Act

New Section 11 of the HOLA begins with a general provision that "Sections 23A and 23B of the FRA shall apply to every savings association in the same manner and to the same extent as if the savings association were a member bank (as defined in such Act)..."[1] However, this initial general parity with banks is then interrupted by several important differences.

First, a savings institution may not make any loan or extension of credit to any affiliate unless that affiliate is engaged only in activities described in Section 10(c)(2)(F)(i) of the HOLA, i.e., permissible bank holding company activities.[2] Next, a savings institution also is barred from entering into any transaction of the type described in Section 23A(b)(7)(B) of the FRA, i.e., investing in the securities of an affiliate, other than with respect to shares of a subsidiary of the institution.[3] Finally, the so-called "sister bank" exemption from the quantitative limitations of Section 23A, which is available to 80 percent commonly-controlled banks pursuant to Section 23A(d)(1), generally is *not* available to "sister thrifts" until January 1, 1995,[4] but, is available for transactions between banks and thrifts that are "sisters" in the same bank/thrift holding company where the thrift is at least 80 percent owned by the same company that also controls a bank, provided every savings institution and every bank owned by such company complies with all applicable capital requirements on a fully phased-in basis and without reliance on goodwill.[5]

In addition to the above-referenced limitations and those imposed under Sections 23A and 23B, Section 11 provides that the Office of Thrift Supervision (OTS), the successor to the FHLBB as federal regulator of federal and state thrifts and savings and loan holding companies, may impose such additional restrictions on any transaction between any savings institution and any affiliate as it determines to be necessary to protect the safety and soundness of the institution.[6]

For purposes of applying the provisions of Sections 23A and 23B of the FRA to savings institutions, Section 11 of the HOLA provides that an "affiliate" of a savings institution includes any company that would be an "affiliate," as defined in Section 23A, of such savings institution if such institution were a "member bank."[7]

New Section 11 of the HOLA also provides that Section 22(h) of the FRA, covering extensions of credit to executive officers, directors, and principal shareholders of a bank, is applicable to savings institutions in the same manner and to the same extent as if the savings institution were a "member bank."[8] As in the Section 23A and 23B context, the OTS is given the authority to impose additional restrictions on loans or extensions of credit to any director or executive officer of a thrift, or any person that directly or indirectly owns, controls, or holds with powers to vote 10 percent or more of any class of voting securities of a thrift, where the OTS deter-

mines that such restrictions are necessary to protect the safety and soundness of the savings institution.[9]

Finally, Section 11 also provides that the OTS has authority to enforce Sections 23A and 23B (and 22(h)) of the FRA as they apply to thrifts. Violations of such sections are subject to penalties which range from $5,000 *per* day for "first tier" offenses, up to the lesser of $1 million or 1 percent of the institution's assets, for "third tier" violations.[11] In this hierarchy, a "first tier" violation is one without certain exacerbating factors; a "second tier" offense involves reckless conduct that is unsafe or unsound, or a breach of fiduciary duty, and which is part of a pattern of misconduct that causes more than minimal loss or that results in or is likely to result in pecuniary gain to the alleged violator; and a "third tier" violation involves a knowing violation, unsafe or unsound conduct, or a breach of fiduciary duty, and knowingly or recklessly causing substantial loss to the thrift or resulting in a substantial pecuniary gain or other benefit to the alleged violator.

II. Section 23A of the Federal Reserve Act

Section 23A employs three complementary approaches to transactions with affiliates controls in order to prevent banks (and now thrifts) from misusing their financial resources for the benefit of their affiliates.[12] First, the section imposes individual and aggregate percentage of capital limits on the dollar amount of a wide variety of affiliate dealings coming within the definition of a "covered transaction." Second, the provision establishes rules for ensuring arms' length dealings between an institution and its affiliates. Finally, the Section precludes the acquisition of "low quality" assets by an institution from its affiliates, and imposes detailed collateralization requirements for affiliate credit transactions.[13]

For purposes of analysis, it is helpful to divide Section 23A into four parts: (1) the types of companies that are affiliates and thereby subject to restrictions; (2) the types of transactions that are covered by the statute; (3) quantitative limitations applicable to covered transactions with an affiliate; and (4) collateral requirements and other qualitative safeguards applicable to transactions with affiliates.[14]

A. What is an "Affiliate"

With certain exceptions, an "affiliate" of a savings institution for purposes of the application of Section 23A includes:[15]

(A) any company that controls the savings institution and any other company that is controlled by the company that controls the institution;

(B) a bank subsidiary of the savings institution;

(C) any company: (1) that is controlled directly or indirectly, by a trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control, directly or indirectly, by trust or otherwise, the savings institution or any company that controls the institution; or (2) in which a majority of the directors or trustees constitute a majority of the persons holding any such office with the savings institution or any company that controls the institution;

(D) any company, including a real estate investment trust, that is sponsored and advised on a contractual basis by a savings institution or any subsidiary or affiliate of the institution or any investment company with respect to which a savings institution or any affiliate thereof is an investment adviser as defined in section 2(a)(20) of the Investment Company Act of 1940; and

(E) any company that the Federal Reserve Board determines by regulation or order to have a relationship with the savings institution or any subsidiary or affiliate of the institution such that covered transactions by the savings institution or its subsidiary with that company may be affected by the relationship to the detriment of the institution or its subsidiary.[16]

Notably, under Section 23A, the definition of an affiliate excludes, among others, any company, other than a bank, that is a subsidiary of a savings institution unless a determination is made not to exclude such a subsidiary company from the "affiliate" definition.[17] Subsidiaries instead are treated as equivalent to the institution itself for purposes of the Section 23A rules.[18] Thus, a transaction between a *subsidiary* of a savings institution and a savings and loan holding company *affiliate* is subject to Section 23A.[19]

B. "Covered Transactions"

The term "covered transaction," which was introduced as a statutory term in the 1982 amendments to the FRA, includes:

(A) a loan or extension of credit to an affiliate;[20]

(B) a purchase of, or an investment in, securities issued by an affiliate;[21]

(C) a purchase of assets, including assets subject to an agreement to repurchase, from an affiliate,

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except purchases of real and personal property that are specifically exempted by the Federal Reserve Board;[22]

(D) the acceptance of securities issued by an affiliate as collateral security for a loan or extension of credit to any person or company; or

(E) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit on behalf of an affiliate.[23]

Certain types of otherwise covered transactions are exempted from the *quantitative* limitations of Section 23A, and thus, for practical purposes, may be regarded as exempted from treatment as a covered transaction. Under Section 23A(d)(1), transactions between certain types of commonly controlled *banks* are exempt from the quantitative limitations that would otherwise apply. Such exemption applies to transactions between a member bank (and its subsidiaries) and another bank:

(A) which controls 80 percent or more of the voting shares of the member bank;

(B) in which the member bank controls 80 percent or more of the voting shares; or

(C) in which 80 percent or more of the voting shares are controlled by the company that controls 80 percent or more of the voting shares of the member bank.[24]

Under Section 11 of the HOLA, however, the special "sister bank" treatment of Section 23A(d)(1) generally is *not* available to savings institutions held in the same structures as described above. But, as noted previously, a more modest "mother/daughter thrift" exemption may have been created.[25] Comparable "sister thrift" treatment is not available as a general matter until January 1, 1995.[26]

Notwithstanding the current unavailability of a "sister thrift" exemption, there does exist a "sister bank/thrift" exemption. That is, special treatment *is* made available for banks and thrifts in the same *bank/thrift* holding company where the thrift is at least 80 percent owned by the same company that also controls the bank, provided all savings institution(s) and bank(s) owned by such company comply with all applicable capital requirements on a fully phased-in basis and without reliance on goodwill.[27]

A series of other transactions, of more limited scope, also are effectively exempted from treatment as a "covered transaction." With respect to the following types of transactions, savings institutions, to the extent that they engage in such transactions, are accorded what in practice is a more limited type of transactional exemption from the scope of Section 23A than that which is available to banks:[28]

(A) making deposits in an affiliated bank or affiliated foreign bank in the ordinary course of correspondent business, subject to any restrictions that the Federal Reserve Board may prescribe by regulation or order;[29]

(B) giving immediate credit to an affiliate for uncollected items received in the ordinary course of business;[30]

(C) making a loan or extension of credit to, or issuing a guarantee, acceptance, or letter of credit on behalf of, an affiliate that is fully secured by obligations of the United States or its agencies, obligations fully guaranteed by the United States or its agencies as to principal and interest, or a segregated, earmarked deposit account with the savings institution;[31] *provided*, that, in the case of any loan or extension of credit, the affiliate is engaged only in activities permissible for bank holding companies;[32]

(D) purchasing securities issued by any company described in Section 4(c)(1) of the Bank Holding Company Act (BHCA);[33]

(E) purchasing assets having a readily identifiable and publicly available market quotation and purchased at that market quotation or, subject to the prohibition on acquiring "low quality assets" from an affiliate, purchasing loans on a nonrecourse basis from affiliated banks;[34] and

(F) purchasing from an affiliate a loan or extension of credit that was originated by the savings institution and sold to the affiliate subject to a repurchase agreement or with recourse.[35]

C. <u>Quantitative Ceilings on Covered Transactions</u>

The aggregate amount of "covered transactions" between a savings institution, *and its subsidiaries*, and any single affiliate is limited to no more than *10 percent* of the institution's "capital stock and surplus," and the aggregate amount of "covered transactions" between an institution, *and its subsidiaries*, and all the institution's affiliates is limited to no more than *20 percent* of the institution's "capital stock and surplus."[36]

The term "aggregate amount of covered transactions" means the amount of the covered transactions in which the institution or its subsidiary is about to engage added to the current amount of all of an institution's outstanding covered trans-

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actions.[37] For this purpose, "hard" assets, e.g., buildings and office equipment, are generally counted at their cost, minus depreciation,[38] while shorter-term assets, such as loans, are counted in decreasing amounts as they amortize. Where assets purchased are subsequently sold, they are subtracted from the amount of the balance of an institution's transactions with the affiliate from which the asset was purchased, and from the institution's overall total of transactions with affiliates.

A critical consideration to bear in mind in the application of the quantitative limits to savings institutions is that, as applied by the FRB and other federal banking agencies, the term "capital stock and surplus" refers in large measure to *tangible* capital.[39] Presumably, a comparable standard will be applied in the savings institution context as a result of various FIRREA mandates to the OTS to impose standards "no less stringent than those established by the Comptroller of the Currency for national banks."[40]

D. Collateral Requirements and Other Qualitative Safeguards

Although the best known safeguards of Section 23A are probably the Section's quantitative percentage limitations on transactions with affiliates, the Section contains several important *qualitative* safeguards as well. One key safeguard is the requirement that each loan or extension of credit to, or guarantee, acceptance, or letter of credit issued on behalf of, an affiliate by a savings institution, *or its subsidiary*, must be secured at the time of the transaction by collateral having a market value equal to at least 100 percent of the amount of the loan or extension of credit, guarantee, acceptance, or letter of credit.[41] The collateral requirements do not apply, however, to an acceptance that is already fully secured either by attached documents or by other property having an ascertainable market value that is involved in the transaction.[42]

In the savings institution context, however, it is also important to note that Section 11(a)(1)(A) of the HOLA flatly prohibits a savings institution from making any loan or extension of credit to an affiliate unless that affiliate is engaged only in permissible bank holding company activities.[43]

Another qualitative safeguard set forth under Section 23A is that *all covered as well as exempted transactions* between a savings institution (and its subsidiaries) and an affiliate must be on terms and conditions consistent with safe and sound banking practices.[44] Also, to the extent that the proceeds of any transaction are used for the benefit of, or transferred to, an affiliate, the transaction will be treated as a transaction with that affiliate.[45] Finally, a savings institution and its subsidiaries may not purchase a "low-quality asset"[46] from an affiliate, unless the purchase is pursuant to a qualifying purchase commitment, *i.e.*, the institution *or the subsidiary*, pursuant to an independent credit evaluation, committed itself to purchase the asset prior to the time the asset was acquired by the affiliate.[47]

III. Section 23B of the Federal Reserve Act

Section 23B of the FRA[48] is a relatively new transactions with affiliates provision added by the Competitive Equality Banking Act of 1987 (CEBA).[49] The Section augments Section 23A by establishing a broad general rule that a wide range of affiliated party transactions, including but not limited to covered transactions, must be on terms at least as favorable to the institution as those that would be available to non-affiliated companies.[50]

As applied to savings institutions, Section 23B covers various types of transactions between an institution, and its subsidiaries, and an affiliate. For purposes of Section 23B, the term "affiliate" has the same definition as found in Section 23A, except that a "bank" is specifically excluded from the definition for purposes of Section 23B.[51]

The transactions covered by Section 23B include:

(A) "covered transactions" that are subject to Section 23A;

(B) a purchase of securities or other assets from an affiliate including assets subject to an agreement to repurchase;

(C) a payment of money or the furnishing of services to an affiliate under contract, lease, or otherwise;

(D) any transaction in which an affiliate acts as an agent or broker or receives a fee for its services to the institution or to any other person; or

(E) any transaction or series of transactions with a third party if an affiliate has a financial interest in the third party or if an affiliate is a participant in the transaction or series of transactions.

Finally, any transaction by an institution or its subsidiary with *any* person will be deemed to be a transaction with an affiliate if *any* of the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate of the institution.[52]

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Section 23B requires that if a savings institution and its subsidiaries engage in the foregoing types of transactions with affiliates activities, they may do so only: (1) on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to the institution, or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies, or (2) in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliated companies.[53]

In addition to the above referenced transactions, Section 23B prohibits several other specific types of transactions between a savings institution, or its subsidiary, and its affiliates. For example, neither an institution nor its subsidiaries may purchase as fiduciary any securities or other assets from an affiliate unless the purchase is permitted under the instrument creating the fiduciary relationship, by court order, or by the law of the jurisdiction governing the fiduciary relationship.[54] In addition, an institution and its subsidiaries generally are further barred from knowingly purchasing or otherwise acquiring, whether acting as principal or fiduciary, during the existence of any underwriting or selling syndicate, any security where a principal underwriter of the security is an affiliate of the institution.[55] Finally, a savings institution or any subsidiary or affiliate of the institution may not publish any advertisement or enter into any agreement stating or suggesting that the institution shall in any way be responsible for the obligations of an affiliate.[56]

IV. Section 22(h) of the Federal Reserve Act

Enacted as part of the Financial Institutions Regulatory and Interest Rate Control Act of 1978,[57] Section 22(h) of the FRA includes four different restrictions on extensions of credit by a member bank to its insiders and entities that such insiders are deemed to control.[58] Three of the restrictions relate to loans and extensions of credit generally; the fourth covers the payment of overdrafts. Significantly, not all of the restrictions in Section 22(h) apply to all types of institutional insiders and their controlled entities — only an institution's "executive officers" are subject to the full spectrum.

Section 11 of the HOLA provides that Section 22(h) of the FRA applies to savings institutions in the same manner and to the same extent as if the institution were a member bank.[59] Thus, in determining the impact of Section 22(h) on savings institutions, it is appropriate to look both to the statute and to Regulation O (Reg O), which was promulgated by the Federal Reserve Board, in part,[60] to implement Section 22(h) for member banks.[61]

Section 22(h) generally requires that all extensions of credit by a savings institution to its insiders and/or their controlled entities (known as "related interests"), that exceed a specified amount, must be approved in advance by a majority of the entire board of directors of the institution. In addition, an institution is prohibited from extending credit on preferential terms to an insider or a related interest of an insider. Section 22(h) also establishes an aggregate lending limit for loans by a savings institution to its executive officers, principal shareholders, and their related interests. Finally, the provision prohibits, with limited exception, an institution's payment of an overdraft by an institution executive officer or director on an account at the institution.[62] As is evident in the following discussion, the scope of these provisions and the insiders affected by these provisions is quite broad.

A. Insiders Covered by Section 22(h)

The "executive officers" covered by the restrictions of Section 22(h) are defined in Reg O to include a person who participates or has the authority to participate (other than in the capacity of a director) in major policymaking functions of the company or savings institution.[63] Directors that do not perform management duties are not included in the term.

By definition, the chairman of the board, president, every vice-president, cashier, secretary and treasurer are presumed to be "executive officers." However, this presumption can be rebutted if a resolution of the board of directors or the bylaws of the company or savings institution exclude any such individual from participating in major policy decisions *and* the individual does not actually participate in such activities.

In addition to the above presumptions, an executive officer of a company that controls a savings institution, *as well as an executive officer of any subsidiary of such controlling company, is presumed to be an executive officer of the institution for purposes of Section 22(h)*.[64] In this regard, however, a direct subsidiary of the institution would not be treated as a subsidiary of the parent holding company.[65] In addition, executive officers of holding company subsidiaries, but not of the holding company itself, can be excluded from coverage as executive officers if the officer is excluded by name or title from participation in major policymaking functions of the savings

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institution by resolution of the board of directors of both the institution and the subsidiary served by such individual, provided that the individual does not actually participate in major policymaking functions of the savings institution.[66]

A "director" covered by Section 22 (h) includes a person who is designated as such by a savings institution or who performs the functions of a director, whether or not he receives compensation for such service. The term generally does not include advisory directors,[67] but would include trustees who perform duties ordinarily performed by directors. As is the case with executive officers of savings institution affiliates, a director of a company controlling a savings institution, and *a director of any other subsidiary of that company, is presumed to be a director of the institution for purposes of the application of Section 22(h)*.[68] However, there is no procedure equivalent to that available for "executive officers" for excluding directors of holding company subsidiaries from coverage as directors.

Section 22(h) is also applicable to "principal shareholders," which are defined as any individual or company that directly or indirectly, or acting through or in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a savings institution.[69] As is the case with executive officers and directors, a "principal shareholder" is presumed to include a principal shareholder of a company that controls an institution, and *a principal shareholder of any other company controlled by such parent company*.[70] Also for purposes of determining principal shareholder status, shares of a savings institution or a company owned or controlled by a member of an individual's immediate family are considered to be controlled by the individual.[71] For this purpose, members of an individual's immediate family are the individual's spouse, minor children, and any children living at home.[72]

Under Section 22(h), any "company" (i.e., a corporation, partnership, trust, association or other organization) controlled by any of the foregoing types of insiders, as well as a political action committee that benefits from, or is controlled by, any of the foregoing insiders, is defined as a "related interest" of the insider, and is subject to the limitations of Section 22(h).

For purposes of the "related interest" concept, control of a company exists where a person or company, directly or indirectly, or acting through or in concert with one or more persons: (1) owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the company; (2) controls the election of a majority of the directors of the company; or (3) has the power to exercise a controlling influence over the management or policies of the company. The Federal Reserve Board presumes control to exist under the third test where (1) an individual is an executive officer and/or director of the company and directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of the company's voting securities *or* (2) the person directly or indirectly owns, controls, or holds with power to vote more than 10 percent of any class of voting security of the company and is the single largest shareholder.[73]

To rebut a presumption of control that arises under the above standards, a person should submit to the OTS written materials that satisfactorily demonstrate the absence of control.[74] Yet to be determined, however, is whether the OTS will apply these standards or a more extensive set of rebuttable control determinations and procedures, perhaps based on the standards in the OTS's Acquisition of Control Regulations.[75]

Partnerships and other entities that lack voting shares may still be deemed to be "related interests" of an insider if the percentage interest of the entity held by the insider would trigger the conclusive presumption of control, if represented by voting shares, or the interest and position maintained by the insider would trigger the rebuttable presumptions (*e.g.*, in the case of a trust, if the insider is a trustee; and in the case of an estate, where companies are controlled by an estate and the insider is the executor of the estate).[76]

An FDIC-insured "bank" is not deemed as a "company" under Section 22(h). Therefore, sister banks are not related interests of each other for purposes of Section 22(h).[77] However, a similar treatment does not appear to be available for sister thrifts. Notwithstanding this disparate treatment, a subsidiary of a savings institution would not be deemed to be a "related interest" of the institution's parent holding company based on the fact that a subsidiary of a "member bank" is excluded from the definition of a "subsidiary."[78]

B. Lending Restrictions and Prohibition on Overdrafts

Section 22(h), as applied to savings institutions, incorporates the loans-to-one-borrower limits imposed on national banks by Section 5200 of the Revised Statutes.[79] Pursuant to Section 22(h), a savings institution is prohibited from extending credit to any of its executive officers and their related interests, or to any of its principal shareholders and their related interests, in an amount that would exceed the lending limits of

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Section 5200.[80] Based on the provisions of Section 5200, loans to executive officers and principal shareholders, and their respective related interests, generally would be limited to 15 percent of an institution's capital and unimpaired surplus in the case of loans that are not fully secured, and an additional 10 percent of the institution's capital and unimpaired surplus in the case of loans that are fully secured by readily marketable collateral having market value, as determined by reliable and continuously available price quotations, at least equal to the amount of the loan.[81] As noted in the Section 23A discussion, these restrictions may prove to be surprisingly tight, since references to capital and unimpaired surplus in this context will in large measure mean the tangible capital of the institution.[82]

The aggregate lending limit does not apply to an extension of credit by an institution to its parent holding company or to other subsidiaries of such controlling company; such loans rather would be subject to the limits of Section 23A.[83] Notwithstanding these exceptions to the aggregate lending limits, however, extensions of credit by an institution to its parent company and to any nonbank subsidiary of such company remain subject to the prohibition on preferential loans and the requirement for prior board of directors' approvals under Section 22(h), as well as the restrictions of Sections 23A and 23B.

Moreover, although the aggregate lending limit would not apply to a company that controls a savings institution, or to other companies that the company controls,[84] the limit *does* apply to extensions of credit to a principal shareholder of such a company, if such shareholder is not another company or is a company holding between 10 and 25 percent of the institution's voting stock that is not deemed to control the institution; to a principal shareholder of any other subsidiary of the controlling company; and to all related interests of those principal shareholders.

Independent of the aggregate lending limit discussed above, a savings institution may not extend credit or grant a line of credit to insiders or to a related interest of an insider if the extension of credit, when aggregated with all other loans to that insider and all related interests of that insider would exceed a prescribed amount. Currently, by reference to Reg O, this amount would be the greater of $25,000 or 5 percent of the institution's capital and unimpaired surplus, or $500,000.[85] This prohibition is not applicable, however, where the extension of credit is approved in advance by a majority of the institution's entire board of directors, with the interested party abstaining from participating in any way, including taking part in discussion of or otherwise attempting to influence the board's decision.[86] Where an extension of credit was made in the form of a line of credit, no additional approval is needed if, within the preceding 14 months, the original line of credit was approved by a vote of a disinterested majority of the board of directors in compliance with the prohibition on preferential lending.[87]

Under the standards of Section 22 (h), an institution also may not extend credit to an insider or to a related interest of an insider unless the extension of credit: (1) is made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions by the institution with persons who are not insiders or employees of the institution, and (2) does not involve more than the normal risk of repayment or present other unfavorable features.[88]

Finally, Section 22(h) prohibits a savings institution from paying an overdraft on an account of any of its executive officers or directors.[89] The overdraft prohibition is not applicable, however, to a principal shareholder who is neither a director or executive officer of the institution (or to a related interest of such a shareholder). Also exempt from the overdraft prohibition are related interests of an executive officer, director or principal shareholder of the institution.[90] In addition, overdrafts paid in accordance with either a written, preauthorized, interest-bearing extension of credit that specifies a method of repayment or a written pre-authorized transfer of funds from another account of the account holder are specifically exempted from the overdraft prohibition.[91] Finally, inadvertent overdrafts are also excluded if they do not exceed $1,000, the account is not overdrawn for more than five business days and the insider is charged the same overdraft fees as other customers.[92]

Overlap Between Sections 23A and 23B and Section 22(h)

A. Companies Subject to Overlapping Application

Evident in the previous discussion is that there is some overlap between the provisions of Sections 23A and 23B of the FRA and the regulatory scheme promulgated pursuant to Section 22(h) of the FRA in Reg O. Unfortunately for thrifts the results are even odder than for banks. The coverages of Sections 23A and 23B, and Section 22(h) and Reg O apparently will literally overlap in the case of *extensions of credit* by a savings institution (or its sub-

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sidiaries) to a *"company"* that would be an "affiliate" for purposes of sections 23A and 23B and that is also one of the following:

(A) a "principal shareholder *in control* of the savings institution, i.e., a parent holding company, including (unlike the banking model) a thrift that itself is a parent holding company;

(B) a "related interest" of a company that is a principal shareholder in control of the savings institution, *i.e.*, a subsidiary of a parent holding company, including (unlike the banking model) any other thrift subsidiary of a parent holding company;

(C) a "related interest" of an individual who is a principal shareholder *in control* of a savings institution, *i.e.*, any company including (unlike the banking model) any other thrift controlled by an individual in a "chain savings institution" structure; or

(D) a "related interest" of an individual who is *in control* of a company that is a principal shareholder *in control* of a savings institution, *i.e.*, any company including (unlike the banking model) any other thrift controlled by an individual in a "chain savings and loan holding company" structure.

B. Effects of the Overlap

For extensions of credit by savings institutions to companies that fall within the area of overlap between Sections 23A and 23B on the one side and Section 22(h) and Reg O on the other, a variety of results follow. In lieu of the aggregate lending limit set forth in Reg O, an extension of credit to a parent holding company and subsidiaries of that company will be subject to the quantitative limitations in Section 23A, but the Reg O prohibition against extensions of preferential loan terms and the requirement for prior approval of directors, if applicable, will also apply. For companies that are related interests of individuals who are either principal shareholders directly in control of a thrift, or principal shareholders in control of a parent holding company of the thrift, extensions of credit by the thrift technically would be subject to the lending limits under both Section 23A and Section 22(h) (and Reg O), as well as to the Reg O prohibition against preferential loan terms and the directors' prior approval requirement, if applicable. In practice, however, (and the FRB staff position), the limits of Section 22(h)/Reg O generally will be more restrictive and thereby controlling.

1. 12 U.S.C. § 1468(a)(1).

2. 12 U.S.C. § 1468(a)(1)(A). An exception to this prohibition is provided by Section 28(e) of the Federal Deposit Insurance Act (FDIA), which allows an institution to accept a "qualified note" from its holding company, or a holding company affiliate, in connection with the transfer by a savings institution of its "junk bond" holdings to the holding company or the affiliate, provided a number of other conditions are satisfied.

3. 12 U.S.C. § 1468(a)(1)(B). This prohibition by its terms applies to investments made by the **institution**; it does not provide that it applies to investments made by **subsidiaries** of the institution.

4. 12 U.S.C. § 1468(a)(2)(B).

5. 12 U.S.C. § 1468(a)(2)(A). The language of this sister bank/thrift exemption would appear to accommodate transactions between *two thrift subsidiaries* within a bank holding company structure, provided the other conditions of the exemption are met. This presents the possibility that existing multiple savings and loan holding companies might look to an acquisition of a bank in order to gain access to a sister thrift exemption.

6. 12 U.S.C. § 1468(a)(4). In this regard, it should be emphasized that the "Conflicts Rules," 12 C.F.R. §§ 563.41 and 563.43, currently continue to apply to transactions between savings institutions not in a holding company structure and "affiliated persons," *and* to transactions between institutions in a holding company structure and *natural persons* who meet the "affiliated person" definition. The new Section 11 transactions with affiliates provisions are in addition to, and do not supercede these regulations.

7. 12 U.S.C. § 1468(a)(3).

8. 12 U.S.C. § 1468(b)(1).

9. 12 U.S.C. § 1468(b)(2).

10. 12 U.S.C. § 1468(c). Congress was quite clear that it intended that only the FRB should have the authority to issue formal exemptive orders under Section 23A of the FRA. *See* H.R. Rep. No. 101-222, 101st Cong., 1st Sess. 408 (1989) (FIRREA Conference Report); H.R. Rep. No. 101-54, Part I, 101st Cong., 1st Sess. 438 (1989); *see also* 135 Cong. Rec. H4969 (daily ed., August 3, 1989) (statement of Rep. Hubbard); 135 Cong. Rec. S10200 (daily ed., August 4, 1989) (statements of Sens. Sanford, Riegle and Cranston). However, some of the more significant issues presented in applying Sections 23A and 23B to thrifts will not involve interpretations of those sections, but rather, of Section 11 of the HOLA.

11. 12 U.S.C. § 1828(j)(4) and (5).

12. Section 23A of the FRA was originally enacted as a part of the Banking Act of 1933, a statute primarily aimed at correcting abuses that had led to the bank failures of the Depression era. That Act, portions of which are commonly referred to as the Glass-Steagall Act, was a response to a banking system collapse, including the stock market crash and resulting financial crisis of the 1930's. The articulated purpose of the Act was to ensure a "safer use of the assets of the banks, to regulate interbank control [and] to prevent the undue diversion of funds into speculative operations." H.R. Rep. No. 150, 73rd Cong., 1st Sess. 1 (1933). According to a contemporary commentator, a fundamental objective of the original Section 23A legislation was to "prevent the misuse of bank resources in virtually all possible financial transactions that might occur between a bank and its affiliate, through the imposition of both quantitative and qualitative limitations on such transactions." Miles, *Banking Affiliate Regulation Under Section 23A of the Federal Reserve Act*, 105 Banking L. J., 476, 481 (1988) (hereinafter, referred to as "Miles").

13. For a comprehensive discussion of Section 23A, *see* Miles, supra at 476.

14. Rose and Talley, *The Banking Affiliates Act of 1982: Amendments to Section 23A*, 68 Fed. Res. Bull. 693, 694 (1982).

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15. Significantly, in the description of what constitutes an "affiliate," a natural person is not included. Coverage of natural persons that are controlling shareholders is provided, however, under Section 22(h) of the FRA. *See* Section 22(h) discussion, below.

16. 12 U.S.C. § 371c(b)(1). With respect to this final provision, the explanation of the guiding principles followed by the Federal Reserve Board in formulating its proposed amendments to Section 23A in 1982, is instructive:

> For the purposes of Section 23A, the Board believes that the term "affiliate" should apply to organizational relationships involving a bank (1) where the relationship is not one of "arm's-length" and (2) where, because of this relationship, the bank may engage in transactions that may adversely affect its condition. Such transactions may be designed either to rescue a financially troubled affiliate or to "drain" a bank for the benefit of an affiliate. It sho[illegible] noted that the emphasis of Se[illegible] is on organizational rela[illegible] an[illegible] the transactions arisin[illegible] rela-tionships, in contrast [illegible] strictl[illegible] "insider" dealings inv[illegible]ng b[illegible] officers, directors or shar[illegible]olde[illegible]

A Discussion of Amendments to Se[illegible] 23A [illegible] the Federal Reserve Act Proposed by th[illegible] [illegible]ard of Governors of the Federal Reserve System, [illegible]ach-ment to letter from Paul A. Volcker to t[illegible] Honorable Jake Garn, October 2, 1981.

17. 12 U.S.C. § 371c(b)(2)(A). In a regulation proposed by the FHLBB in June 1988, which was intended to implement Section 23A as applied by CEBA in the savings and loan holding company context, included as "affiliates" for purposes of the application of Section 23A were subsidiaries of a subsidiary savings institution that were engaged in activities that the savings institution would not be authorized to engage in directly. *See* 53 FR 21838, June 10, 1988. As was proposed in that regulation, it is possible that the OTS could ultimately determine that service corporations engaged in certain activities, or subject to certain percentage ownership interests by a thrift(s), are "affiliates" for purposes of Sections 23A and 23B.

18. The terminology used in Section 11 of the HOLA to apply Sections 23A and 23B of the FRA to savings institutions may have a potentially interesting result in this context. Because Section 11 provides that a savings institution is to be treated as if it were a "member bank," (not a "bank"), a savings institution that is controlled by another savings institution is a "subsidiary" of that institution and, thus, from the perspective of the parent thrift would be excluded from the definition of an "affiliate." Accordingly, although one reading of Section 11(a)(2)(A) of the HOLA may limit the availability of the "sister bank" exemption of Section 23A(d)(1) in the savings institution context, ironically, the same result may be partially, albeit unintentionally, achieved — with a "mother/ daughter thrift" exemption, as it were — through the definitional exclusion of subsidiaries from the term "affiliate." Such an exemption would apply to transactions analyzed from the perspective of the "mother" thrift, but not from the vantage point of the "daughter" thrift.

19. Other companies excluded from the definition of an "affiliate" are: (1) any company engaged solely in holding the premises of the institution; (2) any company engaged solely in conducting a safe deposit business; (3) any company engaged solely in holding obligations of the United States or its agencies or obligations fully guaranteed by the United States or its agencies as to principal and interest; and (4) any company where control results from the exercise of rights arising out of a bona fide debt previously contracted, but only for the period of time specifically authorized under applicable State or Federal Law or regulation, for a period of two years from the date of the exercise of such rights, subject, upon application, to authorization for good cause shown of extensions of time for not more than one year at a time, subject to an aggregate limit of three years. 12 U.S.C. § [illegible](b)(2)(B)-(E).

[illegible] A[illegible]lready noted, however, new Section [illegible] of the HOLA bars a savings institution f[illegible]n m[illegible]y loan or extension of credit [illegible] an[illegible]liate [illegible]he affiliate is not engaged excl[illegible]vely in a[illegible]vities permissible for bank hold[illegible]g companies. [illegible]U.S.C. § 1468(a)(1)(A).

Signific[illegible], th[illegible] [illegible]eder[illegible] [illegible]eserve Board has held that a m[illegible]ber [illegible]s purchase of, or participation [illegible] a l[illegible] o[illegible]inat[illegible] by a mortgage banking affi[illegible]e w[illegible]d [illegible] be regarded as an extension of cre[illegible] that[illegible]te if "the member bank's co[illegible]men[illegible] pu[illegible]se the loan, or a parti[illegible]patio[illegible] therein[illegible]is obtained by the affiliate with[illegible] the cont[illegible] of a proposed transaction or ser[illegible] of pr[illegible]sed transactions, in anticipation of [illegible]iate commitment to make such loans, an[illegible] based upon the bank's independent e[illegible]ua-tion of the credit worthiness of the mort[illegible]-ors. In these ...circumstances, the memb[illegible] bank would be taking advantage of an investment opportunity rather than being impelled by any improper incentive to alleviate working capital needs of the affiliate that are directly attributable to excessive outstanding commitments." 12 C.F.R. § 250.250. The net result is that a transaction that meets the foregoing standards is treated by the FRB as if it were a transaction directly by the bank — looking through the involvement of the affiliate — and therefore as *exempt* from the limitations of Section 23A. However, *participation* in a loan made by a third party lender *to* an affiliate would be counted as an extension of credit to the affiliate to the extent of the participation. Treatment of a *purchase* of a loan already made by a third party to an affiliate could also be viewed as an extension of credit, but an argument might also be made that the transaction is not an extension of credit, but rather an asset purchase from the unrelated third party.

21. Pursuant to Section 11(a)(1)(B) of the HOLA, however, savings institutions are barred from making any purchase of or investment in securities issued by an affiliate, other than with respect to *shares* of a subsidiary of the institution. 12 U.S.C. § 1468(a)(1)(B). This provision, which applies regardless of the types of activities conducted by the subsidiary, could have a significant effect on how institutions fund activities conducted in their service corporation subsidiaries.

22. Exempted from the quantitative limitations of Section 23A, however, are purchases of assets having a readily identifiable and publicly available market quotation which are purchased at that market quotation, and purchases of loans on a non-recourse basis from affiliated "banks." 12 U.S.C. § 371c(d)(6). The former exemption is not applicable, however, to the purchase of marketable securities issued by an affiliate itself. Letter from J. Virgil Mattingly, Jr., to William P. Meyer, Esq., (May 6, 1986). Moreover, the latter exemption may not be available to affiliated thrifts at all, because, as already noted, savings institutions are "member banks," not "banks," for purposes of the application of Sections 23A and 23B.

23. 12 U.S.C. § 371c(b)(7). Arguably, the issuance of these financial instruments on behalf of an affiliate is not subject to the limitation imposed by Section 11 of the HOLA, which bars a savings institution from making loans or extensions of credit to affiliates that are not engaged exclusively in activities permissible for bank holding companies. Since the two types of transactions are listed separately as "covered transactions," it would appear that both would have been referenced in the limi-[illegible]ation imposed by Section 11 of the HOLA, [illegible]er than just the one, if the intention was to [illegible]ver both.

24. [illegible]C. § 371c(d). This "sister bank" ex[illegible]ption [illegible]es not apply, however, where [illegible] of the [illegible]ks involved is a foreign bank.

2[illegible] As [illegible]viously noted, where one savings insti[illegible]n is a subsidiary of another savings institution, the subsidiary institution may not come within the definition of an "affiliate," and thus from the perspective of the parent institution, transactions with its subsidiary institution are not subject to the limits of Section 23A.

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26. 12 U.S.C. § 1468(a)(2)(B). However, the legislative history of the FIRREA is dotted with "clarifications" in the House and Senate debates on the legislation to the effect that the Federal Reserve Board could — and was encouraged to — use its exemption authority under Section 23A(e)(2) of the FRA to accord "sister thrifts" comparable treatment to "sister banks" under Section 23A(d)(1). See, e.g., 135 Cong. Rec. H 4997 (daily ed. August 3, 1989) (statements of Reps. Gonzales and Carper); 135 Cong. Rec. S 10200 (daily ed. August 4, 1989) (statements of Sens. Garn, Riegle and Sanford).

27. 12 U.S.C. § 1468(a)(2)(A). As already noted, this sister bank/thrift exemption also would appear to be available for transactions between *two thrifts* that are owned by a bank holding company.

28. The scope of these exemptions is more limited for two reasons. First, savings institutions are subject to a prohibition on making loans or extensions of credit to any affiliate not engaged solely in the types of activities permissible for bank holding companies. Thus, exemptions pertaining to extensions of credit are basically meaningless to savings institutions with respect to loans and other extensions of credit to such affiliates. Second, because of the terminology used in Section 11 of the HOLA, savings institutions are generally to be treated in the same manner as a "member bank." Thus, where Section 23A uses the term "member bank," it is appropriate to read "savings institution" in determining the application of the Section to thrifts. However, Section 11 of the HOLA does not, (except in one narrow situation) provide that savings institutions also are to be treated as "banks" under the Section. Accordingly, where a provision exempts a transaction between a "member bank" and a "bank," the translation in the savings institution context is an exempt transaction would appear to be one between a savings institution and a bank.

29. 12 U.S.C. § 371c(d)(2).

30. 12 U.S.C. § 371c(d)(3).

31. 12 U.S.C. § 371c(d)(4).

32. 12 U.S.C. § 1468(a)(1)(A). Section 11 of the HOLA prohibits a savings institution from making *any* loan or extension of credit to any affiliate unless the affiliate is engaged only in activities described in Section 10(c)(2)(F)(i) of the HOLA.

33. 12 U.S.C. § 371c(d)(5). Generally, this refers to a company engaged in (1) holding or operating properties used wholly or substantially by any banking subsidiary of a bank [savings and loan] holding company in the operations of that subsidiary; (2) conducting a safe deposit business; (3) furnishing services to the holding company or its subsidiaries; or (4) liquidating certain assets. 12 U.S.C. § 1843(c)(1).

34. 12 U.S.C. § 371c(d)(6).

35. 12 U.S.C. § 371c(d)(7).

36. 12 U.S.C. § 371c(a)(1). In applying the 10 percent individual affiliate limit, an affiliate and *its* subsidiaries, if any, are treated as *separate* affiliates.

37. 12 U.S.C. § 371c(b)(8).

38. With regard to depreciable assets, the amount of reduction would be equal to the actual amount of depreciation taken on the books of the institution.

39. *See, e.g.*, 12 C.F.R. § 250.161 (interpretation of the Federal Reserve Board regarding treatment of capital notes and debentures as "capital," "capital stock" or "surplus," and denying such treatment); 12 C.F.R. § 250.162 (interpretation of the Federal Reserve Board treating undivided profits as "capital stock and surplus"); 12 C.F.R. § [illegible] (interpretation of the Office of the Comptroller of the Currency providing an extensive definition of capital stock and surplus).

In a 1988 opinion, the FRB staff specifically identified "capital stock and surplus" for purposes of Section 23A by referring to categories on the "Consolidated Report of Condition" for commercial banks. These included total equity capital (which was the sum of perpetual preferred stock, common stock, surplus, undivided profits and capital reserves, and cumulative foreign currency transaction adjustments), plus allowances for loan and lease losses and bad debts, as well as for securities and other contingencies. *Excluded* were unearned income and deferred taxes which would become payable with respect to the tax-free portion of reserves if such portion were transferred from the reserves. Also excluded were reserves for dividends declared and reserves for taxes, interest and expenses. Letter from Roger T. Cole to Sara A. Kelsey, February 25, 1988.

40. *See e.g.*, 12 U.S.C. § 1463(c). *See* also H.R. Rep. No. 54, Part I, 101st Cong., 1st Sess. 438 (1989) (where the House Banking Committee expressed its expectation that the standards of Sections 23A and 23B "will be applied to savings and loan holding companies in a no less stringent manner as they are applied by the [FRB] to bank holding companies.").

41. 12 U.S.C. § 371c(c)(1). The required level of collateral will depend upon the type of collateral. A 100 percent level is required where the collateral is composed of obligations of the United States or its agencies; for obligations fully guaranteed by the United States or its agencies as to principal and interest; for notes, drafts, bills of exchange or bankers' acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank; or for a segregated, earmarked deposit account with the savings institution. Where the collateral is composed of obligations of any state or political subdivision thereof the required level is 110 percent; 120 percent for collateral composed of other debt instruments, including receivables; and 130 percent for collateral composed of stock, leases, or other real or personal property. 12 U.S.C. § 371c(c)(1).

Low quality assets are not acceptable as collateral for any extensions of credit to an affiliate. 12 U.S.C. § 371c(c)(3). The Federal Reserve Board also has indicated that mortgage servicing rights do not qualify as acceptable collateral for purposes of Section 23A. Letter from Michael Bradfield to Gail Runnfelt, August 31, 1987. In addition, securities issued by an affiliate of a member bank are not eligible collateral. 12 U.S.C. § 371c(c)(4). Collateral also must be replaced by additional eligible collateral where needed to keep the percentage of the collateral value relative to the amount of the outstanding loan or extension of credit, guarantee, acceptance, or letter of credit equal to the minimum percentage required at the inception of the transaction. 12 U.S.C. § 371c(c)(2).

42. 12 U.S.C. § 371c(c)(5).

43. As previously noted, this bar may not reach issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

44. 12 U.S.C. § 371c(a)(4).

45. 12 U.S.C. § 371c(a)(2). This would cover, for example, the extension of credit to an unrelated third party in order to purchase property from an affiliate. The precise language of this provision is interesting to contrast with similar terminology of Section 23B. The attribution rule of Section 23B explicitly applies if *any* proceeds of a transaction benefit an affiliate. *See* 12 U.S.C. § 371c-1(a)(3). The language also is notable in that the attribution rule applies only when the transaction resulting in the benefit to the affiliate is by the institution; not when the transaction is by a subsidiary of the institution.

46. A "low-quality asset" is an asset that falls into one or more of the following categories:

(A) an asset classified as "substandard," "doubtful," or "loss" or treated as "other loans especially mentioned" in the most recent report of examination or inspection of an affiliate prepared by a Federal or state supervisory agency;

(B) an asset in a nonaccrual status;

(C) an asset on which principal or interest payments are more than thirty days past due; or

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(D) an asset whose terms have been renegotiated or compromised due to the deteriorating financial condition of the obligor.

12 U.S.C. § 371c(b)(10).

47. 12 U.S.C. § 371c(a)(3).

48. 12 U.S.C. § 371c-1.

49. 12 U.S.C. § 371c-1.

50. The addition of Section 23[illegible] to t[illegible] [illegible]latory scheme of transactions with [illegible]ates [illegible] a rather interesting history. As de[illegible]ibed by one commentator:

> In 1983 and 1984, Senate bills S. 1609 and S. 2851 proposed the expansion of financial services that would be offered by banks to include insurance underwriting and brokerage, real estate development, and certain securities activities, which would have required a repeal of certain Glass-Steagall Act restrictions. Both these bills included proposals to amend the Federal Reserve Act by adding a new Section 23B, which would supplement Section 23A by providing further restrictions on banks and their affiliates. The purpose of this provision was to provide the Federal Reserve Board with greater flexibility in regulating conflicts of interest between banks and their holding company affiliates that would arise from the expanded services and operations that affiliates would be able to offer as a result of such legislation ...Although these proposed bills ...were not passed, Section 23B resurfaced in [CEBA].

Miles, *supra*, at 478 note 4.

51. 12 U.S.C. § 371c-1(d)(1). Apparently, although by its terms Section 23B does not recognize a "sister bank" exemption comparable to that contained in Section 23A, the exclusion of "banks" from the definition of affiliate would accomplish the same result, but on a much larger scale, by excluding from the "affiliate" definition sister banks and affiliate banks in chain banking operations that are not otherwise eligible for the sister bank exemption of Section 23A. In the thrift context, however, because Section 11 of the HOLA specifies that savings institutions are to be treated in the same manner as "member banks," not "banks", for purposes of Sections 23A and 23B, savings institutions apparently would not enjoy the same definitional exclusion from the scope of Section 23B as provided to "banks."

52. 12 U.S.C. § 371c(a)(2).

53. 12 U.S.C. § 371c-1(a)(1). For a discussion of the purpose of this safeguard see H.R. Rep. No. 261, 100th Cong., 1st Sess. 133 (1987).

54. 12 U.S.C. § 371c-1(b)(1)(A).

55. 12 U.S.C. § 371c-1(b)(1). This prohibition is not applicable, however, if the purchase or acquisition of the securities is approved, before the securities were initially offered for sale to the public, by a majority of the directors of the institution who are not officers or employees of the institution or of any affiliate involved. 12 U.S.C. § 371c-1(b)(2).

[illegible] U.S.C. § 371c-1(c).

[illegible] P[illegible]. L. No. 95-630, Section 104, 92 Stat. 3[illegible], 3644 (1978).

[illegible] 12 [illegible].C. § 3[illegible]. Section 22(h), unlike section [illegible]A, does n[illegible] include extension of credit by a [illegible]bsidiary of a[illegible]nstitution within the scope [illegible]ohibi[illegible]s and limitations.

59. 12 U.S.C. § [illegible](b)[illegible]

60. The provision[illegible] Re[illegible] [illegible] im[illegible]lement Sections 11(i) and 22(g) [illegible] [illegible]RA [illegible]S.C. §§ 248(i) and 375a, and [illegible]S.C. [illegible]17([illegible]), which establishes an [illegible]annu[illegible] repor[illegible]g requirement for banks.

61. It also should be recalled that, [illegible] tim[illegible] being at least, the "Conflicts Rules" of [illegible] OTS continue to apply to "affiliated per[illegible]s" of savings institutions not owned by a h[illegible]ing company and to holding company con[illegible]trolled institutions with respect to certain individuals that also meet the definition of an "affiliated person." *See* 12 C.F.R. §§ 563.41 and 563.43.

62. For a comprehensive discussion of Section 22(h), *see e.g.*, Mattingly, *Insider Lending Restrictions and Reporting Requirements Under the Financial Institutions Regulatory and Interest Rate Control Act of 1978, As Amended*, Annual Review of Banking Law, vol. 3 (1984), at 21, (hereinafter referred to as "Mattingly").

63. 12 C.F.R. § 215.2(d). As explained by one commentator:

> The term includes an individual who is substantially and significantly involved in the formulation of major or significant corporate or bank policy, is authorized to represent the corporation in substantial or top-level discussions or negotiations, and is directly accountable to the chief executive officer of the bank or company or its board of directors.

Mattingly, *supra*, at 33.

64. 12 C.F.R. § 215.2(d).

65. *See* 12 C.F.R. § 215.2(c).

66. *See* 12 C.F.R. § 215.2(d).

67. Advisory directors are excluded from the definition of a "director" if the advisory director (1) is not elected by the shareholders of the company or the institution, (2) is not authorized to vote on matters before the board of directors, and (3) provides solely general policy advice to the board of directors. 12 C.F.R. § 215.2(c).

68. 12 U.S.C. § 375b(6)(D).

69. 12 U.S.C. § 375b(1)-(3). An 18 percent ownership threshold applies, however, in the case of institutions located in areas with a population of less than 30,000 persons.

70. 12 U.S.C. § 375b(6)(D). As observed by one commentator:

> Thus, any individual or person controlling more than ten percent of the voting shares of a [holding company] is considered a principal shareholder of the [holding company's subsidiary institution(s)], whether or not the shareholder in fact exercises control over the [holding company]. Moreover, any individual or company owning or controlling more than ten percent of the voting shares of any [illegible]ubsidiary of a [holding company], wo[illegible]d also be considered a principal [illegible]der of each subsidiary [insti[illegible]tion] [illegible] the [holding company], even th[illegible]gh the person or company may [illegible]e no control or influence [illegible] policies of the [holding com[illegible]] or any of its subsidiary [institutions].

Mattingly, *supra*, at 38.

71. 12 C.F.R. § 215.2(j). Curiously, this family attribution rule does not apply, however, in determining the status of a company that might be controlled by an insider to determine whether such a company is a "related interest" of an executive officer, director, or principal shareholder of an institution.

72. 12 C.F.R. § 215.2(e).

73. 12 C.F.R. § 215.2(b)(24).

74. 12 C.F.R. § 215.2(b)(4). The rebuttal process is used only for rebuttal of control determinations. It does not apply in the context of determining "principal shareholder" status.

75. *See* 12 C.F.R. § 574.4(b).

76. Mattingly, *supra*, at 43.

77. 12 C.F.R. § 215.2(a).

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78. 12 C.F.R. § 215.2(l).

79. 12 U.S.C. § 84.

80. Notably, directors and their related interests are *not* subject to this provision.

81. In Section 5200 of the Revised Statutes there is a list of ten exceptions to the percentage ceilings. These provide for higher limits or no limits at all for certain secured extensions of credit. See 12 U.S.C. § 84(c)(1)-(10). For example, an extension of credit fully secured by United States government obligations is not subject to any lending limit. However, loans exempt from the aggregate lending limits would still be subject to the requirement for prior board of director approval and the prohibition against preferential loans, where applicable.

82. [illegible] 12 [illegible].F.R. § 3.100 (interpretation of the Offic[illegible] of the Comptroller of the Currency). [illegible]otab[illegible], th[illegible] allowed the inclusion of s[illegible] note[illegible] [illegible]nd debentures in the capital b[illegible] of a m[illegible]ber bank for purposes of apply[illegible] Section 22(h[illegible] [illegible]nd Reg O. Since thrifts ar[illegible] [illegible]sed t[illegible] subject to Section 22(h) in the [illegible] [illegible]er [illegible] to the same extent as member [illegible]ks, [illegible]eatment presumably should a[illegible] be [illegible] [illegible]le t[illegible] [illegible]rifts in calculating their Secti[illegible] 22(h[illegible] [illegible]en[illegible]g limits. *See* 44 FR 12962 (1979); 12 C.[illegible] [illegible]15.2[illegible]

83. 12 C.F.R. § 215.4(c). No[illegible], how[illegible]er, that Section 11(a)(1)(A) of the HOLA [illegible]rs a sav[illegible]ings institution from making a[illegible] loan [illegible] extension of credit to *any* affiliate [illegible] not exclusively engaged in activities permissible for bank holding company affiliates. 1[illegible] U.S.C. § 1468(a)(1)(A).

84. *Id*.

85. 12 C.F.R. § 215.4(b)(1).

86. 12 U.S.C. § 375b(2).

87. 12 C.F.R. § 215.4(b)(2).

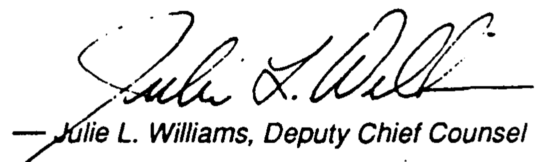
88. 12 U.S.C. § 375b(3).

89. 12 U.S.C. § 375b(4); 12 C.F.R. § 215.4(d).

90. 12 C.F.R. § 215.4(d).

91. 12 C.F.R. § 215.4(d).

[illegible]2. *I*[illegible]



—Julie L. Williams, Deputy Chief Counsel