

OFFICE OF THRIFT SUPERVISION

Order Approving Application To Expand Operations Of A Service Corporation

Order No.: 2003-31
Date: August 1, 2003
Re: Docket No. 04410

Sovereign Bank, Wyomissing, Pennsylvania (Savings Bank), a federal savings bank, has filed an application with the Office of Thrift Supervision (OTS) under 12 U.S.C. § 1828(m) and 12 C.F.R. Part 559, requesting approval for its wholly owned service corporation subsidiary, Sovereign Securities Corporation, LLC (Service Corporation), to engage in the underwriting of investment grade corporate debt securities.

The Proposed Activity

The Service Corporation proposes to underwrite investment grade corporate debt securities. The Service Corporation plans to participate in the corporate debt market in two ways. First, it will distribute debt securities to registered broker-dealers who will then redistribute them to their clients. Second, the Service Corporation will establish a corporate bond trading desk to provide new issue and secondary investment grade corporate debt securities exclusively to its institutional investors.

Approval Standards

In considering whether a proposed investment in a service corporation by a federal savings association is permissible, OTS must consider whether the activity is permissible, whether the amount of the investment is permissible, the state of incorporation of the proposed service corporation and the nature of the investors, and whether there are any supervisory or safety and soundness reasons to limit or to refuse to permit the investment.

Permissible Activity

Section 5(c)(4)(B) of the Home Owners' Loan Act (HOLA), which authorizes federal savings associations to invest in service corporations, does not specify the types of activities in which service corporations may engage. Section 559.3(e)(2)(i) of the OTS Subordinate Organization Regulations states that a federal association may request approval for a service corporation to engage in any activity that is

“reasonably related to the activities of financial institutions” by filing an application with OTS. There are no specific criteria for determining whether an activity meets the “reasonably related” standard. The regulations list several activities that are preapproved for service corporations. Underwriting investment grade corporate debt is not a preapproved activity under 12 C.F.R. § 559.4.

Neither OTS nor its predecessor, the Federal Home Loan Bank Board, has previously considered whether underwriting investment grade corporate debt securities is a permissible activity for a service corporation. In this instance, however, there are two factors, the nature and purpose of the underwriting activity, and the type of risk it presents, that leads us to conclude that the underwriting of investment grade corporate debt securities is “reasonably related to the activities of financial institutions.”

First, with respect to the nature of the proposed activity, OTS considers the underwriting and dealing in corporate debt (and equity) securities as a part of the general business of banking because the activities are the functional equivalent or logical outgrowth of activities conducted by thrifts, potentially benefit customers and increase revenues and competition, and the risks associated with underwriting and dealing in such securities are the same risks already assumed by the institution in underwriting and dealing in bank-eligible securities. Further, the underwriting of corporate debt is similar to the activities presently permitted for federal savings associations, including purchasing corporate bonds for their own account and making a direct loan to a corporation. OTS notes that the Office of the Comptroller of the Currency (OCC) has approved applications of national banks for their subsidiaries to underwrite and deal in all types of debt and equity securities (other than interests in open-end investment companies)¹ and to underwrite and deal in investment grade corporate bonds² (collectively, the OCC Approvals). In each of the OCC Approvals, the OCC concluded that the activities are a part of the “business of banking.”

Further, with respect to risk, the underwriting of corporate debt securities involves the same kind of risk assessments that occur when depository institutions purchase corporate bonds for their own account or make a direct loan to a corporation.

Based on the foregoing, OTS concludes that the Service Corporation’s proposed activity is permissible for service corporations of federal savings associations.

An existing service corporation would conduct the proposed underwriting activity. OTS previously concluded that the Service Corporation meets the

¹ OCC Conditional Approval No. 351 (January 28, 2000) (Approval No. 351).

² OCC Conditional Approval No. 331 (November 3, 1999) (Approval No. 331).

ownership and location requirements of section 5(c)(4)(B) of the HOLA and 12 C.F.R. Part 559, and also concluded that the Service Corporation's form of ownership is permissible.³ The application indicates that neither the ownership nor the location of the Service Corporation has changed. In addition, the Savings Bank will not make additional investments in, or loans to, the Service Corporation in order for it to engage in the proposed activity. Accordingly, the application does not raise any issues regarding the permissible level of investment in service corporations.

The application presents sufficient information to conclude that the Service Corporation will comply the requirements of 12 C.F.R. § 545.74, as appropriate, and with the separate corporate identity requirements of 12 C.F.R. § 559.10. Based on the application, OTS concludes that the proposed activity is not objectionable on safety and soundness or supervisory grounds.

For the reasons set forth above, OTS concludes that the Service Corporation's proposed activity is permissible for service corporations and that the application satisfies the applicable approval standards, provided that the following conditions are complied with in a manner satisfactory to the Northeast Regional Director, or his designee (Regional Director). Accordingly, the application is hereby approved, subject to the following conditions:

1. The Savings Bank must receive all required regulatory approvals prior to commencing the proposed activity with copies of the approvals provided to the Regional Office;
2. The Service Corporation must commence operations no later than twelve months from the date of the approval order, unless the Regional Director, or his designee, grants an extension; and
3. The Service Corporation must not deviate materially from any of the activities, facts or representations described in the application, except with the prior written non-objection of the Regional Director, or his designee.

³ See OTS Order No 2001-66 (Oct. 29, 2001).

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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 August 1, 2003.



Scott M. Albinson
Managing Director
Office of Supervision