



Office of Thrift Supervision  
Department of the Treasury

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May 6, 1994

MEMORANDUM

TO: Kenneth P. Slosser  
Assistant Regional Director,  
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FROM: Howard C. Bluver *HEB*  
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SUBJECT: Application of Section 23B of the Federal Reserve  
Act and 12 C.F.R. § 563.42 to a Proposed  
Transaction Involving [REDACTED]

[REDACTED] FSB (the "Association") and its parent,  
[REDACTED] (the "Holding Company") have proposed  
a restructuring of the Association whereby the Association will  
sell a significant block of loans to a newly-formed subsidiary of  
the Holding Company. The Association will in turn be sold to  
investors. We conclude that the sale of assets contemplated in the  
restructuring as proposed is subject to section 23B of the Federal  
Reserve Act. In determining whether the "arms length" standard of  
section 23B is satisfied, however, you may properly consider the  
terms of the entire transaction, including the amount of the  
capital infusion into the Association.

Background

In order to facilitate the recapitalization of the  
Association, the Holding Company has proposed a multi-part  
transaction -- which will be effected simultaneously -- summarized  
as follows. Investors will purchase the stock of the Association  
from the Holding Company through the formation of a new holding  
company created for the purpose of acquiring the Association.  
Simultaneous with the sale of the Association, the Association will  
sell a certain amount of performing and non-performing loans to  
Recovery Corporation (the "Corporation"), a newly-created, wholly-  
owned subsidiary of the Holding Company. The Corporation will pay

cash to the Association for the non-recourse purchase of such loans, funded in part by a debt offering (in which the loans will serve as collateral) and in part from a portion of the purchase price of the Association, which the Holding Company will downstream to the Corporation.

In addition, a significant amount of capital will be infused into the Association by virtue of the sale to new investors by the new holding company of several classes of securities in the public and private capital markets. At the close of the transaction, the Association will no longer be owned by the Holding Company, will have significantly fewer troubled assets and will be well-capitalized under the OTS's prompt corrective action standards.

### Discussion

Under section 11(a) of the Home Owners' Loan Act ("HOLA"), sections 23A and 23B of the FRA apply to a savings association "in the same manner and to the same extent as if the savings association were a member bank" of the Federal Reserve System.<sup>1</sup> Sections 23A and 23B impose quantitative and qualitative restrictions on certain transactions between an institution and its affiliates. The requirements of these statutory provisions have also been incorporated into OTS regulations.<sup>2</sup>

We conclude that section 23A is not triggered by the proposed restructuring because the restructuring does not constitute a "covered transaction" within the meaning of section 23A.<sup>3</sup> Section 23B, however, applies to the sale of assets to an affiliate.<sup>4</sup> As the restructuring contemplates the sale of loans by the Association to the Corporation, an affiliate,<sup>5</sup> the requirements of section 23B apply to the transaction.

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<sup>1</sup> 12 U.S.C. § 1468.

<sup>2</sup> 12 C.F.R. §§ 563.41 and 42 (1993).

<sup>3</sup> See 12 U.S.C. § 371c(b)(7); 12 C.F.R. § 563.41(b)(7) ("covered transaction" under section 23A does not include sale of assets).

<sup>4</sup> 12 C.F.R. § 563.42(a)(2)(ii). See also 12 U.S.C. § 371c-1(a)(2)(B). For purposes of this section, an "affiliate" includes "any . . . company that is controlled by the company that controls the savings association." 12 C.F.R. § 563.42(d)(1), citing 12 C.F.R. § 563.41.

<sup>5</sup> See 12 U.S.C. § 371c-1(d)(1); 12 C.F.R. § 563.42(d)(1).

Section 23B provides that a savings association may engage in transactions only:

(A) on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to [it] or its subsidiary, as those prevailing at the time for comparable transactions with or involving other nonaffiliated companies, or

(B) 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.<sup>6</sup>

The Board of Governors of the Federal Reserve System ("FRB"), which has authority to interpret section 23B,<sup>7</sup> has described the operation of this provision as requiring that transactions with an affiliate be conducted on "non-preferential" terms.<sup>8</sup> For purposes of determining whether the proposed asset sale comports with section 23B, it is appropriate to consider -- under the express statutory provisions -- the terms of comparable transactions to the extent such comparables exist. We are further informed orally by the staff of the FRB that, in assessing whether an asset sale that is an integral component of a more comprehensive transaction meets the comparability requirement of section 23B, it is appropriate to consider the terms of the entire transaction, including the amount of the capital infused into the Association. We defer to the Regional Office to determine, based upon its familiarity with the facts at issue and the marketplace, whether the "arms-length" requirement of section 23B has been satisfied here.

In reaching the conclusions set forth in this memorandum, we have relied upon the representations made by the Association, as summarized herein. Our conclusions depend upon the accuracy and completeness of those representations. Any material change in circumstances from those described herein might require different conclusions.

If you have any questions regarding the foregoing, please call Laurie Nicoli at (202) 906-7452.

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<sup>6</sup> 12 C.F.R. § 563.42(a)(1). See also 12 U.S.C. § 371c-1(a)(1).

<sup>7</sup> See H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 408 (1989).

<sup>8</sup> See, e.g., J.P. Morgan & Company Incorporated, 75 Fed. Res. Bull. 192, 203 & n. 35; The Chase Manhattan Corporation, 73 Fed. Res. Bull. 367 (1987).