

OFFICE OF THRIFT SUPERVISION

Approval of Service Corporation Application

Order No. 2002-13

Date: April 29, 2002

Re: Docket No. 2859

Branch County Federal Savings and Loan Association, Coldwater, Michigan (Savings Bank) has applied to the Office of Thrift Supervision (OTS), pursuant to 12 U.S.C. § 1828(m) and 12 C.F.R. Part 559, to make a cash investment, through its existing first-tier Michigan-chartered service corporation, Community Services Group, Inc., in Michigan League Mortgage Partners, L.L.C. (Lower-tier Entity). The Lower-tier Entity will place funds in a reinsurance pool sponsored by a Vermont-chartered reinsurance company (Insurance Company), to reinsure private mortgage insurance on loans originated by the Savings Bank and other depository institutions that have invested in the Lower-tier Entity. (The foregoing is referred to as the Application.)

The Lower-tier Entity will establish and maintain a reinsurance pool in a "protected cell" administered by the Insurance Company. The Insurance Company was formed under Vermont's "Sponsored-Cell" legislation, in order to enter into reinsurance arrangements with various entities. For each entity with which the Insurance Company does business, the Insurance Company establishes a separate "cell." Each cell has financial responsibility, under Vermont law, only for reinsurance arrangements pertaining to that cell.¹ Funds in the LLC cell could not be used to satisfy liabilities of other cells or of the Insurance Company.

The Lower-tier Entity, through the protected cell, will reinsure a portion of the loss on private mortgage insurance written on mortgages originated by the Savings Bank and other investors in the Lower-tier Entity for which mortgage insurance has been provided by an affiliate of the Insurance Company (Mortgage Insurer). In consideration for the protected cell assuming certain reinsurance risks, the Mortgage Insurer will cede a portion of its premium.

Under the terms of the reinsurance agreements, the Insurance Company will administer the protected cell, and related funds. In connection with the agreements, the Mortgage Insurer will deposit ceded premiums in a trust established by the Insurance Company for the benefit of the Mortgage Insurer. The purpose of the trust is to secure the reinsurance obligations of the protected cell by holding premiums ceded by the Mortgage Insurer. Although the cell will be responsible for reinsurance obligations on loans originated by various investors in the Lower-tier Entity, under an agreement to be entered into among investors in the Lower-tier Entity, an institution whose loan(s) create a reinsurance obligation will reimburse the other institutions for any loss in their investment resulting from the payment.

¹ Vt. Stat. Ann. Tit. 8, § 6021.

OTS regulations, at 12 C.F.R. § 559.4(a), provide that a service corporation of a federal association may engage in "any activity that all federal savings associations may conduct directly, except taking deposits." OTS has concluded that federal associations may engage in activities of the type contemplated in the Application, pursuant to their incidental authority.²

Section 5(c)(4)(B) of the Home Owners' Loan Act provides that a federal association may make investments in the capital stock, obligations, or other securities of any corporation organized under the laws of the State in which a federal savings association's home office is located, if such corporation's entire capital stock may be purchased only by savings associations of such state and federal associations with their home office in the state. The Savings Bank's first-tier subsidiary is a corporation, organized under Michigan laws. The Savings Bank's home office is located in Michigan, and the Savings Bank owns all of the first-tier service corporation's stock. Accordingly, the Application meets these section 5(c)(4)(B) requirements.

OTS regulations, at 12 C.F.R. § 559.3(f)(2), state that a service corporation may invest in lower-tier entities, without the requirement that such lower-tier entities be incorporated or be owned solely by savings associations, as long as the lower-tier entity is engaged solely in activities that are permissible for a service corporation. OTS does not object to the chartering of the Lower-tier Entity as a Michigan limited liability company, rather than a corporation. OTS has taken the position that the HOLA authorization to invest in service corporations should be read to permit any organizational form that provides the same basic protections as the corporate form of organization, including limited liability.³ Based on the nature of the Lower-tier Entity, OTS concludes that the establishment of the Lower-tier Entity is consistent with this standard.

Federal savings associations may invest up to three percent of assets in service corporations, provided that any investment in excess of two percent of assets must serve primarily community, inner city, or community development purposes.⁴ In addition, OTS may, at any time, limit a savings association's investment in a service corporation, or may limit or refuse to permit any activities of a service corporation, for supervisory, legal, or safety and soundness reasons. The Savings Bank's total investment in service corporations will be within the statutory and regulatory limits.

Based on the Application, OTS concludes that the establishment of the service corporation is not objectionable on safety and soundness or supervisory grounds, provided that the Savings Bank, the first-tier service corporation and the Lower-tier Entity satisfy the conditions set forth below, which are intended to ensure that the proposed activities do not raise supervisory concerns, in a manner satisfactory to the Southeast Regional Director, or his designee (together, the Regional Director).

² See Op. C. C. (March 11, 1999).

³ See 61 Fed. Reg. 66561, at 66564 (Dec. 18, 1996).

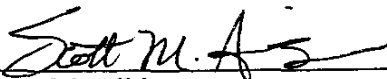
⁴ 12 C.F.R. § 559.5.

For the reasons set forth above, OTS has determined that the Application satisfies all applicable approval standards and criteria, and the Application is hereby approved, subject to the following conditions:

1. The Lower-tier Entity must commence the activities proposed in the Application within one hundred and twenty (120) calendar days from the date of this Order. This time period may be extended for up to 120 calendar days, for good cause, by the Regional Director;
2. The Savings Bank must obtain prior written clearance from the Regional Director prior to approving any material deviation from the activities, facts, representations or level of investment described in the Application;
3. While the Lower-tier Entity is a subsidiary of the Savings Bank, the portion of reinsurance risk assumed by the Lower-tier Entity attributable to the Savings Bank must be considered: (i) in determining the loan-to-value ratio for loans on each of the Savings Bank's books for purposes of determining whether such loans exceed the Supervisory Loan-to-Value Limits set forth in the Appendix to 12 C.F.R. § 560.101, and (ii) in determining whether such loans are "Qualifying Mortgage Loans" for risk-weighting purposes set forth in 12 C.F.R. Part 567; and
4. While the Lower-tier Entity is a subsidiary of the Savings Bank, the Savings Bank, for purposes of calculating its regulatory capital as provided in 12 C.F.R. § 567.6(a)(2)(i)(C), must treat the amount of the Lower-tier Entity's maximum reinsurance obligation on any loan that the Savings Bank has sold as a loan sold with recourse.

By order of the Director of the Office of Thrift Supervision, or his designee, effective

April 29, 2002



Scott M. Albinson
Managing Director
Office of Supervision