Net Worth Maintenance and Prenuptial Agreements

Summary: This Bulletin defines the requirements for net worth maintenance agreements and prenuptial agreements that the Board will impose on acquirers of insured institutions.

For Further Information Contact:
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General Policy: It is Board policy that all acquirers must execute either a limited net worth maintenance agreement (net worth agreement) or a prenuptial agreement prior to closing an acquisition of a FSLIC insured institution if the institution will not, upon consummation of the transaction, meet its fully phased-in minimum capital requirement, excluding regulatory capital resulting from granted forbearances or FSLIC assistance that otherwise serve to increase the institution's regulatory capital (net capital).

Background: Federal Home Loan Bank Board Resolution No. 88-685, issued August 12, 1988, rescinds the prior Board policy requiring open-ended net worth maintenance agreements from holding company acquirers as a condition of approval of acquisition transactions. In lieu of the open-ended net worth maintenance agreement, the Board has substituted two alternative forms of agreement and provided that the acquirer must agree to one of the two, as a matter of general policy. In addition, the Board has applied this policy to all acquirers, including both holding companies and individuals.

It is the policy of the Board to ensure, insofar as possible, that future acquirers of insured institutions have sufficient incentive to conduct their business in a prudent manner. An effective means to encourage such prudent conduct is to require the owners of insured institutions to maintain a substantial financial stake in the continued health of their institutions by satisfying the Board's minimum capital requirements. As a result, this policy is designed to facilitate the adequate capitalization of acquired institutions or, where that may not be possible, to provide additional protection to the FSLIC by enabling the Board to take active management control of deteriorating institutions at an intervention point where the institution may not yet have reached insolvency in real terms.

Procedures: The Board intends to delegate to the Principal Supervisory Agents or to its Washington staff, under applicable standards for delegations of authority to act on applications, as much of the decision-making as possible, subject to the customary reservation of cases that raise significant issues of law or policy. As a general rule, an acquisition will not present a significant policy issue if:

1. The acquirer enters into an agreement or undertaking for a period of ten years that would prohibit the acquirer from paying dividends in excess of one-half of net income during any period in which the Association does not meet its fully phased-in capital requirement, without the prior approval of the Principal Supervisory Agent, and

2. The acquirer invests sufficient assets in the acquired institution such that it meets its fully phased-in minimum capital requirement, excluding regulatory capital resulting from granted forbearances that otherwise serve to increase the institution's regulatory capital (net capital) immediately following the acquisition;

3. The acquired institution has net capital immediately following the transaction that is at least equal to the lesser of the industry's minimum capital requirement (as adjusted by the "April calculation") or 6% of net assets, and the acquirer agrees to execute either (a) a prenuptial agreement that is triggered when net capital declines below 2% of net assets at any point in the future, or (b) a binding agreement to invest additional capital no later than 10 years from the date of acquisition in an amount that would equal the difference at that time between the institution's regulatory capital (net capital), and the institution's fully phased-in capital requirement. In no event, how-
ever, may the institution's net capital immediately following the acquisition be less than 3% of total assets under this delegation.

**Limited Net-Worth Maintenance Agreements:** The maximum amount of liability for an acquirer under a limited net worth maintenance agreement should generally be the difference between the institution's net capital immediately following the transaction and the institution's fully phased-in capital requirement immediately following the transaction. The amount of investment that will be required when it is due will be the amount necessary to restore the institution's net capital to a position where it meets the industry's minimum capital requirement (as adjusted by the April calculation) at the due date, but not to exceed the maximum amount of liability. The additional investment will be due (1) whenever the institution's net capital falls below the minimum capital required under subparagraph (3), or (2) at the expiration date of the agreement.

Limited capital maintenance agreements will expire after a period of ten years unless the Association's net capital exceeds its fully phased-in capital requirement for a period of two consecutive years, at which point the agreement will terminate.

In the case of any binding agreement to infuse additional capital, such an agreement shall be acceptable only if the acquirer has adequate resources to satisfy its obligations under the agreement. In order to demonstrate that it has "adequate resources", the acquirer must either have market capitalization or net worth, excluding its investment in the acquired entity, significantly in excess of the amount of liability under the agreement or the agreement must be guaranteed by a third party with such resources. For the purposes of limited net worth maintenance agreements, if the acquirer does not have adequate resources, it is itself an insured institution, the transaction will present a significant policy issue and require Board review unless the agreement is guaranteed by a third party that is not an insured institution.

Regardless of whether the acquirer owns 100% of the stock of the acquired institution or less than 100%, the acquirer generally must accept the full responsibility for the limited net worth maintenance agreement unless other parties with adequate resources agree to accept part of the obligation. For acquirers that would control significantly less than 100% of the stock, the Board will consider alternative proposals.

**Prenuptial Agreements:** Acquirers may generally elect the prenuptial agreement option only where the acquirer holds sufficient control or receives the advance agreement from other shareholders that will enable the FSLIC to fully exercise its rights under the prenuptial agreement pursuant to the institution's charter and bylaws and applicable State and Federal law. Any transactions that raise questions regarding the FSLIC's ability to exercise its rights will present a significant policy issue and require Board review.

**Interim Agreements:** Where an acquirer has entered into an open-ended net worth maintenance agreement after August 12, 1988, the Board will consider requests to modify those agreements and substitute either a prenuptial agreement or a limited net worth maintenance agreement.

A limited net worth maintenance agreement is a binding agreement to invest up to an agreed upon amount of additional funds in the insured institution if the acquired institution does not meet its minimum fully phased-in net capital requirement at a negotiated point in time (or earlier if the institution's capital drops below a predetermined level).

A prenuptial agreement is an agreement that allows the FSLIC or its designated agent to vote the shares of the Association, remove management and directors, and generally exercise operating control over the Association and sell the shares if the Association's capital declines below a predetermined "trigger point."

All references to "net capital" throughout this document refer to regulatory capital excluding regulatory capital resulting from granted forbearances or FSLIC assistance that otherwise serve to increase the institution's regulatory capital.

*Net assets equals total assets minus FSLIC-guaranteed assets, including FSLIC notes and assets subject to full capital loss and yield maintenance coverage agreements.*

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