

OFFICE OF THRIFT SUPERVISION

Approval of Applications to Form Operating Subsidiaries

Order No.: 2003-54
Date: October 21, 2003
Docket No.: 04410

Sovereign Bank, Wyomissing, Pennsylvania (Savings Bank), a federal 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 establish the following seven operating subsidiaries: SOV APEX Co., Wilmington, Delaware (InvestCo); SOV Facilitation LLC, Wilmington, Delaware (NewCo); SOV Collateral Management LLC, Wilmington, Delaware (DelCo); SOV Charter Limited, London, England (UK Trustee); SOV Trust Manager Co., Wilmington, Delaware (Manager); SOV Funding Trust, Wilmington, Delaware (Trust); and SOV Asset Management LLC, Wilmington, Delaware (DelCo Sub). Collectively, the seven operating subsidiaries are referred to herein as the Operating Subsidiaries. In addition, the Savings Bank has requested that OTS waive a provision in 12 C.F.R. § 559.12(a) to the extent necessary to permit the transaction with the proposed acceleration provisions for the repurchase of certain of the securities being issued in connection with the proposed transaction.

The Proposed Activity

The Savings Bank is a wholly owned direct subsidiary of Sovereign Bancorp, Inc., Philadelphia, Pennsylvania. The Savings Bank proposes to establish the Operating Subsidiaries to facilitate a financing transaction, in which the Savings Bank will obtain financing through the Operating Subsidiaries.

The Savings Bank will cause the Operating Subsidiaries to be formed in a multi-tiered structure, as described in the application. Six of the operating subsidiaries will be organized in the United States and one will be organized in the United Kingdom. InvestCo and Manager will be Delaware corporations. DelCo, DelCo Sub, and NewCo, will be Delaware limited liability companies. Trust will be a Delaware trust which will issue voting interests. The UK Trustee will be a limited liability company chartered in England and Wales and will operate in the United Kingdom.

The Savings Bank has provided commitments to OTS to waive any foreign secrecy laws and to provide access to any documentation regarding the financing transaction to OTS and FDIC and to maintain a copy of the books and records of the Operating Subsidiaries in the United States, including the UK Trustee.

Approval Standards

Operating Subsidiary Application

Generally, a federal savings association may invest in an operating subsidiary if: (1) the subsidiary engages only in activities permissible for federal associations to engage in directly; (2) the federal association owns, directly or indirectly, more than 50 percent of the voting shares of the operating subsidiary; and (3) no person or entity other than the federal association exercises operating control over the operating subsidiary.¹ In addition, OTS may, at any time, limit a savings association's investment in operating subsidiaries, or may limit or refuse to permit any activities of an operating subsidiary, for supervisory, legal, or safety and soundness reasons.²

With regard to the requirement that the subsidiary may engage only in activities permissible for federal associations to engage in directly, the Operating Subsidiaries propose to contribute assets and cash for securities, to issue certain securities, or to make or administer loans, in connection with the proposed financing transaction. The application indicates that the Operating Subsidiaries' proposed activities are permissible for a federal association.

With regard to the requirement that the federal association own, directly or indirectly, more than 50 percent of the voting shares of the operating subsidiary, the application indicates that the Operating Subsidiaries will satisfy this requirement. The application describes the ownership structure and indicates that the Savings Bank will satisfy the requirement that it own, directly or indirectly, more than 50 percent of the voting power of each of the Operating Subsidiaries.

With regard to the requirement that no person or entity other than the federal association exercises operating control over the operating subsidiary, the application indicates that no other party will have voting control over the Operating Subsidiaries. Also, the application indicates that the Savings Bank will have operating control of each of the Operating Subsidiaries.

The Subordinate Organization regulation, at 12 C.F.R. § 559.3(c)(1) refers to "voting shares," and certain of the Operating Subsidiaries will be organized as limited liability companies or a trust. The preamble to the final OTS Subordinate Organization regulations addresses whether an operating subsidiary may be structured other than as a general corporation. The preamble states, in relevant part:

While OTS expects that the vast majority of operating subsidiaries will continue to be structured as corporations, in the interest of increasing federal thrifts' flexibility in structuring their operations, the agency has . . . [removed] specific references to 'incorporation.' An operating subsidiary must still satisfy the basic requirements of majority ownership interest, limited liability, and effective

¹ 12 C.F.R. § 559.2, 559.3(c)(1), and (e)(1) (2003).

² 12 C.F.R. § 559.1(a) (2003).

operating control. . . OTS will therefore continue to address requests by thrifts to establish an operating subsidiary in a noncorporate form on a case-by-case basis through its § 559.11 notice and review process. Organizational forms that meet the requirements of the regulations and do not present safety and soundness concerns will be permitted.³

In this case, OTS has determined there are no supervisory concerns with the organizational form of the Operating Subsidiaries that will be organized as limited liability corporations or a trust.

The application adequately demonstrates that the Savings Bank will comply with the corporate separateness requirements set forth in 12 C.F.R. § 559.10.

The application indicates that the Savings Bank will comply with 12 C.F.R. § 559.12, which sets forth the requirements for the issuance of securities by a subsidiary, with the exception of the requested waiver for the acceleration provision, discussed below.

With regard to supervisory considerations, the proposed transaction involves a complex financing transaction. OTS has reviewed the application, and has concluded that the transaction does not present supervisory concerns, provided that the conditions set forth below are satisfied.

Waiver Request

The Savings Bank has requested that OTS waive a provision in 12 C.F.R. § 559.12(a) stating that “[a] subsidiary may not issue any security the payment, maturity or redemption of which may be accelerated upon the condition that [the parent savings association is] insolvent or [has] been placed into receivership.”

The Savings Bank has requested a waiver of this provision for a proposed acceleration provision in certain of the transaction documents for the proposed financing. The provision would provide for the accelerated repurchase of certain of the securities to be issued in the financing.

In pertinent part, the Waiver Regulation provides that the “Director may, for good cause and to the extent permitted by statute, waive the applicability of any provision of this chapter.”⁴

As the text of the Waiver Regulation suggests, the only substantive limitation is that the waiver authority does not extend to regulatory provisions prescribed by statute. There is no statute prohibiting subsidiaries of savings associations from issuing securities that provide for acceleration upon the insolvency of the parent association. Therefore, the only issue raised by

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

⁴ 12 C.F.R. § 500.30(a) (referring to Chapter V of 12 C.F.R.) (Waiver Regulation)

the request is whether "good cause" exists to justify the waiver. The purpose of the acceleration prohibition is to prevent the insolvency or receivership of the parent association from impacting the operating value of the subsidiary.⁵

The Savings Bank indicates that it has chosen to include the acceleration provision, because it is seeking a lower cost of financing. In this case, the OTS has determined that the requested waiver does not raise any safety and soundness concerns. The OTS has approved similar waiver requests in the past.

Conclusion

Based on the foregoing, OTS concludes that the application satisfies all applicable approval standards and criteria, with the exception of 12 C.F.R. § 559.12(a), provided that the following conditions are complied with in a manner satisfactory to the Northeast Regional Director, or his designee (Regional Director). Pursuant to 12 C.F.R. § 500.30(a), OTS hereby waives the applicability of 12 C.F.R. § 559.12(a), to the extent necessary to enable the Savings Bank and the Operating Subsidiaries to include the proposed acceleration provision. Accordingly, the Application is hereby approved, subject to the following conditions:

1. The Savings Bank must receive all required regulatory approvals for the transactions prior to consummation of the proposed transaction with copies of all such approvals supplied to the Regional Office;
2. The proposed transactions must be consummated within 120 calendar days of the date of this Order;
3. No later than the business day prior to the date of consummation of the transactions, the Savings Bank must submit, to the satisfaction of the Regional Director, any updated transaction documents blacklined to show the changes from the immediately preceding drafts provided to OTS;
4. No later than the business day prior to the date of consummation of the proposed transactions, the Savings Bank must submit to OTS copies of all executed tax, legal and accounting opinions obtained in conjunction with the proposed transactions, substantially in the form of the most recent drafts of such documents submitted to OTS;
5. On the business day prior to the date of consummation of the proposed transaction, the chief financial officers of the Savings Bank and the Operating Subsidiaries must certify in writing to the Regional Director that no material adverse changes have occurred with respect to the financial condition or operation of the Savings Bank and the Operating Subsidiaries as disclosed in the Application, including but not limited to directors, shareholders or the business plan. If additional information having a material adverse bearing on any feature of

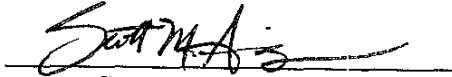
⁵ See 49 FR 29360 (Jul. 20, 1984).

the Application is brought to the attention of the Savings Bank, the Operating Subsidiaries, or the OTS since the date of the financial statement submitted with the Application, the transaction must not be consummated unless the information is presented to the Regional Director, and the Regional Director provides written nonobjection to consummation of the transactions;

6. The Savings Bank must advise the Regional Director in writing within 5 calendar days after the effective date of the proposed transactions: (a) of the effective date of the transaction; and (b) that the transaction was consummated in accordance with all applicable laws and regulations, the Application, and this Order;
7. No later than 30 calendar days following the date of consummation of the proposed transactions, the Savings Bank must submit all executed transaction documents blacklined to show any changes from the drafts submitted with the Application;
8. The Operating Subsidiaries must not materially deviate from any of the activities, facts, representations or commitments described in the Application, except with the prior written nonobjection of the Regional Director;
9. No later than 30 calendar days following consummation of the proposed transactions:
 - a. The Savings Bank must establish and document internal controls that demonstrate adequate oversight of the foreign operating subsidiary, and provide materials documenting the institution of such internal controls to the Regional Director;
 - b. The Savings Bank and the foreign operating subsidiary must consent in writing to the jurisdiction of the U.S. over, and the applicability of U.S. law to, the foreign operating subsidiary for purposes of all claims made by, proceedings initiated by, or obligations to, the U.S., OTS and any U.S. governmental agency, department or division, and must consent in writing to the jurisdiction of OTS over the foreign office subsidiary for purposes of examination, supervision and enforcement; and
 - c. The Savings Bank and the foreign operating subsidiary must consent in writing to the disclosure by foreign governmental authorities to OTS of such information on the operations of the foreign operating subsidiary that OTS deems necessary from time to time to determine and enforce compliance with applicable U.S. law.

Any time period set forth herein may be extended for up to 120 calendar days, for good cause, by the Regional Director.

By order of the Director of the Office of Thrift Supervision, or his designee, effective October 21, 2003.



Scott M. Albinson
Managing Director
Office of Supervision