January 12, 1994

Re: Employees' Credit Union
("Credit Union")

Dear [Name]:

This is in response to your letter of July 9, 1993, as amended on July 23, 1993, and related correspondence, in which you asked: (1) whether it is legally permissible under the Home Owners’ Loan Act ("HOLA") and OTS regulations thereunder for a Federal mutual savings association to acquire the assets, liabilities, and equity of a credit union in a purchase and assumption transaction; (2) whether a Federal mutual savings association converting to Federal stock form may issue common stock in excess of its pro forma market value for the purpose of raising additional capital to fund specified acquisitions of credit unions to occur upon conversion or shortly thereafter and, if so, what limitations would apply to such issuances; and (3) whether a recently converted savings association may issue additional common stock to accomplish other acquisitions of state-chartered credit unions.

In our opinion, the purchase and assumption of a credit union’s assets and liabilities and acquisition of such credit union’s equity by a Federal mutual savings association are generally permissible transactions under the HOLA and OTS regulations, subject to the limitations described below.

With respect to your second question, the OTS mutual to stock conversion regulations do not permit conversion stock issuances in excess of the pro forma valuation of the converting savings association. However, if good cause is shown, the OTS may grant a waiver of the conversion regulations to permit a converting Federal mutual savings association to issue common stock in a standard conversion in excess of the association’s pro forma market value. A determination that good cause exists
depends on all the relevant facts and circumstances presented in
the context of a particular conversion transaction. Accordingly,
we cannot advise you whether we would recommend that a waiver be
granted with respect to the proposed acquisitions. To recommend
a waiver of the pro forma market value requirement we would
require, at a minimum, that certain conditions, discussed below,
be satisfied.

With respect to your third question, a recently-converted
savings association may issue additional capital stock, subject
to prior OTS approval, in order to undertake acquisitions of
state-chartered credit unions following conversion.

Background

The Credit Union is a mutual credit union chartered by the
State of and insured by the National Credit Union
Administration ("NCUA"). At 1993, the Credit Union had
total assets of , total liabilities and members' accounts of , and total reserves and undivided
earnings of .

The Credit Union proposes to apply to the OTS to charter a
new Federal mutual savings association, pursuant to 12 C.F.R.
§ 543.2 (1993).1 Immediately upon organization, the de novo
Federal mutual savings association would purchase all of the
assets, assume all of the liabilities, and acquire substantially
all of the equity of the Credit Union in a transaction under the
OTS transfer of assets regulation, 12 C.F.R. § 563.22(b) (1993).2
In the final step of the transaction, the newly-chartered Federal
mutual savings association would convert to a Federal stock
savings association in a standard conversion under the OTS mutual
to stock conversion regulations.3

You have submitted a letter dated February 4, 1993, from the
General Counsel of the State Banking Department of the State of
addressed to you that states that the proposed series of

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1. The Credit Union would also apply to the Federal
Deposit Insurance Corporation ("FDIC") for insurance of accounts
for the new Federal mutual savings association as a member of the
Savings Association Insurance Fund.

2. The transaction would require FDIC approval under the
Bank Merger Act, 12 U.S.C. § 1828(c), because the Credit Union's
deposits are insured by the NCUA. To the extent NCUA approval
is necessary for this transaction, we direct you to the NCUA.
Our opinion does not address any requirements that may derive
from NCUA insurance.

transactions is "in compliance with Oklahoma law and would not appear to run afoul of any of the provisions concerning credit unions in Oklahoma."

Additionally, you have represented that the Credit Union contemplates entering into letters of intent, prior to conversion, with various Oklahoma-chartered credit unions to acquire such credit unions upon completion of the Credit Union's conversion to a Federal stock savings association or shortly thereafter.

You have inquired whether it is legally permissible under the HOLA and OTS regulations thereunder for a Federal mutual savings association to acquire the Credit Union in a purchase and assumption transaction. In addition, you have inquired whether a Federal mutual savings association may issue common stock in excess of its pro forma market value in its standard conversion to stock form. You represent that the purpose of the issuance of additional common stock would be to raise capital to acquire additional credit unions with which the Credit Union would have entered into letters of intent for acquisition prior to conversion. In so doing, the converted association would like to raise enough capital to not only fund the acquisitions, but also to prevent decreases of the converted association's regulatory capital ratios upon the acquisition of the credit unions. Finally, you asked how soon after completion of the standard conversion the savings association may issue additional common stock to engage in future acquisitions of credit unions.

Analysis

1. Acquisition of the Credit Union by a De Novo Federal Mutual Savings Association

   A. Authority under Sections 5(a) and 5(d)(3) of the HOLA

The HOLA does not provide explicit authority for a Federal savings association to acquire a credit union in a purchase and assumption transaction. However, section 5(a) of the HOLA authorizes the OTS, under such regulations as the OTS may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of Federal savings associations. In addition, section 5(d)(3)(A) of the HOLA provides that the OTS "may prescribe regulations for the reorganization, consolidation, liquidation, and dissolution of

savings associations . . . ." Together, these sections provide the OTS with broad authority to issue regulations governing combination transactions involving a savings association.

OTS regulations promulgated under the HOLA explicitly provide that:

A Federal savings association may exercise all authority granted to it by the [HOLA] . . . . , and its charter and bylaws, whether or not implemented specifically by Office regulations, subject to the limitations and interpretations contained in this part.4

OTS also requires de novo Federal mutual savings associations to have a charter in the form specified in 12 C.F.R. § 544.1 (1993) ("Model Federal Mutual Charter"). Section 4 of the Model Federal Mutual Charter states that Federal mutual savings associations "may pursue any or all of the lawful objectives of a Federal mutual savings association chartered under section 5 of the Home Owners' Loan Act [12 U.S.C. § 1464] and to exercise all the express, implied, and incidental powers conferred thereby . . . ." A reorganization is a lawful objective of a Federal mutual savings association.7 Indeed, OTS regulations specifically allow Federal mutual associations to adopt a pre-approved charter amendment that states specifically that they have the power to "wind up and dissolve, merge, consolidate, convert or reorganize."8

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4 12 U.S.C. § 1464(d)(3)(A). Section 5(d)(3)(A) of the HOLA also authorizes OTS to promulgate regulations "for the merger of insured savings associations with insured savings associations." 12 U.S.C. § 1464(d)(3). As is more fully explained below, this clause does not apply to the transaction you describe because the savings association's transaction would be with a credit union rather than an insured savings association.


8 12 C.F.R. § 544.2(b) (1993) (emphasis added). Federal mutual savings associations have the power to reorganize without adopting the optional charter provision. The current optional provision relating to reorganizations was mandatory before 1983. See 12 C.F.R. § 544.1(a), (b), and (c) (1983). In 1983, the FHLBB revised the Model Federal Mutual Charter to allow for a "simple statement of purpose and powers, but provided for the option of a more detailed powers section as a pre-approved (continued...)"
A "reorganization" includes a bulk purchase of assets and an assumption of liabilities. In 1985, the FHLBB amended its regulations relating to combinations involving federal stock associations to authorize bulk purchases of assets between federal stock associations and depository institutions, including credit unions. 50 Fed. Reg. 16,071, 16,074 (1985) (now codified at 12 C.F.R. § 552.13(b)(2) (1993)). In so doing, the FHLBB concluded that a "bulk purchase of assets and assumption of liabilities where all or substantially all of the assets of one entity are acquired by another entity, is in corporate structure, a reorganization, rather than a merger." Id. This definition of the term "reorganization" depended on principles of corporate law that apply with equal force to mutual and stock associations. Indeed, in 1986, a FHLBB staff legal opinion concluded that a Federal mutual association had the authority under the Federal mutual charter to "reorganize" by purchasing the assets and assuming the liabilities of an FDIC-insured state chartered commercial bank.9

Accordingly, Federal mutual associations have the authority under section 5 of the HOLA, 12 C.F.R. § 545.1 (1993), and section 4 of the Model Federal Mutual Charter to "reorganize" by means of bulk purchases of assets and assumptions of liabilities of other depository institutions (including credit unions),

1(...continued)
charter amendment to a mutual charter." 48 Fed. Reg. 44,174, 44,175 (1983). The FHLBB's objective was to create a charter that would remain current even if the statutory authority of Federal associations was expanded or altered. Id. Thus, although the optional powers section contains a more detailed description of the powers of a Federal mutual association, section 4 of the Model Federal Mutual Charter already contains a statement of powers as broad as the law permits, which includes the power to reorganize.

9 Op. Corporate and Securities Division (FHLLB), Feb. 19, 1986 (Acquisition of [Redacted] Bank and Trust Company, [Redacted], Illinois by [Redacted] Federal Savings and Loan Association, [Redacted], Illinois) (Redacted) at 3 ("Since the [Federal Home Loan Bank] Board has already recognized that, subject to certain standards, a P&A [Purchase and Assumption] transaction with a FDIC insured commercial bank is a permissible reorganization for a federal stock association, we would raise no objection to the Board acting under its authority to interpret the charters it has approved to permit a similar transaction for a federal mutual association."). [Redacted] had the more detailed pre-1983 model charter. However, as explained in footnote 8 above, this difference is without legal consequence because the current simpler Model Federal Mutual Charter confers the same powers as the former more detailed charter.
subject to compliance with all applicable statutory and regulatory requirements and safety and soundness principles. In particular, a purchase and assumption transaction would require OTS approval under the OTS transfer of assets regulations, 12 C.F.R. § 563.22(b) (1993). Further, 12 C.F.R. § 543.6(c) (1993) provides that when a Federal savings association's charter is issued, the association must promptly qualify as a member of a Federal Home Loan Bank, and meet all necessary requirements to obtain insurance of accounts from the FDIC.\(^\text{11}\)

**B. Section 10(s) of the HOLA**

Section 10(s) of the HOLA was enacted as part of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA").\(^\text{12}\) Section 10(s) provides explicit authority for Federal savings associations to acquire and be acquired by any insured depository institution,\(^\text{13}\) subject to sections 5(d)(3) and 18(c) of the FDIA and all other applicable laws.

Before the enactment of FDICIA, OTS regulations did not authorize mergers between Federal stock associations and banks.\(^\text{14}\) Under section 552.13, combinations between Federal stock associations and banks had to be accomplished through a purchase and assumption transaction, or by converting one of the constituent institutions to a different type of depository institution that had the power to merge with the other institution. After the enactment of section 10(s), associations are clearly free to merge with any FDIC-insured depository institution, including banks. Because the FDIC does not insure

\(^{10}\) See \(\text{at}\) 3 (It would be an appropriate exercise of the FHLLB's discretion to use established standards to determine whether a proposed purchase and assumption transaction is consistent with the interest of the association's depositors and the principles of safety and soundness.).

\(^{11}\) You have advised us that the Credit Union would meet the requirements for Federal Home Loan Bank membership.


\(^{13}\) An "insured depository institution" means "any bank or savings association the deposits of which are insured by the [Federal Deposit Insurance] Corporation . . . ." 12 U.S.C. § 1813(c)(2).

credit union deposits, section 10(s), does not authorize a savings association to merge with a credit union.

However, in our view, section 10(s) does not limit independent pre-existing authority of Federal associations to engage in combination transactions not described in section 10(s) (such as combinations involving depository institutions not insured by the FDIC, including credit unions). Courts have held that subsequent legislation is not presumed to repeal existing law in the absence of expressed intent.15 Because neither the plain language of section 10(s) nor its legislative history indicates an intent to limit the pre-existing authority of Federal associations to engage in reorganizations, as permitted under sections 5(a) and 5(d)(3) of the HOLA, section 10(s) does not limit section 5(d)(3)'s authorization to reorganize.

2. Ability to Issue Additional Common Stock in a Standard Conversion

Section 5(i) of the HOLA states that mutual to stock conversions shall be subject to such regulations as the Director may prescribe.16 Section 563b.3(c)(1) provides that a converting savings association "shall issue and sell its capital stock at a total price equal to the estimated pro forma market value of such stock in the converted savings association, based on an independent valuation."17

As a result of the aforementioned requirement, savings associations are not generally permitted to sell common stock at an aggregate price deviating from the estimated pro forma market value of the converting savings association. The purposes of the requirements are to ensure that the converting savings association is not injured by the conversion process as it must receive fair value for the sale of its stock; the prospective shareholders are treated equitably, fairly and not in a disparate manner; prospective shareholders are not subjected to manipulative or deceptive practices; and insider windfalls and

15 See Watts v. Alaska, 451 U.S. 259, 266-267 (1981) (courts are reluctant to find repeal by implication even when a later statute is not entirely harmonious with an earlier one); see also United States v. Barrett, 837 F.2d 933, 934 (10th Cir., 1988) (unless the text or legislative history of the later statute shows that Congress intended to repeal the earlier one and simply failed to do so expressly, a court must give effect to both).


abuse are prevented." Where the terms of the sale of the conversion stock are inequitable or detrimental to eligible accountholders, the savings association, other savings associations, or contrary to the public interest, the OTS has broad authority to deny a conversion application.

The Director may waive requirements of the OTS mutual to stock conversion regulations where good cause is shown. Whether good cause exists in any situation, of course, depends greatly on all of the relevant facts and circumstances presented in the context of a particular conversion transaction. Your letter does not describe any details of particular acquisitions. Accordingly, we cannot advise you whether we would recommend that a waiver request be granted with respect to the proposed acquisitions.

Nevertheless, it is appropriate to note that in considering whether to recommend a waiver of the pro forma market value requirement for the type of proposed acquisitions described in your letters, we would require, at a minimum, consistent with the purposes of the pro forma sale requirement, that:

(i) the issuance of additional common stock in the conversion be earmarked for specific acquisitions, as identified and discussed in the conversion prospectus; the specific amounts earmarked for the acquisitions must be fully documented and justified, separate from the independent appraisal of the converting association’s pro forma value;

(ii) the issuance of additional common stock in the conversion be for the purpose of preventing decreases in capital that would otherwise occur as a result of the proposed acquisitions;

(iii) there be a demonstration of a bona fide intention to proceed with each acquisition, including, at a minimum, a definitive acquisition agreement;

(iv) the contemplated acquisitions be scheduled to occur at the time of the proposed conversion or within a reasonable time thereafter; and

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the offering circular used to sell stock fully and fairly disclose: (a) the reasons for sales in excess of the pro forma market value; (b) the pending acquisition transactions; (c) the impact on the savings association and prospective shareholders; (d) the consequences of the failure to consummate any of the proposed acquisitions, including the use of funds earmarked for such acquisition; and all other material disclosures regarding the proposed acquisitions. 21

3. Ability to Issue Common Stock to Undertake Acquisitions After Conversion

The OTS has routinely conditioned approvals of standard conversion applications on the converted savings association receiving prior OTS approval to issue additional capital stock within the first year following the completion of the conversion.

Thus, the converted savings association could issue additional capital stock in order to undertake acquisitions of state-chartered credit unions following the conversion, subject to prior OTS approval. Whether the OTS would approve any particular issuance of capital stock for an acquisition would depend, inter alia, on the potential impact of the issuance on the converted savings association and the equitable treatment of its existing and proposed shareholders.

In addition, while there are no specific regulatory limitations on the number of transactions the Credit Union could undertake, the OTS would, as appropriate, consider any proposed transaction under the standards set forth in the applicable statutes and regulations. These standards would result in the OTS considering, among other things, the impact on the converted savings association with respect to, inter alia, managerial and financial resources, ability to serve its community, future prospects, regulatory capital levels, and liquidity ratios. Should any safety and soundness concerns arise which the

21 Please note the requirements to include detailed information concerning potential acquisitions in offering circulars. See Securities and Exchange Commission ("SEC"), Regulation S-X, Rule 3-05 and Article 11, 17 C.F.R. § 210.3-05 and .11-01. At sec, Financial Reporting Release No. 1, Section 506 of the Financial Reporting Codification, and SEC Staff Accounting Bulletin No. 80, November 21, 1988, Topic 1.J. Whether disclosure would be required by the converting Federal mutual association would depend on the extent to which the Credit Union has pursued acquisitions with other credit unions at the time of the offering.
converted savings association cannot successfully address, any particular acquisition may not be approved.

In reaching the foregoing conclusions, we have relied on the factual representations contained in the materials submitted to us. Our positions thus depend on the accuracy and completeness of those representations. Moreover, any material change in circumstances from those set forth in your submissions could result in conclusions different from those expressed herein.

Any questions regarding the foregoing may be directed to Lawrence D. Kaplan, Senior Attorney, at (202) 906-7508, Kevin A. Corcoran, Assistant Chief Counsel, at (202) 906-6962, or V. Gerard Comizio, Deputy Chief Counsel, at (202) 906-6411.

Sincerely,

[Signature]

Carolyn B. Lieberman
Acting Chief Counsel