The attached interim final rule and request for comment regarding Savings Associations – Transactions with Affiliates was published in the Federal Register on December 20, 2002.
DEPARTMENT OF THE TREASURY
Office of Thrift Supervision

12 CFR Parts 506, 559, 562, and 563
[No. 2002–64]
RIN 1550–AB55

Savings Associations—Transactions with Affiliates

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Interim final rule with request for comment.

SUMMARY: The Office of Thrift Supervision (OTS) is revising its regulations on transactions with affiliates. This interim final rule conforms OTS regulations to the Board of Governors of the Federal Reserve System (FRB) final rule implementing sections 23A and 23B of the Federal Reserve Act (FRA). The FRB rule (Regulation W) combines statutory restrictions on transactions with affiliates with new and existing interpretations and exemptions.

DATES: This interim final rule is effective April 1, 2003. Comments must be received on or before February 18, 2003.

ADDRESSES: Mail: Send comments to Regulation Comments, Chief Counsel’s Office, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552. Attention: No. 2002–64. E-mail: Send e-mails to regs.comments@ots.treas.gov. Attention: No. 2002–64, and include your name and telephone number.

FOR FURTHER INFORMATION CONTACT: Karen A. Osterloh, Special Counsel, (202) 906–6639, Regulations and Legislation Division, Chief Counsel’s Office, or Donna Deale, Manager, (202) 906–7488, Supervision Policy, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPORTING INFORMATION:
I. Background

Section 11(a)(1) of the Home Owners’ Loan Act (HOLA) (12 U.S.C. 1468a(a)(1)) applies sections 23A and 23B of the FRA (12 U.S.C. 371c and 371c–1) to every 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. Section 23A of the FRA imposes three major limitations on a member bank’s (and its subsidiaries’) transactions with affiliates. First, section 23A limits the amount of “covered transactions” with any single affiliate to no more than 10 percent of the member bank’s capital stock and surplus. Covered transactions with all affiliates are limited to no more than 20 percent of the member bank’s capital stock and surplus. A covered transaction includes a loan or extension of credit to an affiliate, a purchase of or investment in securities issued by an affiliate, a purchase of assets from an affiliate, the acceptance of securities issued by an affiliate as collateral, and extension of credit for a loan or extension of credit to any person or company, and the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate.

Second, section 23A requires that all covered transactions between a member bank and its affiliates be on terms and conditions that are consistent with safe and sound banking practices and prohibits a member bank from purchasing low-quality assets from an affiliate. Finally, section 23A requires that a member bank’s extensions of credit to affiliates and guarantees on behalf of affiliates be appropriately secured by a statutorily defined amount of collateral.

Section 23B of the FRA protects member banks by requiring that transactions between the bank and its affiliates occur on market terms—on terms and under circumstances that are substantially the same, or at least as favorable to the bank, as those prevailing at the time for comparable transactions with unaffiliated companies. Section 23B applies to covered transactions under section 23A, as well as other transactions, such as the sale of securities or other assets to an affiliate and the payment of money or the furnishing of services to an affiliate. Section 23B also prohibits certain purchases and acquisitions of securities by a member bank or its subsidiary subject to certain conditions, and prohibits certain advertisements or agreements that state or suggest that the member bank is responsible for the obligations of its affiliates.

In addition to the section 23A and 23B restrictions, section 11(a)(1) of the HOLA imposes two prohibitions on savings associations. First, a savings association may not make a loan or other extension of credit to any affiliate unless that affiliate is engaged only in activities that a bank holding company may conduct. In addition, no savings association may purchase or invest in securities issued by an affiliate, other than with respect to shares of a subsidiary. Section 11(a)(4) of the HOLA authorizes OTS to impose such additional restrictions on transactions between a savings association and any affiliate as it
determines to be necessary to protect the safety and soundness of the association.

In 1991, OTS issued comprehensive rules implementing section 11(a) of the HOLA.3 These rules, which are currently codified at 12 CFR 563.41 and 563.42 (2002), define and clarify the application of sections 23A and 23B to savings associations and their subsidiaries, implement the two prohibitions imposed under section 11(a) of the HOLA, and impose additional restrictions and safeguards, as authorized by section 11(a)(4) of the HOLA. OTS has made only minor amendments to these rules since 1991.

The FRB has statutory authority to issue regulations to administer and carry out the purposes of sections 23A and 23B of the FRA.4 Until recently, the FRB had promulgated no comprehensive regulations on this subject. Instead, the FRB relied on a series of regulatory interpretations and informal staff guidance.5 The FRB recently issued Regulation W, a comprehensive final rule implementing sections 23A and 23B of the FRA.6 Regulation W incorporates many existing FRB interpretations, supersedes certain outdated interpretations, exempts specific types of transactions, and implements revisions to sections 23A and 23B contained in the Gramm-Leach-Bliley Act (GLBA).7

The FRB’s final rule does not by its terms apply to savings associations. However, because sections 23A and 23B apply to every savings association in the same manner and to the same extent as if the savings association were a member bank, OTS is revising its regulations on transactions with affiliates to reflect Regulation W. Today’s interim final rule has three goals:

- To incorporate all applicable provisions and exceptions prescribed by the FRB in Regulation W;
- To provide guidance concerning the relationship between the additional prohibitions under section 11(a)(1) of the HOLA and Regulation W; and
- To set out the additional restrictions OTS imposes under section 11(a)(4) of the HOLA.

II. General Approach

OTS is replacing its existing rules on transactions with affiliates at 12 CFR 563.41 and 563.42 (2002) with a new interim final rule, which will be codified at 12 CFR 563.41. The interim final rule cross references the substantive provisions contained in Regulation W; interprets Regulation W to the extent necessary to apply these restrictions to savings associations; incorporates the prohibitions in section 11(a)(1) of the HOLA; and imposes various additional restrictions on savings associations under section 11(a)(4) of the HOLA.

OTS considered, but is not adopting, an alternative presentation. Specifically, OTS reviewed whether its rule should restate, with appropriate revisions, all of Regulation W. While this alternative presentation would consolidate in one place all regulations under section 11(a) of the HOLA, OTS believes that this approach would be duplicative. Moreover, this approach would require OTS to revise its regulations every time that the FRB amends Regulation W. The approach in this interim final rule, on the other hand, will ensure that most amendments to Regulation W are automatically incorporated in OTS rules without further notice and comment rulemaking. OTS specifically seeks public comment on which approach is more suitable.

III. Interim Final Rule—12 CFR 563.41

A. Scope

The interim final rule at § 563.41(a) sets out the scope of the new rule. Specifically, it states that § 563.41 implements section 11(a) of the HOLA, which applies sections 23A and 23B of the FRA to every savings association in the same manner and to the same extent as if the association were a member bank; prohibits certain types of transactions with affiliates; and authorizes OTS to impose additional restrictions on savings association transactions with affiliates.

The interim final rule implements only section 11(a) of the HOLA. It does not contain every statutory or regulatory restriction on transactions between savings associations and their affiliates. For example, the rule does not address additional restrictions on transactions with affiliates that OTS may require as prompt corrective action under section 36(f)(2)(B) of the Federal Deposit Insurance Act (FDIA). 12 U.S.C. 1831o(f)(2)(B).

B. Sections 23A and 23B of the FRA/Regulation W

The interim final rule at § 563.41(b) states that a savings association must comply with sections 23A and 23B of the FRA and Regulation W. To clarify Regulation W for savings associations, OTS has prepared a chart briefly explaining how specific sections of Regulation W apply and explaining why other sections do not apply to savings associations. These provisions are described below.

1. Applying Regulation W to Savings Associations

Regulation W by its terms applies only to member banks and defines this term as “any national bank, State bank, banking association, or trust company that is a member of the Federal Reserve System. For purposes of this definition, an operating subsidiary of a member bank is treated as part of the member bank.” 12 CFR 223.3(w). To ensure that Regulation W applies to savings associations and their subsidiaries in the same manner and to the same extent as member banks, the interim final rule at § 563.41(b)(11) states that the term “member bank” as used in Regulation W includes a savings association.

Like the existing rule, the interim final rule defines “savings association” to include federal and state-chartered savings associations and most thrift subsidiaries.8 Savings association also includes any savings bank or cooperative bank that is a savings association under section 10(l) of the HOLA.9 This provision reflects the agency’s long-standing interpretation that a savings bank or cooperative bank that elects to be treated as a savings association for the purposes of section 10(l) of the HOLA has also made an election to be treated as a savings association for the purposes of section 11 of the HOLA.10 Accordingly, the interim final rule continues to include within the definition of savings association those state banks and cooperative banks that are subsidiaries of section 10(l) holding companies.

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1 56 FR 34005 (July 25, 1991).
3 The FRB codified some of these interpretations at 12 CFR 250.240 through 250.250 (2002).
4 67 FR 76560 (Dec. 12, 2002), to be codified as 12 CFR part 223. In this rule, OTS cites to 12 CFR part 223 as it will be codified in the 2003 Code of Federal Regulations, rather than by citation to publication of the final rule in the Federal Register.
6 See 12 CFR 563.41(b)(5)(2002), which incorporates the definition of savings association at 12 CFR 583.21(2002). Thrift subsidiaries are discussed below.
7 Section 10(l) of the HOLA states: “Notwithstanding any other provision of law, a savings bank (as defined in 12 U.S.C. 1813(g)] and a cooperative bank that is an insured bank (as defined in 12 U.S.C. 1813[H]) upon application shall be deemed to be a savings association for the purposes of [section 10 of the HOLA]; if the Director of OTS determines that such bank is a qualified thrift lender * * *.” 12 U.S.C. 1467A(l).
8 See section 10(d) of the HOLA. 12 U.S.C. 1467a(d).
OTS has also revised the reference to “operating subsidiaries.” Under Regulation W, the definition of affiliate generally excludes any company that is a subsidiary of the member bank unless the subsidiary is: (1) A depository institution; (2) a financial subsidiary; 9 (3) a company that is directly controlled by one or more affiliates (other than depository institution affiliates) or by a shareholder that controls the member bank or a group of shareholders that together control the member bank; (4) an employee stock option plan, trust, or other similar organization that exists for the benefit of the shareholders, partners, members, or employees of the member bank; or (5) any other company that the FRB or appropriate banking agency determines to be an affiliate. 12 CFR 223.2(b)(1)(i)–(v). The FRB refers to all non-affiliate subsidiaries as “operating subsidiaries.” 12 CFR 223.3(aa). OTS believes that this term is unnecessary and confusing given the use of the term “operating subsidiary” in other OTS regulations. See 12 CFR part 559. Accordingly, the chart at § 563.41(b) of the interim final rule does not use the term “operating subsidiary.” Instead, where it is appropriate to refer to a subsidiary that is not an affiliate, the chart uses the phrase “non-affiliate subsidiary.”

2. Affiliates

Under Regulation W, the term “affiliate” is defined to include parent companies (any company that controls the member bank); companies under common control with the member bank; companies under other types of common control; companies with interlocking directors or trustees; companies that are sponsored and advised on a contractual basis by the member bank, its subsidiary, or an affiliate; investment companies for which a member bank or any affiliate is an investment advisor; depository institution subsidiaries of a member bank; financial subsidiaries; companies held under merchant banking or insurance company investment authority; partnerships for which the member bank or an affiliate serves as general partner; subsidiaries of affiliates; and other companies that the FRB deems to be an affiliate of the member bank. 12 CFR 223.2(a). This definition specifically excludes certain companies, including most subsidiaries of member banks. 12 CFR 223.2(b). The interim final rule adopts the FRB definition of affiliate except as described below.

a. Control

One of the fundamental concepts underlying the definition of affiliate is the concept of control. Regulation W states that control by a company or shareholder over another company means that:

• The company or shareholder, directly or indirectly, or acting through one or more persons, owns, controls, or has the power to vote 25 percent or more of any class of voting securities or other similar voting interest of the other company.

• The company or shareholder controls in any manner the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the other company.

The Board determines, after notice and opportunity for hearing, that the company or shareholder, directly or indirectly, exercises a controlling influence over the management or policies of the other company. 12 CFR 223.3(g)(1).

Regulation W also includes specific provisions addressing ownership or control of shares as a fiduciary, shares by a subsidiary, convertible securities, and nonvoting equity securities. See 12 CFR 223.3(g)(2)–(5).

When OTS promulgated its transactions with affiliates regulation in 1991, it exercised its authority under section 11(a)(4) of the HOLA to expand the definition of control. Specifically, existing § 563.41(b)(3) states that a company or shareholder has control over another company if the company or shareholder, directly or indirectly, or acting through one or more persons owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the other company or if the company or shareholder would be deemed to control another company under 12 CFR 574.4(a) or presumed to control the company under 12 CFR 574.4(b). As a related matter, OTS also adopted its own concept of control to define a subsidiary of a savings association. Specifically, existing § 563.41(b)(4) defines subsidiary of a savings association as a company that is controlled by a savings association within the meaning of part 574.

This interim final rule at § 563.41(b)(6) continues to use the existing OTS definition of control. 10

10 OTS made one minor revision to its existing definition of control. Under OTS’s current transactions with affiliates rules, no company is deemed to own or control a company by virtue of its ownership or control of shares in a fiduciary capacity, except under certain circumstances. OTS-regulated savings associations are accustomed to applying part 574 control concepts to transactions with affiliates and in numerous other contexts. See definitions of control used in 12 CFR part 559 (subordinate organizations) and 12 CFR part 563b (the mutual-to-stock conversions rule). While this definition is more expansive than the FRB’s definition of control, its use is consistent with section 11(a)(4) of the HOLA, which permits OTS to impose additional restrictions on savings associations’ transactions with affiliates. OTS specifically requests comments on whether these control rules continue to be appropriate or whether it should conform these rules more closely to Regulation W.

b. Financial Subsidiaries

Regulation W defines affiliate to include a financial subsidiary of a member bank. 12 CFR 223.2(a)(8). A financial subsidiary is defined as any subsidiary of a member bank that “engages, directly or indirectly, in any activity that national banks are not permitted to engage in directly or that is conducted on terms and conditions that differ from those that govern the conduct of such activity by national banks.” The definition excludes a subsidiary that “a national bank is specifically authorized to own or control by the express terms of a Federal statute.” 11

Approximately 100 thrifts have investments in subsidiaries called service corporations that engage in activities in which a national bank may not engage directly. Regulation W did not address whether these thrift subsidiaries would be considered to be financial subsidiaries. For the reasons stated below, OTS concludes that savings association subsidiaries are not financial subsidiaries under the definition in Regulation W.

OTS believes that service corporations would fall within the exception to the definition of financial subsidiary. As noted above, Regulation W states that a financial subsidiary does not include a subsidiary that a national bank is specifically authorized by the express terms of a Federal statute to own or control. This exception is based on the definition of a financial subsidiary of a national bank at 12 U.S.C. 24a, which also expressly provides that bank service companies are not financial

8 Financial subsidiaries are discussed in this preamble at section III.B.2.b.

11 12 CFR 223.3(g).

has updated this provision to more closely reflect the related FRB provision at 12 CFR 223.3(g)(2).
The text of section 23A(e) of FRA provides further evidence that Congress did not intend to include thrift subsidiaries as financial subsidiaries. Section 23A(e)(1) defined financial subsidiary as any company that is “a subsidiary of a bank that would be a financial subsidiary of a national bank under [12 U.S.C. 24a].” Congress could have used the phrase “a subsidiary of an insured depository institution that would be a financial subsidiary of a national bank.” The use of the phrase “subsidiary of a bank that would be a financial subsidiary of a national bank,” however, suggests that Congress intended a limited application of this definition only to subsidiaries of national and state banks.

OTS notes that a contrary interpretation would also fail to recognize that Congress specifically and comprehensively addressed the regulation of savings associations and their subsidiaries in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). In FIRREA, Congress intended a limited application of this definition only to subsidiaries of national and state banks.

Accordingly, the interim final rule at § 563.41(b) states that the Regulation W references to financial subsidiaries do not apply to savings associations and their subsidiaries. These references include 12 CFR 223.2(a)(8) and (b)(1)(iii) (affiliate includes a financial subsidiary); 12 CFR 223.2(a)(8) and (b)(1)(ii) (affiliate includes a financial subsidiary); 12 CFR 223.3(p)(i) (definition of financial subsidiary); and 12 CFR 223.32 (rules that apply to a financial subsidiary of a member bank).

c. Companies That Are Both Subsidiaries and Affiliates

Under Regulation W, subsidiaries of a member bank are generally not affiliates unless the subsidiary is: (1) a depository institution; (2) a financial subsidiary; (3) directly controlled by one or more affiliates (other than depository institution affiliates) of the member bank, by a shareholder that controls the member bank, or by a group of shareholders that together control the member bank; (4) an employee stock option plan (ESOP), trust, or similar organization that exists for the benefit of shareholders, partners, members, or employees of the member bank or its affiliates, or (5) determined by the FRB.

FIRREA also established prudential limits on these transactions. Section 505(5) of the HOLA requires Federal and state chartered savings associations to deduct from capital all investments and extensions of credit to any subsidiary engaged in activities that are not permissible for national banks. Other depository institutions are not subject to as extensive restrictions on their investments in subsidiaries that engage in activities that are impermissible to a national bank. By contrast, national banks must deduct equity and retained earnings in financial subsidiaries, but not debt investments. 12 U.S.C. 24a(c).

Finally, OTS believes that its interpretation is consistent with the purposes of sections 23A and 23B of the FRA. These two provisions were designed to limit the risks to an institution (and the Federal deposit insurance funds) from transactions between the institution and its affiliates, and to limit the ability of an institution to transfer to its affiliates the subsidy arising from the institution’s access to the Federal safety net. OTS has addressed these risks through its comprehensive regulation of the relationship between savings associations and their subsidiaries. Under this regulatory scheme, OTS has not experienced significant problems that would warrant the application of sections 23A and 23B to these subordinate organizations. In light of this successful record, there is no demonstrable need to apply affiliate restrictions to thrift subsidiaries by classifying them as financial subsidiaries.
or appropriate federal banking agency to be an affiliate.\textsuperscript{20} Except for references to financial subsidiaries, the OTS interim final rule follows Regulation W. This will modify OTS’s current treatment of thrift subsidiaries. In one respect, the interim final rule will add to the definition of affiliate a subsidiary that is an ESOP, trust, or similar organization that exists for the benefit of shareholders, partners, members, or employees of the member bank or its affiliates.

In another respect, the interim rule will delete from the OTS definition of affiliate “any company that would be an affiliate under [12 CFR 563.41(b)(1) (2002)] but for the fact that it is a subsidiary of a savings association.”\textsuperscript{21} By contrast, the corollary provision of Regulation W only includes as affiliates those companies that are directly controlled by one or more affiliates or by shareholders that control the institutions. The application of these two provisions leads to slightly different results. For example, a subsidiary that is sponsored and advised on a contractual basis by the OTS or the FRB to continue to consider these and other factors when it makes its determination under the safety and soundness standard.\textsuperscript{22}

The interim final rule addresses OTS authority to make case-by-case determinations at § 563.41(b)(3). OTS has reworded the safety and soundness standard to more accurately reflect section 11(a)(4) of the HOLA and has deleted the list of supervisory factors as unnecessary. OTS, however, will continue to consider these and other factors when it makes its determination under the safety and soundness standard.\textsuperscript{23}

3. Other Provisions of Regulation W

a. Capital Stock and Surplus

Regulation W’s definition of the phrase “capital stock and surplus” uses capital terms such as Tier 1 and Tier 2 capital. By contrast, the existing OTS definition of the phrase “capital stock and surplus” cross-references the definition of unimpaired capital and unimpaired surplus under OTS’s loans-to-one-borrower rule, which uses thrift-specific capital terms such as core and supplementary capital. To ensure that thrifts will be able to apply this definition, the interim rule continues to use the current OTS definition. For similar reasons, all citations to the Call Report will refer to the Thrift Report.

b. U.S. Branches or Agencies of Foreign Banks

OTS does not regulate U.S. branches or agencies of foreign banks. Accordingly, § 563.41(b) of the interim final rule states that 12 CFR 223.61, which addresses these entities, does not apply.\textsuperscript{24}

C. Additional Prohibitions and Restrictions under Section 11 of the HOLA

Section 11(a) of the HOLA imposes two prohibitions on savings associations in addition to those found in sections 23A and 23B of the FRA, and authorizes OTS to impose additional restrictions on a savings association’s transactions with affiliates. Paragraph (c) of the interim final rule addresses these additional provisions.

1. Regulation W Definitions

The interim final rule applies Regulation W definitions to the additional section 11 prohibitions and restrictions, except as described in the chart at § 563.41(b) of the interim rule.

2. Loans and Extensions of Credit

Section 11(a)(1)(A) of the HOLA states that “no loan or other extension of credit may be made to any affiliate unless that affiliate is engaged only in activities described at section 10(c)(2)(F)(i) of the HOLA.” Section 10(c)(2)(F)(i) of the HOLA refers to activities “which the [FRB], by regulation, has determined to be permissible for bank holding companies under [12 U.S.C. 1843(c)], unless the Director, by regulation, prohibits or limits any such activities for savings and loan holding companies.”\textsuperscript{25} Thus, under section 11(a)(1)(A), a savings association may not make a loan or other extension of credit to an affiliate engaged in non-bank holding company activities. OTS restates this restriction at § 563.41(c)(1) of the interim final rule.\textsuperscript{26}

For the purposes of this prohibition, the current rule states that a loan or other extension of credit includes a purchase of assets from an affiliate that is subject to the affiliate’s agreement to repurchase. As a result, the existing rule and the regulations issued on behalf of, an affiliate must be secured by collateral having a market value equal to a set percentage of the transaction. A transaction that is secured by notes, drafts, bills of exchange, or bankers’ acceptances that are eligible for rediscount or purchase by a Federal Reserve Bank must be collateralized at 100 percent. 12 U.S.C. 371c(c)(10)(A)(iii). This provision requires only that the cited instruments must be eligible for purchase or reinvestment and imposes no requirement that the institution must be a member bank. The current OTS rule adds to the statutory provision by stating that collateral that is eligible for rediscount or purchase by a Federal Home Loan Bank may also be collateralized at 100 percent. 12 CFR 563.41(b)(11)(i)(C). The additional language in the current OTS rule is not necessary to ensure that savings associations have parity with member banks. Accordingly, the interim rule does not include this current language provisions.

25 These activities are approved for bank holding companies by regulation at 12 CFR 225.28, or by case-by-case order of the FRB in accordance with 12 CFR 225.23 and 225.24.

26 The chart in the interim rule at § 563.41(b)(7) also refers to this prohibition.
generally prohibits these agreements with affiliates that are engaged in non-bank holding company activities. The current rule, however, exempts certain agreements that involve United States Treasury securities and that meet specified requirements.

Section 11 of the HOLA does not define “loan or other extension of credit,” and does not compel a legal conclusion that purchases of assets that are subject to an affiliate’s agreement to repurchase are, or are not, prohibited by statute. When it originally promulgated this provision, OTS noted that section 11(a)(1)(A) focused on prohibiting transactions with non-banking affiliates that transfer credit and other risks to the savings association. Because a purchase of assets that is subject to an agreement to repurchase generally bears many of the economic characteristics of a loan or extension of credit to such an affiliate,27 OTS concluded that it was appropriate to treat most of these transactions as loans or extensions of credit under section 11(a)(1)(A), OTS requests comment on whether it should retain these provisions on purchases of assets that are subject to agreements to repurchase.

In addition to the rules on purchases of assets that are subject to an agreement to repurchase, OTS has issued a number of interpretations regarding the loan prohibition. These interpretations are contained in various documents including preambles to proposed and final rules, opinion letters, and other guidance. For example, OTS has considered whether a savings association is barred from extending credit to an affiliate that directly engages only in activities permissible for a bank holding company, but owns subsidiaries engaged in activities not permissible for bank holding companies, such as real estate development. OTS determined that, in the case of affiliates that are not savings associations, such activities are imputed to each parent affiliate in a vertical ownership chain up to, but not including, a controlling holding company in the corporate structure.

Activities are not, however, attributed downward to subsidiaries of an affiliate.28 Where non-bank holding company activities are attributed to an affiliate from its subsidiary, a savings association is barred from extending credit to that affiliate. While this guidance reflects OTS’s existing position, OTS has not incorporated its interpretations on the attribution of activities in the interim final rule. OTS specifically requests comment on whether it should include this guidance in the final rule.

OTS has also considered whether a third party attribution rule applies to the loan prohibition. Sections 23A(a)(2) and 23B(a)(3) of the FRA require a member bank (and thus savings associations) to treat any transaction with an affiliate as a transaction with an affiliate that uses the benefit of, transferred to, an affiliate. Regulation W includes this third party attribution rule at 12 CFR 223.16 and 223.52(b). By contrast, section 11(a)(1)(A) of the HOLA does not include a third party attribution rule, and OTS has declined to infer such a rule for the purposes of section 11. As a result, OTS’s existing rules implementing section 11(a)(1)(A) do not prohibit a loan or extension of credit to a non-affiliate where the proceeds are used for the benefit of, or transferred to, an affiliate that engages in non-bank holding company activities.29 The interim final rule includes a similar provision. Several OTS legal opinions, however, indicate that the agency may, nonetheless, attribute such a loan to an affiliate if the loan is not bona fide or is not of independent substance, or there is evidence that the loan was a prearranged step in a series of transactions designed to channel funds to an affiliate to which the institution could not lend directly.30 OTS requests comment on whether it should include this additional guidance in the final rule.

3. Purchases or Investments in Securities Issued by an Affiliate

Section 11(a)(1)(B) provides that “‘no savings association may enter into any transaction described in section 23Ab(7)(B) of [the FRA] with any affiliate other than with respect to shares of a subsidiary.’” Section 23Ab(7)(B) of the FRA describes “a purchase of or investment in securities issued by [an] affiliate.”

Section 563.41(c)(2) of the interim final rule restates this restriction.31 To ensure that a savings association may make investments in a bank or savings association that is a subordinate organization, the interim final rule also continues to state that the term subsidiary includes a bank and a savings association for the purposes of this provision. OTS has issued a number of legal opinions interpreting this prohibition and is considering including these interpretations in the rule. OTS specifically requests comment on whether it should include these or other interpretations of section 11(a)(1)(B) of the HOLA in the final rule.32

4. Recordkeeping

Currently §§ 563.41(e) and 563.42(e) require a savings association to make and retain records that reflect in reasonable detail all transactions between a savings association (and its subsidiaries) and affiliates, and transactions with an unaffiliated party that are attributed to an affiliate under the third party attribution rule. The current rule also includes minimum recordkeeping requirements at § 563.410(1)(i) through (vii). OTS imposed these recordkeeping requirements under its authority at section 11(a)(4) of the HOLA, which permits OTS to impose additional restrictions to protect the safety and soundness of savings associations. The interim final rule retains these requirements at § 563.41(c)(3).

5. Notice

Under the existing rules, OTS may require certain savings associations to notify it at least 30 days before the savings association or its subsidiary conducts a transaction with an affiliate. These associations include a savings association that commenced de novo operations within the past two years, an association that was the subject (or whose holding company was the subject) of an approved application or notice under the control regulations at 12 CFR part 574 within the past two years, an association with a composite CAMELS rating of “4” or “5,” an association that does not meet all regulatory capital requirements, an association that has entered into a

27 The savings association transfers funds to the affiliate, expecting to be repaid when the company repurchases the assets. The purchased assets, essentially amount to collateral, since the savings association is required to return the assets at the time of repurchase. The principal risk to the savings association, its depositors and the deposit insurance fund is credit risk—the possibility that the affiliate will default on its obligation to make the repurchase. These types of agreements are generally considered the functional equivalent of a loan or extension of credit. See amendments to Federal Financial Institutions Examination Council Policy Statement on Repurchase Agreements of Depositary Institutions with Securities Dealers and Others, 63 FR 6935 (February 11, 1998).

28 The chart in the interim rule at §563.41(b)[6] also refers to this prohibition.

29 See Op. Acting Chief Counsel (Sept. 9, 1993) (Purchases of mortgage-backed securities that are guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae from an affiliate are not subject to the section 11(a)(1)(B) prohibition) and Op. Acting Chief Counsel (June 30, 1993) (Purchases of securities, including mutual funds, issued by an affiliate, are not prohibited if the purchase is made on a riskless principal or agency basis).

30 The chart in the interim rule at §563.41(b)[6] also refers to this prohibition.
consent to merge or a supervisory agreement or has been the subject of a cease and desist order within the past two years, an association that is the subject of a formal enforcement proceeding, a problem association, and an association that is in a troubled condition.

OTS restates these requirements with minor revisions at paragraph (c)(4) of the interim final rule. OTS has clarified that “troubled condition” is defined at 12 CFR 563.555. OTS has also deleted specific references to problem institutions, institutions that have a composite rating of 4 or 5 under CAMELS, and institutions that are subject to a cease and desist order. These institutions will either fall within the definition of troubled condition, or one of the other listed categories.

IV. Solicitation of Comments Regarding the Use of Plain Language

Section 722 of the GLBA [33] requires federal banking agencies to use “plain language” in all proposed and final rules published after January 1, 2000. OTS invites comments on how to make this rule easier to understand. For example:

(1) Have we organized the material to suit your needs? If not, how could the material be better organized?

(2) Do we clearly state the requirements in the rule? If not, how could the rule be more clearly stated?

(3) Does the rule contain technical language or jargon that is not clear? If so, what language requires clarification?

(4) Would a different format (grouping and order of sections, use of headings, paragraphing) make the rule easier to understand? If so, what changes to the format would make the rule easier to understand?

V. Issuance of an Interim final rule

Section 553 of the Administrative Procedure Act (APA) permits an agency to issue a rule without prior notice and public comment if the agency, for good cause, finds that notice and comment is impractical, unnecessary, or contrary to the public interest, and explains its finding when it publishes the final rule. 5 U.S.C. 553(b)(B).

Among the purposes of this interim final rule are updating existing OTS rules to reflect FRB’s newly issued Regulation W, interpreting Regulation W to the extent necessary to apply it to savings associations, providing guidance concerning the relationship between the prohibitions imposed by section 11(a)(1) of the HOLA and Regulation W, and clearly setting out additional restrictions imposed by OTS under section 11(a)(4) of the HOLA. OTS’s existing regulations at 12 CFR 563.41 and 563.42 contain provisions that conflict with final Regulation W and do not reflect updated interpretations contained in Regulation W. As a result, the continued retention of these rules following the effective date of Regulation W is likely to cause undue confusion concerning applicable restrictions on transactions with affiliates. OTS has already received numerous inquiries on these matters. Having an interim final rule in place will help to minimize this confusion and ensure a smoother transition for savings associations as OTS implements Regulation W. OTS therefore believes that prior notice and public comment on this interim final rule is impractical, unnecessary, and contrary to the public interest.

VI. Effective Date and Transition Rule

The FRB made Regulation W effective April 1, 2003. Accordingly, transactions entered into on or after April 1, 2003, will be immediately subject to Regulation W. Transactions entered into after the date of publication of Regulation W in the Federal Register, but before April 1, 2003, will become subject to Regulation W on April 1, 2003.

The FRB included a limited transition rule for transactions consummated on or before the publication date of Regulation W. Under this transition rule, if such a transaction would become subject to section 23A or 23B (or the treatment of the transaction would change) solely as a result of Regulation W, the transaction will not become subject to Regulation W until July 1, 2003. A transaction is subject to section 23A or 23B solely as a result of Regulation W, if the transaction is subject to section 23A or 23B under Regulation W, but was not subject to section 23A or 23B (or the treatment of the transaction would change) solely as a result of Regulation W. Similarly, a transaction’s treatment under section 23A or section 23B changes solely as a result of Regulation W if the treatment of the transaction under Regulation W differs from the treatment of the transaction under the terms of sections 23A and 23B or any written interpretation of the statute by the FRB or its staff dated before publication of Regulation W.

There are two exceptions to the FRB transition rule. First, a transaction that otherwise qualifies for the transition period will immediately become subject to Regulation W if it is renewed, extended, or materially altered on or after April 1, 2003. Second, a purchase of assets that was committed on or before the publication of Regulation W and that qualifies for the transaction rule, is not subject to the new requirements in Regulation W.

To relieve regulatory burden, the FRB also permits member banks to apply specified provisions before Regulation W’s effective date. Member banks may apply the following rules beginning on the date of publication of Regulation W:

(1) Section 223.16(c)(4) (general purpose credit card exemption); (2) §§ 223.24(a), (b), and (c) (valuation principles applicable to extensions of credit secured by affiliate securities); (3) § 223.31(d) (exemption for step transactions involving the acquisition of an affiliate that becomes a non-affiliate subsidiary after the acquisition); (4) §§ 223.41(d) (exemption for internal corporate reorganization transactions); and (5) §§ 223.42(c), (f), (g), (i), (j), and (k) (exemptions for transactions secured by cash or U.S. government securities, purchases of certain marketable securities, purchases of municipal securities, asset purchases by a newly formed institution, transactions approved under the Bank Merger Act, and purchases of extensions of credit from an affiliate).

In today’s interim final rule, OTS has established the same effective date, will apply identical transition rules, and will permit savings associations to apply the specified sections of Regulation W before the effective date of the rule. OTS, however, requests comment on whether the appropriate dates for these periods should be based on the date of publication of this interim rule, rather than the date of publication of Regulation W.

VII. Executive Order 12866

The Director of OTS has determined that this rule does not constitute a “significant regulatory action” for the purposes of Executive Order 12866.

VIII. Regulatory Flexibility Act Analysis

An initial regulatory flexibility analysis under the Regulatory Flexibility Act (RFA) is required when an agency must publish a general notice of proposed rulemaking. 5 U.S.C. 603. As noted above, OTS has determined that it is not necessary to publish a notice of proposed rulemaking for this interim final rule. Accordingly, the RFA does not require an initial regulatory flexibility analysis. Nonetheless, OTS has considered the likely impacts of this rule on small businesses and believes that the rule
will not have a significant impact on a substantial number of small entities. OTS has had comprehensive regulations implementing section 11 of the HOLA since 1991. Today’s interim final rule updates these provisions to incorporate Regulation W, interprets Regulation W to the extent necessary to apply the FRB rule to savings associations, clarifies the relationship between section 11(a)(1) of the HOLA and Regulation W, and sets out the additional restrictions imposed under section 11(a)(4) of the HOLA. In light of existing § 563.41, OTS does not believe that the interim final rule will significantly increase the applicable burdens for small or large savings associations. Accordingly, a regulatory flexibility analysis is not required.

IX. Unfunded Mandates Act of 1995

The Unfunded Mandates Reform Act of 1995, Public Law 104–4 (Unfunded Mandates Act) applies only when an agency is required to issue a general notice of proposed rulemaking or a final rule for which a general notice of proposed rulemaking was published, 2 U.S.C. 1532. As noted above, OTS has determined that a notice of proposed rulemaking is not required. Accordingly, OTS has concluded that the Unfunded Mandates Act does not require an analysis of this interim final rule.

Moreover, OTS has determined that the interim final rule will not result in expenditures by state, local, or tribal governments or by the private sector of $100 million or more. OTS has had comprehensive regulations implementing section 11 of the HOLA since 1991. Today’s interim final rule merely updates these provisions to incorporate Regulation W, interprets Regulation W to the extent necessary to apply the FRB rule to savings associations, interprets Regulation W to the extent necessary to apply the FRB rule to savings associations, clarifies the relationship between section 11(a)(1) of the HOLA and Regulation W, and sets out the additional restrictions imposed under section 11(a)(4) of the HOLA. In light of existing § 563.41, OTS does not believe that the interim final rule will significantly increase the applicable burdens for savings associations and will not result in increased expenditures by these institutions. Accordingly, OTS has not prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

X. Paperwork Reduction Act of 1995

The information collection requirements in the existing OTS rules at 12 CFR 563.41(e) and 563.42(e) were previously approved under OMB control number 1550–0078. The interim final rule incorporates these requirements at § 563.41(c)(3) and (4), and does not make any substantive changes that affect the overall burden of compliance.

List of Subjects

12 CFR Part 506

Reporting and recordkeeping requirements.

12 CFR Part 559

Reporting and recordkeeping requirements, Savings associations, Subsidiaries.

12 CFR Part 562

Accounting, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 563

Accounting, Advertising, Crime, Currency, Investments, Reporting and recordkeeping requirements, Savings associations, Securities, Surety bonds.

Accordingly, the Office of Thrift Supervision amends chapter V, title 12, Code of Federal Regulations to read as follows:

PART 506—INFORMATION COLLECTION REQUIREMENTS UNDER THE PAPERWORK REDUCTION ACT

1. The authority citation for part 506 continues to read as follows:

Authority: 44 U.S.C. 3501 et seq.

2. Amend § 506.1(b) by adding an entry for § 563.41(c)(3) and (4), and by removing the entries for § 563.41(e) and § 563.42(e) to read as follows:

§ 506.1 OMB control numbers assigned pursuant to the Paperwork Reduction Act.

<table>
<thead>
<tr>
<th>(b) Display.</th>
</tr>
</thead>
<tbody>
<tr>
<td>12 CFR part or section where identified and described.</td>
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<td>* * * * *</td>
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<tr>
<td>* * * * *</td>
</tr>
</tbody>
</table>

PART 559—SUBORDINATE ORGANIZATIONS

3. The authority citation for part 559 continues to read as follows:


4. Amend § 559.3 by revising paragraph (l) to read as follows:

§ 559.3 What are the characteristics of, and what requirements apply to, subordinate organizations of Federal savings associations?

<table>
<thead>
<tr>
<th>Operating subsidiary</th>
<th>Service corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>* * * * *</td>
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</table>

(l) How do the transactions with affiliates (TWA) regulations (§ 563.41 of this chapter) apply?

(1) Section (2) Section 563.41 of this chapter explains how TWA applies. Generally, an operating subsidiary is not an affiliate, unless it is a depository institution; is directly controlled by another affiliate of the savings association; or is an employee stock option plan, trust, or similar organization that exists for the benefit of shareholders, partners, members, or employees of the savings association or an affiliate. An operating subsidiary’s transactions with affiliates are aggregated with those of the thrift.
PART 562—REGULATORY REPORTING STANDARDS

5. The authority citation for part 562 continues to read as follows:


§562.4 [Amended]

6. Amend §562.4(a) and (e) by removing “12 CFR 563.41(b)(1)” and adding in lieu thereof “12 CFR 563.41.”

PART 563—SAVINGS ASSOCIATIONS—OPERATIONS

7. The authority citation for part 563 continues to read as follows:

Authority: 12 U.S.C. 375b, 1462, 1462a, 1463, 1464, 1467a, 1468, 1817, 1820, 1826, 1831o, 3806; 42 U.S.C. 4106.

8. Revise §563.41 to read as follows:

§563.41 Transactions with affiliates.

(a) Scope. (1) This section implements section 11(a) of the Home Owners’ Loan Act (12 U.S.C. 1468(a)). Section 11(a) applies sections 23A and 23B of the Federal Reserve Act (12 U.S.C. 371c and 371c-1) to every savings association in the same manner and to the same extent as if the association were a member bank; prohibits certain types of transactions with affiliates; and authorizes OTS to impose additional restrictions on a savings association’s transactions with affiliates.

(2) For the purposes of this section, “savings association” defined at section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813), and also includes any savings bank or any cooperative bank that is a savings association under 12 U.S.C. 1467a(i). A non-affiliate subsidiary of a savings association as described in paragraph (b)(12) of this section is treated as part of the savings association.

(b) Sections 23A and 23B of the FRA/Regulation W. A savings association must comply with sections 23A and 23B of the Federal Reserve Act and the Federal Reserve Board (FRB) implementing regulations at 12 CFR part 223 (Regulation W), except as described in the following chart:

<table>
<thead>
<tr>
<th>Provision of Regulation W</th>
<th>Application</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) 12 CFR 223.1—Authority, purpose, and scope</td>
<td>Does not apply. Section 563.41(a) addresses these matters.</td>
</tr>
<tr>
<td>(2) 12 CFR 223.2(a)(8)—“Affiliate” includes a financial subsidiary</td>
<td>Does not apply. Savings association subsidiaries do not meet the statutory definition of financial subsidiary.</td>
</tr>
<tr>
<td>(3) 12 CFR 223.2(a)(12)—Board or appropriate Federal banking agency determination that “affiliate” includes other types of companies</td>
<td>Shall be read to include the following statement: “Affiliate also includes any company that OTS determines, by order or regulation, to present a risk to the safety and soundness of the savings association.”</td>
</tr>
<tr>
<td>(4) 12 CFR 223.3(b)(1)(ii)—“Affiliate” includes a subsidiary that is a financial subsidiary</td>
<td>Does not apply. Savings association subsidiaries do not meet the statutory definition of financial subsidiary.</td>
</tr>
<tr>
<td>(5) 12 CFR 223.3(d)—Definition of “capital stock and surplus”</td>
<td>Does not apply. Capital stock and surplus means “unimpaired capital and unimpaired surplus,” as defined in 12 CFR 560.93(b)(11).</td>
</tr>
</tbody>
</table>
| (6) 12 CFR 223.3(g)—Definition of “control” | Does not apply. (i) “Control” by a company or shareholder over another company means that the company or shareholder:
(A) Directly or indirectly, or acting through one or more other persons owns, controls or has the power to vote 25 percent or more of any class of voting securities of the other company;
(B) Is deemed to control the company under 12 CFR 574.4(a); or
(C) Is presumed to control the company under 12 CFR 574.4(b) and control has not been rebutted.

(ii) Notwithstanding any other provision of this rule, no company owns or controls another company by virtue of its ownership or control of shares in a fiduciary capacity, except as provided in 12 CFR 223.2(a)(3) or if the company owning or controlling the shares is a business trust.

Shall be read to incorporate §563.41(c)(1), which prohibits loans extensions of credit to an affiliate, unless the affiliate, is engaged in the activities described at 12 U.S.C. 1467a(c)(2)(F)(i), as defined in §584.2-2 of this chapter.

Shall be read to incorporate §563.41(c)(2), which prohibits purchases and investments in securities issued by an affiliate, other than with respect to shares of a subsidiary.

Shall be read to include the following statement: “For the purposes of this definition, a non-affiliate subsidiary of a savings association is treated as part of the depository institution.”

Shall be read to include the following statement: “Member bank also includes a savings association. For purposes of this definition, a non-affiliate subsidiary of a savings association is treated as part of the savings association.”

Shall be read to include the following statement: “However, a subsidiary of a savings association means a company that is controlled by the savings association within the meaning of part 574 of this chapter.”

Shall be read to refer to “operating subsidiary” instead of “a non-affiliate subsidiary.”

Does not apply. Savings association subsidiaries do not meet the statutory definition of financial subsidiary. |
(c) Additional prohibitions and restrictions. A savings association must comply with the additional prohibitions and restrictions in this paragraph. Except as described in paragraph (b) of this section, the definitions in 12 CFR part 223 apply to these additional prohibitions and restrictions.

(1) Loans and extensions of credit. (i) A savings association may not make a loan or other extension of credit to an affiliate, unless the affiliate is solely engaged in the activities described at 12 U.S.C. 1467a(c)(2)(F)(i), as defined in §584.2–2 of this chapter. This paragraph (c)(1) does not prohibit a loan or extension of credit to a non-affiliate, merely because proceeds of the transaction are used for the benefit of, or transferred to, an affiliate.

(ii) For the purposes of this paragraph (c)(1), a loan or other extension of credit includes a purchase of assets from an affiliate that is subject to the affiliate’s agreement to repurchase the assets. Such a purchase is not a loan or extension of credit, however, if the purchase is a transaction or series of transactions meeting all of the following requirements:

(A) The savings association purchases United States Treasury securities from the affiliate, the affiliate agrees to repurchase the securities at the end of a stated term, the remaining term of the securities purchased by the savings association exceeds the term of the affiliate’s repurchase agreement, and the savings association has possession or control of the securities and the right to dispose of the securities at any time during the term of the agreement and upon default;

(B) The savings association purchases United States Treasury securities from the savings association and the savings association agrees to repurchase the securities at the end of a stated term.

(C) The aggregate amount of the affiliate’s outstanding obligations to repurchase securities from the savings association under the repurchase obligation described at paragraph (c)(1)(iii)(A) of this section, at all times, is less than the aggregate amount of the savings association’s outstanding obligations to repurchase securities from the affiliate under paragraph (c)(1)(iii)(B) of this section.

(2) Purchases or investments in securities. A savings association may not purchase or invest in securities issued by any affiliate other than with respect to shares of a subsidiary. For the purposes of this paragraph (c)(2), subsidiary includes a bank and a savings association.

(3) Recordkeeping. A savings association must make and retain records that reflect, in reasonable detail, all transactions between the savings association and its affiliates and any other person to the extent that the proceeds of a transaction are used for the benefit of, or transferred to, an affiliate. At a minimum, these records must:

(i) Identify the affiliate;

(ii) Specify the dollar amount of the transaction and demonstrate that this amount is within the quantitative limits in 12 CFR 223.11 and 223.12, or that the transaction is not subject to those limits;

(iii) Indicate whether the transaction involves a low-quality asset;

(iv) Identify the type and amount of any collateral involved in the transaction and demonstrate that this collateral meets the requirements in 12 CFR 223.14 or that the transaction is not subject to those requirements;

(v) Demonstrate that the transaction complies with 12 CFR part 223, subpart F or that the transaction is not subject to those requirements;

(vi) Demonstrate that all loans and extensions of credit to affiliates comply with paragraph (c)(1) of this section; and

(vii) Be readily accessible for examination and supervisory purposes.

(4) Notice requirement. (i) OTS may require a savings association to notify the agency before the savings association may engage in a transaction with an affiliate or a subsidiary (other than exempt transactions under 12 CFR part 223). OTS may impose this requirement if:

(A) The savings association is in troubled condition as defined at §563.555 of this part;

(B) The savings association does not meet its regulatory capital requirements;

(C) The savings association commenced de novo operations within the past two years;

(D) OTS approved an application or notice under 12 CFR part 574 involving the savings association or its holding company within the past two years;

(E) The savings association entered into a consent to merge or a supervisory agreement within the past two years; or

(F) OTS or another banking agency initiated a formal enforcement proceeding against the savings association and the proceeding is pending.

(ii) OTS must notify the savings association in writing that it has imposed the notice requirement and must identify the circumstance listed in paragraph (c)(4)(i) of this section that supports the imposition of the notice requirement.

(iii) If OTS has imposed the notice requirement under this paragraph, a savings association must provide a written notice to OTS at least 30 days before the savings association may enter into a transaction with an affiliate or a subsidiary. The written notice must include a full description of the transaction. If OTS does not object during the 30-day period, the savings association may proceed with the proposed transaction.

§563.42 [Removed]

9. Remove §563.42.

10. Amend §563.43 by revising paragraph (d) to read as follows:

§563.43 Loans by savings associations to their executive officers, directors, and principal shareholders.

* * * * * *

(d) The term subsidiary includes a savings association that is controlled within the meaning of §563.41(b)(6) of this part by a company (including for this purpose an insured depository institution) that is a savings and loan holding company. When used to refer to a subsidiary of a savings association, the term subsidiary means a “subsidiary” as that term is defined at §563.41(b)(13) of this part.

* * * * * *

Dated: December 12, 2002.

By the Office of Thrift Supervision.

James E. Gilleran,

Director.

[FR Doc. 02–31782 Filed 12–19–02; 8:45 am]

BILLING CODE 6720–01–P