FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

September 25, 1992

DALLAS, TEXAS 75222

Notice 92-88

TO: The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

SUBJECT

Transactions with Affiliates

DETAILS

The Federal Reserve Board announced that it has issued a rule to exclude from section 23A of the Federal Reserve Act transactions between insured depository institutions that are subject to review under the Bank Merger Act. The exclusion is intended to reduce unnecessary regulatory burden by eliminating the need for duplicative federal applications.

The rule was effective September 11, 1992.

ATTACHMENT

A copy of the Board's notice as it appears on pages 41643-44, Vol. 57, No. 177, of the Federal Register dated September 11, 1992, is attached.

MORE INFORMATION

For more information, please contact Michael Johnson at (214) 922-6081. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely yours,

Robert D. McTeer, Jr.

12 CFR Part 250

[Docket No. R-0762]

Transactions with Affiliates

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final Rule.

SUMMARY: The Board is adopting a rule to exclude from section 23A of the Federal Reserve Act transactions between affiliated insured depository institutions that are subject to the Bank Merger Act. The exclusion would be available only for transactions that are approved by the appropriate federal banking agency under the Bank Merger Act. The exemption would be available by regulation, and transactions that meet the proposed criteria will not require additional Board review under section 23A. The exclusion is intended to reduce unnecessary regulatory burden by eliminating the need for duplicative federal applications.

EFFECTIVE DATE: September 11, 1992.

FOR FURTHER INFORMATION CONTACT: Christopher J. Bellini, Attorney (202/452-3269), Legal Division, Board of Governors of the Federal Reserve System. For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

Background

Section 23A of the Federal Reserve Act (12 U.S.C. 371c) governs the ability of an insured depository institution to lend to or purchase assets of an affiliate. Through its applicability to the purchase of assets, section 23A covers a situation in which an insured depository institution merges with, or purchases all or substantially all of the assets of, an affiliate insured depository institution, unless one of the exemptions in section 23A applies or the Board uses its general authority to grant a case specific exemption. Merger and similar asset acquisition transactions between insured depository institutions are also subject to review and approval by the primary federal banking or thrift authority under the Bank Merger Act (12 U.S.C. 1828(c)) for safety and soundness as well as competitive effects.

Section 23A provides an exemption from the quantitative and collateral restrictions of the statute for transactions between banks affiliated in a bank holding company system (12 U.S.C. 371c(d)(1)).[1] The Board also has not required a section 23A exemption to transfer low-quality assets between affiliated banks in a merger or similar asset acquisition transaction approved under the Bank Merger Act because of the review conducted under that statute of the safety and soundness aspects of the transaction. As a result, in such transactions, duplicative applications under the Bank Merger Act and section 23A have been avoided.

Affiliated thrift institutions became subject to section 23A in 1989 as a result of the enactment of FIRREA (12 U.S.C. 1468(a)(1)). While FIRREA applied section 23A to thrifts in the same manner as it applies to a member bank, FIRREA delayed until 1995 the ability of most thrifts to take advantage of the statutory exemption under section 23A for transactions between affiliated institutions in a holding company system (12 U.S.C. 1468(a)(2)).[2] Accordingly, before engaging in a merger or similar asset acquisition transaction, affiliated thrifts have since 1989 been required to obtain a specific exemption from the Board under section 23A even though the thrifts also must obtain an approval from the acquiring institution's primary federal regulator under the Bank Merger Act.

Section 23A provides the Board with general authority to act by order or regulation to grant specific exemptions from its provisions for transactions that the Board determines are in the public interest and consistent with the purposes of the statute. In considering requests for exemptions, the Board has reviewed carefully the effect of the transaction on the safety and soundness of the institutions involved. The legislative history of FIRREA further indicates that Congress intended this general exemptive authority to extend to transactions involving affiliated thrifts where an exemption is consistent with the purposes of section 23A and with prior Board exemptions. The Board has granted specific exemptions under section 23A for affiliated thrifts involved in merger transactions with the concurrence of the primary federal regulator (the Office of Thrift Supervision) which had conducted a safety and soundness review of the transaction under the Bank Merger Act.

In order to eliminate the need for these duplicative federal applications, the Board proposed to adopt an exemption from section 23A for transactions that are subject to review and approval under the Bank Merger Act.[3] Specifically, the Board proposed to exempt the purchase by one insured depository institution of all or substantially all of the assets of an affiliated insured depository institution, or the merger or consolidation of such institutions, in a transaction in which only one of the institutions continues to operate. The Board did so in light of the fact that in reviewing the Bank Merger Act application for such transactions, the primary federal regulator would conduct the safety and soundness analysis that the Board undertakes in reviewing the section 23A request.

Proposal as Adopted

The Board has determined to adopt the regulation as proposed with a modification to address an issue raised by several commentors and supported by the Office of the Comptroller of the Currency. The Board has determined that the exemption from section 23A should be modified to include all transactions between affiliated insured depository institutions that have been approved by the appropriate federal banking agency under the Bank Merger Act. In this regard, the Board has deleted the restriction in its proposal stipulating that as a result of the transaction only one of the insured depository institutions must continue to operate.

Response to Public Comments

In response to its proposal, the Board received 15 public comments: 10 by holding companies, 2 by law firms, and one each by a depository institution, a corporation, and a trade association. All the commentors favor the exemption because it would reduce regulatory burden and legal and compliance costs by eliminating duplicative regulatory filings. The commentors maintain that the proposal would pose no risk to the safety and soundness of the institutions involved in the transaction, the banking system, or the deposit insurance system because of the existing requirement for prior regulatory review of the transaction under the Bank Merger Act.

[1] To be eligible for the exemption, the bank holding company must control at least 80 percent of the shares of the affiliated banks.

[2] Thrifts in a bank holding company system are eligible for the exemption if every thrift and bank controlled by the holding company meet all applicable fully phased-in capital rules without reliance on goodwill.

[3] 57 FR 28809, June 29, 1992.

Accordingly, the commentors feel the proposal is in the public interest.

Seven of the commentors also contend that the Board's reasoning supports broadening the proposal to include the other categories of merger or asset acquisition transactions that are subject to approval under the Bank Merger Act. These transactions are (1) the sale of a branch or a particular line of business by an insured depository institution to an affiliated insured depository institution,—a transaction in which both institutions continue to operate; and (2) a purchase of assets by an insured depository institution from a nonbank affiliate.

In light of these comments and in order to further reduce unnecessary regulatory burden, the Board has modified the proposal to include all transactions between affiliated insured depository institutions that are subject to review and approval under the Bank Merger Act. The Board notes that in such transactions a prior safety and soundness review under the Bank Merger Act will be performed and that such transactions permit the more flexible movement of assets to promote improved allocative efficiency among affiliated insured depository institutions.

The Board, however, has determined that transactions between an insured depository institution and a nonbank affiliate that are subject to the Bank Merger Act should not be automatically exempted from section 23A. The legislative history of section 23A and prior Board experience indicate that these transactions contain a greater potential for risk of loss to an insured depository institution and thus are appropriately subject to greater regulatory scrutiny. In this regard, certain of the 1982 amendments to section 23A were prompted by the adverse effect on banks that had resulted from transactions with their nonbank affiliates. Moreover, in analyzing prior section 23A requests, the Board has noted the potential adverse effect on an insured depository institution from such transactions and has granted exemptions only sparingly. Finally, an insured depository institution has no protection under FIRREA from losses incurred in transactions with its nonbank affiliates.[4] Accordingly, the Board has determined that these transactions should continue to be reviewed under section 23A on a case-by-case basis.

[4] The cross-guarantee provisions of FIRREA make insured depository institutions affiliated in holding company systems responsible for each others losses. 12 U.S.C. 1815(e).

Other Comments

Two commentors contend that the Board should include in the proposal all merger and asset acquisition transactions that are subject to approval by federal banking agencies under other federal statutes or regulations. The Board notes, however, that the factors or analysis that an agency considers under such statutes or regulations may be different from the factors or analysis considered under the Bank Merger Act or section 23A.

Finally, a commentor contends that the exemption should apply to all purchases of assets between affiliated insured depository institutions provided that the insured depository institutions perform the safety and soundness analysis required under the Bank Merger Act. The Board believes that such an exemption would not be consistent with the purposes of section 23A or in the public interest because of the potential for abuse to an insured depository institution from affiliate transactions that do not receive prior regulatory review and exceed the thresholds established in section 23A. Accordingly, the Board has determined not to modify the exemption to include these other two categories of transactions.

Final Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (Pub. L. 96-354, 5 U.S.C. 601 *et seq.*), the Board does not believe that the interpretation would have a significant adverse economic impact on a substantial number of small entities. The interpretation would reduce regulatory burdens imposed by section 23A of the Federal Reserve Act and have no particular adverse effect on other entities.

Effective Date

The provisions of the Administrative Procedures Act (APA) (5 U.S.C. 553(d)) that generally prescribe a 30 day prior notice of the effective date of a rule have not been followed in connection with the adoption of this rule because the Board is granting an exemption and reducing regulatory burden. The APA grants a specific exemption from the deferred effective date requirements in these instances (5 U.S.C. 553(d)(1)).

List of Subjects in 12 CFR Part 250

Federal Reserve System.

For the reasons set forth in the preamble, the Board is amending Title 12 of the Code of Federal Regulations, part 250, as follows:

PART 250—MISCELLANEOUS INTERPRETATIONS

1. The authority citation for part 250 is revised to read as follows:

Authority: 12 U.S.C. 248(i) and 371c(e).

2. Section 250.241 is added to read as follows:

§250.241 Exclusion from section 23A of the Federal Reserve Act for certain transactions subject to review under the Bank Merger Act.

(a) *Grant of Exemption.* Section 23A of the Federal Reserve Act shall not apply to a transaction between affiliated insured depository institutions if the transaction has been approved by the appropriate federal banking agency pursuant to the Bank Merger Act.

(b) *Definitions.* For purposes of this section, the terms "appropriate federal banking agency" and "insured depository institution" are defined as those terms are defined in section 3 of the Federal Deposit Insurance Act.

By order of the Board of Governors of the Federal Reserve System, September 4, 1992.

William W. Wiles,

Secretary of the Board.

[FR Doc. 92-21879 Filed 9-10-92; 8:45 am]

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