

**Underwriting Authority for Asset-Backed Securities by an Operating Subsidiary**

**Summary Conclusion:** An operating subsidiary of a federal savings association may own, sell, underwrite, and deal in asset-backed securities, because a federal savings association may engage in these activities either as an express power under the HOLA or as an incidental power.

**Date:** September 14, 2004

**Subjects:** Home Owners' Loan Act/Savings Association Powers

P-2004-5



**Office of Thrift Supervision**

Department of the Treasury

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September 14, 2004

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Re: Underwriting Authority for Asset-Backed Securities  
and Related Instruments by an Operating Subsidiary

Dear [ ]:

This responds to your recent letter on behalf of [ ] (Association), with regard to permissible activities for the operating subsidiary of a federal savings association. In your letter, you request a legal opinion on whether an operating subsidiary of a federal savings association may own, sell and underwrite asset-backed securities. The Association's holding company, [ ] (Holding Company), currently conducts this activity through a wholly-owned subsidiary, [ ] (Corp.) and desires to continue the activity in an operating subsidiary after moving Corp. directly under the federal savings association. For the reasons set forth more fully below, we agree that owning, selling and underwriting securities backed by assets in which a federal savings association may invest are permissible activities for a federal savings association and thus for an operating subsidiary of a federal savings association.

**I. Background**

Corp. currently owns, sells, and underwrites asset-backed securities as a direct subsidiary of Holding Company. Corp. is a registered broker-dealer with the Securities and Exchange Commission, a member of the National Association of Securities Dealers, and is licensed throughout the United States. Corp. was incorporated in [ ] to deal in asset-backed securities (ABS) and related fixed income instruments in the institutional market. Corp., with [ ] employees, has capital of approximately \$[ ] million and operates from offices in [ ] and [ ]. None of Corp.'s customers are individuals.

Corp. currently underwrites securitizations of financial assets originated or purchased by the Association or unaffiliated institutions. Corp. buys, sells, underwrites and deals in mortgage loans, credit card receivables, automobile loans and receivables, and other consumer loans, including securities that are unrated or rated less than investment grade.<sup>1</sup>

You have indicated that if Corp. were to operate directly under the Association as an operating subsidiary, there would be considerable savings on discounts and commissions. You request confirmation that the activities currently conducted by Corp. would be permissible for a federal savings association, and therefore, permissible for the operating subsidiary of a federal savings association. You have concluded that the investment limits applicable to corporate debt securities do not apply to the activities of underwriting and dealing in the ABS contemplated by this opinion request.

You have also indicated that the Association believes it already has the authority, either expressly or pursuant to its incidental powers, to invest in, deal in, and underwrite interests in mortgage loans, including single family and multi-family residential first lien loans and home equity loans and lines of credit, credit card receivables, automobile loans and receivables and other consumer loans of a type that a federal savings association may originate or purchase (Permitted ABS).

Finally, you provide an extensive discussion of why the prohibition under Section 28(d) of the FDIA<sup>2</sup> for federal savings associations to acquire or retain, either directly or through a subsidiary, any corporate debt security not of investment grade, unless the security is issued or guaranteed by certain government sponsored corporations, applies to "junk bonds",<sup>3</sup> and not to the type of unrated ABS securities contemplated by this letter.<sup>4</sup>

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<sup>1</sup> This opinion does not address whether underwriting financial assets that are unrated or less than investment grade would raise any supervisory concerns or whether moving Corp. from an affiliate to an operating subsidiary would raise any issues under the transactions with affiliates regulations.

<sup>2</sup> 12 U.S.C.A. § 1831e(d) (West 2001).

<sup>3</sup> See H.R. Conf. Rep. No. 19, 101<sup>st</sup> Cong. 1<sup>st</sup> Sess. 326; 135 Cong. Rec. H2763 (daily ed. June 15, 1989) (Statement of Rep. Markey.)

<sup>4</sup> See FDIC Advisory Op. 95-17, Sept. 18, 1995 (FDIC Ad. Op.) (NHTSA mortgage-backed notes purchased by federal savings association were not "corporate debt securities" for purposes of Section 28(d), notwithstanding that the securities were unrated.)

## II. Discussion

Pursuant to Section 5(c) of the Home Owners' Loan Act (HOLA), a federal savings association may invest in, sell, or otherwise deal in residential real property loans,<sup>5</sup> loans for personal, family, or household purposes, (*e.g.*, consumer loans),<sup>6</sup> and mortgage-backed securities.<sup>7</sup> There are no investment limits for the residential real property loans or mortgage-backed securities, but consumer loans are limited to 35% of an association's assets.<sup>8</sup> Section 5(c)(1)(H) of HOLA also expressly permits a federal savings association to underwrite and deal in municipal securities.<sup>9</sup> These types of securities are limited by the statute to ten percent of the association's capital in obligations of any one issuer.

Many federal savings associations leverage their assets by repackaging them as securities and then selling them to other investors. This process allows the institution to use the proceeds from the sales to fund other lending. As you know, federal savings associations, like other insured depository institutions, may use asset securitization to sell any type of loan or other credit receivables they are authorized to originate or purchase.<sup>10</sup> Assets typically securitized by institutions include credit card receivables, automobile receivable paper, commercial and residential first mortgages, commercial loans, home equity loans, and student loans.<sup>11</sup> For a number of strategic reasons, a federal savings association may choose to conduct such activities in an operating subsidiary. OTS regulations permit an operating subsidiary of a federal savings association to engage in

<sup>5</sup> 12 U.S.C.A. § 1464(c)(1)(B) (West 2001).

<sup>6</sup> 12 U.S.C.A. § 1464(c)(2)(D) (West 2001).

<sup>7</sup> 12 U.S.C.A. § 1464(c)(1)(R) (West 2001 & Supp. 2004) federal savings associations may invest in certain high quality mortgage-backed securities.

<sup>8</sup> See 12 C.F.R. § 560.30 (2004). While there is no statutory investment limitation on certain categories of loans and investments, including credit card loans, home improvement loans, education loans, and deposit account loans, OTS may establish individual limits on such loans and investments if an association's concentration in such loans or investments present a safety or soundness concern.

<sup>9</sup> 12 U.S.C.A. § 1464(c)(1)(H) (West 2001). See OTS Ops. Chief Counsel (October 29, 2001) (10/29/01 Op.) (municipal securities), and (June 19, 2001) (6/19/01 Op.) (underwrite and deal in general obligation and municipal revenue bonds and municipal notes of states and their political subdivisions at the service corporation level).

<sup>10</sup> See Interagency Guidance on Asset Securitization Activities, December 13, 1999.

<sup>11</sup> *Id.* p. 2.

any activity that a federal savings association may conduct directly.<sup>12</sup> Consequently, an operating subsidiary may engage in asset securitization because the federal savings association may conduct the activity directly.

This opinion request asks OTS to find that the Association may conduct certain underwriting activities in a newly formed operating subsidiary, and notes that OTS has previously permitted federal savings associations to underwrite and deal in certain securities issued by States and their political subdivisions.<sup>13</sup>

Therefore, because OTS has already concluded that asset securitization is appropriate for any type of loan or other credit receivable a federal savings association is authorized to originate or purchase, and the HOLA authorizes federal savings associations to invest in, sell or otherwise deal in the types of asset-backed securities that are the subject of this letter, Permitted ABS, we conclude a federal savings association or its operating subsidiary may engage in this activity.<sup>14</sup>

We also note that OTS has long recognized that federal savings associations possess extensive “incidental” powers, *i.e.*, powers that are incident to the express powers granted to federal savings associations by the HOLA.<sup>15</sup> These incidental powers provide an alternative basis for the Office’s conclusion.

OTS used various analyses over the years to determine whether a particular activity lies within the scope of a federal savings association power under section 5 of the HOLA. Our analysis has evolved to focus on the following factors: (1) is the activity consistent with Congressional purpose for federal savings associations; (2) is the activity similar to, or does it facilitate the conduct of, an activity already expressly authorized by Congress; (3) does the activity relate to the financial intermediary role that federal savings associations were intended to fulfill; and (4) is the activity necessary for the federal savings association to remain competitive and relevant in the modern economy?<sup>16</sup>

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<sup>12</sup> 12 C.F.R. § 559.3(e) (2004).

<sup>13</sup> See 10/29/01 Op.

<sup>14</sup> OTS notes that some ABS securities have no investment limitations; however, investment limitations will apply for certain types of ABS securities, such as commercial loans and other assets limited by HOLA. See 12 C.F.R. § 560.32 (2004).

<sup>15</sup> See OTS Memorandum Chief Counsel (March 25, 1994) (surveying Supreme Court decisions and other federal cases related to incidental powers). See also 1/10/95 Op. (authority to underwrite credit insurance is subsumed within authority of federal savings associations to lend).

<sup>16</sup> See *id.* (surveying law related to incidental powers).

First, Congress has consistently expanded the powers of federal savings associations to include activities that the public has come to expect to be offered by financial service providers. Thus, modern thrifts are expected to serve as consumer oriented financial intermediaries that will meet the needs of consumers.<sup>17</sup> Providing a range of activities including, but not limited to, owning, selling, underwriting or dealing in ABS is consistent with the congressional purpose.

Second, as noted above, the HOLA expressly authorizes federal savings associations to invest in certain mortgage-backed securities.<sup>18</sup> Owning, selling, underwriting and dealing in other securities backed by assets, such as mortgages, in which the federal savings association may engage, facilitate lending activities by raising funds for further originations.

Third, owning, selling, underwriting and dealing in ABS, by creating a secondary market for the products of a federal savings association, furthers the financial intermediary role that federal savings associations were intended to fulfill. OTS has described securitization of assets as an effective financial intermediation and risk management tool.<sup>19</sup>

Fourth, the ability of federal savings associations to engage in such ABS sales, in addition to their traditional deposit and lending activities, provides customer convenience and allows federal savings associations to compete with all other financial institutions including national banks, in providing “one stop” shopping.<sup>20</sup> Allowing federal savings

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<sup>17</sup> S. Rep. No. 96-368, at 13 (1979).

<sup>18</sup> 12 U.S.C.A. 1464(c)(1)(R).

<sup>19</sup> See Thrift Activities Handbook at 221.1. See also Interagency Guidance on Asset Securitization Activities, December 13, 1999.

<sup>20</sup> See S. Rep. No. 96-368, at 13, (discussion of how the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St Germain Depository Institutions Act of 1982 granted broad statutory power to federal savings associations to become ‘convenient one-stop family financial centers’); See OTS Ops. Chief Counsel (Mar. 25, 1994) (surveying law related to incidental powers), (Jan. 10, 1995) (authority to underwrite credit insurance is subsumed within authority of federal savings associations to lend), and (May 5, 2000) (collecting referral fees), and (Apr. 3, 2000) (providing currency exchange forward contracts). See also *Security Industry Association v. Clarke*, 885 F. 2d 1034 (2d Cir. 1988), *cert. denied*, 493 U.S. 1070 (1990) (the authority of a national bank to sell mortgage-backed securities is incidental to the business of banking, and to the express power of a bank to sell its mortgage loans); OCC Interpretive Letter No. 388 (June 16, 1987) (national banks are authorized to sell securities backed by their mortgage assets or other lawfully acquired assets); and 12 C.F.R. § 1.3(g) (2004).

associations to own, sell, underwrite and deal in ABS will assist them in remaining competitive and relevant in the modern economy.

Finally, OTS agrees with your analysis that the type of unrated ABS securities contemplated by this opinion request, that is, interests in loans or pools of loans that a federal savings association may invest in directly, are not of the type of securities Congress intended to prohibit by section 28 of the FDIA (*i.e.* junk bonds).<sup>21</sup>

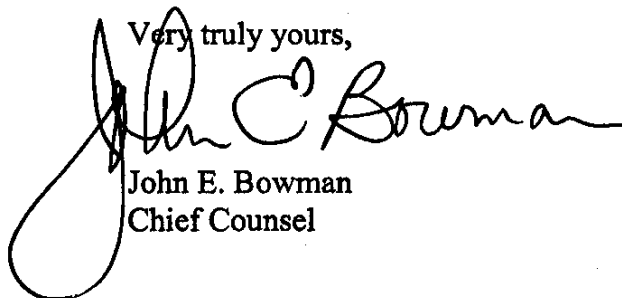
### III. Conclusion

For the reasons stated above, we conclude that an operating subsidiary of a federal savings association may own, sell, underwrite or deal in Permitted ABS securities because a federal savings association may engage in these activities either as an express power under the HOLA or as an incidental power of a federal savings association.

In reaching the foregoing conclusion, we have relied upon the factual representations made in the materials you submitted to us, as summarized herein. Our conclusions necessarily depend on the accuracy and completeness of those facts. Any material difference in facts or circumstances from those described herein could result in different conclusions.

We trust that this is responsive to your inquiry. If you have any further questions regarding this matter, please contact David Permut, Senior Attorney, at (202) 906-7505.

Very truly yours,



John E. Bowman  
Chief Counsel

cc: Regional Directors  
Regional Counsel

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<sup>21</sup> See FDIC Ad. Op.