

Handbook: Thrift Activities
Subject: Capital Adequacy

Section: 320
TB 5a

April 12, 1990

Capital Maintenance Agreements

RESCINDED

Summary: This Bulletin sets forth the policy of the Office of Thrift Supervision (OTS) with respect to capital maintenance obligations of acquirers and owners of savings associations. Thrift Bulletin 5 (TB 5), dated October 19, 1988, is rescinded with the issuance of this Bulletin.

For Further Information Contact: Your District Office, Supervision, or the Corporate and Securities Division, Chief Counsel's Office, OTS, Washington, D.C.

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Background:

Federal Home Loan Bank Board Resolution No. 88-685, issued August 12, 1988, rescinded the prior Board policy that required open-ended net worth maintenance agreements from holding company and individual acquirers as a condition of approval of acquisition transactions.¹ In lieu of the open-ended net worth maintenance agreement, the Board substituted two alternative forms of agreement and provided that an acquirer must agree to one of the two, as a matter of general policy. The Board applied this policy to both individual and holding company acquirers. The Board's policy was implemented through Thrift Bulletin 5, issued October 19, 1988. Due to the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), a number of provisions of TB 5 are being revised.

General Policy:

OTS's policy is to ensure that owners of savings associations have sufficient incentive to conduct their business in a prudent manner and that savings associations achieve the capital levels required by the FIRREA as soon as possible, and, in

any event, prior to January 1, 1995. These goals are closely related, since a way to encourage prudent conduct is to require the owners of savings associations to maintain a substantial financial stake in their savings associations.

Acquisitions of savings associations should result in associations that meet their fully phased-in capital requirements at the time of acquisition. The fully phased-in capital requirement is defined as the savings association's minimum capital requirement under the statutory and regulatory standards to be applicable on January 1, 1995 or such standard as may be imposed under an individual minimum capital requirement.

Policy for transactions that result in savings associations not meeting their fully phased-in capital requirement:

Acquirers of savings associations must execute a limited capital maintenance agreement prior to acquiring a savings association if the association will not, upon consummation of the transaction, meet its fully phased-in capital requirement. Furthermore, the acquirer must submit a capital plan for the resulting savings association that is acceptable to the District Director (See Thrift Bulletin 38-3). The plan must demonstrate that the resulting savings association will comply with its fully phased-in capital requirement within a reasonable period of time not to extend beyond

December 31, 1994. This policy is also applicable (as described below) to owner(s) of savings associations engaged in other significant transactions.

A limited capital maintenance agreement is an enforceable obligation to invest up to an agreed-upon amount of additional funds in the savings association if the savings association does not maintain its capital above a specified level.

Applicability:

The OTS policy regarding limited capital maintenance agreements applies to acquisitions of savings associations or savings and loan holding companies (Savings and Loan Holding Company Act, 12 U.S.C. 1467a, and the Change in Bank Control Act, 12 U.S.C. 1817(j)), to individuals acquiring a savings association through the use of an interim savings association in a transaction subject to the Bank Merger Act, 12 U.S.C. 1828(c), and to individuals who control operating savings associations that acquire other savings associations through mergers, also subject to the Bank Mergers Act.

Limited Capital Maintenance Agreements:

The maximum amount of liability for an acquirer of a savings association or owner of an association that acquires another association through merger (collectively referred to as an "acquirer") under

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the standard limited capital maintenance agreement equals the dollar amount of the difference between the acquired or resulting savings association's capital and its fully phased-in capital requirement immediately following the transaction. The responsibility to infuse capital under the agreement will arise whenever the amount of the savings association's capital falls below its minimum capital requirement. At such time, the acquirer must infuse capital sufficient to restore the savings association's capital to the savings association's current minimum capital requirement.

Limited capital maintenance agreements will, in general, expire after five years or upon the acquirer demonstrating, to the satisfaction of the District Director, that the savings association's capital has exceeded the fully phased-in capital requirement for eight consecutive quarters.

In the case of any enforceable obligation to infuse additional capital, such an obligation generally will be acceptable only if the acquirer has adequate resources to satisfy its obligations under the agreement. In order to demonstrate that it has "adequate resources," the acquirer must either have a market capitalization or net worth, excluding its investment in the acquired entity, significantly in excess of the amount of the acquirer's obligation under the agreement. In lieu of its own resources, the acquirer may substitute a guarantee by a third party with such resources that is acceptable to the OTS. If the acquirer itself is a savings association or does not have adequate resources, or if the third party guarantee is provided by a savings association, the transaction will present a significant policy issue and require review by the Director.

Requirement for acquisitions and mergers (except as noted elsewhere in this Bulletin):

Transaction:	Limited Capital Maintenance Agreement Requirement:
Acquisitions/Mergers; Acquirer has more than 50% control ²	Full Obligation
Acquisitions/Mergers; Acquirer has 25% to 50% control	Pro-rata Obligation
Acquisitions/Mergers; Acquirer has less than 25% control	None

Under the *full obligation*, the acquirer must execute a limited capital maintenance agreement under which the potential liability equals the dollar amount of the difference between the savings association's capital and its fully phased-in capital requirement immediately following the transaction.

Under the *pro-rata obligation*, the acquirer must execute a limited capital maintenance agreement under which the potential liability equals the percentage of ownership multiplied by the dollar amount of the difference between the savings association's capital and its fully phased-in capital requirement immediately following the transaction.

De Novo Transactions:

De novo associations are required to meet the fully phased-in capital requirement. As a result, owner(s) of de novo savings associations are not required to execute limited capital maintenance agreements.

Simple Holding Company Reorganizations:

Limited capital maintenance agreements are not required for simple holding company reorganizations where an association establishes its own holding company, including creation of a holding company concurrently with a mutual-to-stock conversion in a simple holding company conversion, and there is no material change in the association or, in the case of an existing stock savings association, its stock ownership.

Standard conversions:

A limited capital maintenance agreement is not required where an association engages in a standard conversion or simple holding company conversion (where no individual or group of individuals may acquire more than 10 percent of the association's stock in the conversion). A savings association engaged in any mutual-to-stock conversion where the savings association does not meet the minimum capital requirements is required to comply with Thrift Bulletin 36a ("Guidelines for FIRREA Capital Plans, Exemptions and Exceptions") and successor Bulletins.

Other conversions:

A party that acquires control of a savings association through a modified conversion, voluntary supervisory conversion, or merger conversion must execute a limited capital maintenance agreement consistent with the requirements for other acquisitions and mergers, as described above.

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Increases in control by current owner(s):

A current owner(s) engaged in a transaction that increases its control of a savings association to greater than 50% must execute a limited capital maintenance agreement. Although a limited capital maintenance agreement generally will not be imposed where the control level is below 50%, OTS may, under certain circumstances, require such an agreement.

Savings associations that meet the fully phased-in capital requirement:

Where the capital of the resulting savings association equals or exceeds the fully phased-in capital requirement upon consummation of the transaction, the acquirer or owner will not be required to enter into a limited capital maintenance agreement.

RTC transactions:

Assisted transactions involving the Resolution Trust Corporation (RTC) are not covered by this Bulletin.

Previously Executed Agreements:

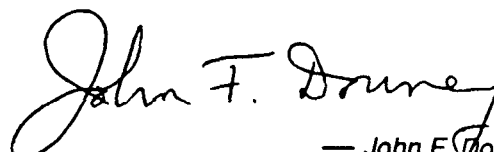
Net Worth Maintenance Agreements and Prenuptial Agreements executed prior to the issuance of this Bulletin remain in effect and are fully enforceable by the OTS or the RTC as appropriate.

Delegation:

An application subject to this Bulletin may be decided by the District Director unless the application raises a significant issue of policy or law. Applications that fail to comply with the policies set forth in this Bulletin are deemed to present such issues. OTS Washington staff will consult with the Director before rendering a decision on an application, or send the application to the Director for a decision, where the application presents a significant issue of law or policy.

In general, non-standard conditions should not be imposed. The District Director must receive the concurrence of the Washington staff or the Director before imposing an agreement that contains non-standard conditions.

- 1 There have also been net worth maintenance agreements executed in connection with forbearances and approvals not related to acquisitions.
- 2 For the purposes of this Bulletin, "control" may be determined by:
 - ownership of any class of voting stock of a savings association (directly or indirectly, or acting in concert with others);
 - ownership of irrevocable proxies of any class of voting stock or any combination of voting stock and irrevocable proxies; or,
 - control in any manner of the election of the directors of the savings association.
 - On a case-by-case basis, substantial acquisitions of non-voting stock may also warrant requiring an acquirer to enter into a limited capital maintenance agreement.


— John F. Downey
Acting Senior Deputy Director for Supervision