



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

May 19, 2008

A. Patrick Doyle, Esq.
Arnold & Porter LLP
399 Park Avenue
New York, New York 10022

Dear Mr. Doyle:

This is in response to the request by Merrill Lynch Bank & Trust Co., FSB (“MLFSB”), New York, New York, for a limited exemption from section 23A of the Federal Reserve Act and the Board’s Regulation W to facilitate a one-time corporate reorganization.

MLFSB acquired First Franklin Financial Corporation (“First Franklin”), San Jose, California, from National City Bank, Cleveland, Ohio, on December 30, 2006. First Franklin originated primarily subprime mortgage loans for sale in the secondary market. The documents for the loan sales and securitization transactions included representations and warranties that, if breached, would obligate First Franklin to repurchase the loans in certain circumstances. In some cases, MLFSB provided guarantees of First Franklin’s performance under these transaction documents (“Guarantees”).

Because of the deterioration of the subprime mortgage market, Merrill Lynch & Co. (“Merrill Lynch”), the parent of MLFSB, announced that it would discontinue mortgage operations at First Franklin in March 2008. Merrill Lynch now proposes to have MLFSB transfer its entire ownership interest in First Franklin to Merrill Lynch Mortgage Services Corporation (“MLMSC”), an indirect, wholly owned subsidiary of Merrill Lynch. [REDACTED.] At present, the potential obligations of First Franklin related to loans sold total approximately \$[REDACTED]. [REDACTED].

Section 23A and Regulation W limit the amount of “covered transactions” between a bank (including a federal savings bank) and any single affiliate to 10 percent of the bank’s capital stock and surplus, and limit the amount of covered transactions between a bank and all its affiliates to 20 percent of the bank’s capital stock and surplus.¹ “Covered transactions” include the purchase of assets by a bank from an affiliate, the extension of credit by a bank to an affiliate, the issuance of a guarantee by a bank on behalf of an affiliate, and certain other transactions.² The statute and regulation also require a bank to secure its extensions of credit to, and guarantees on behalf of, affiliates with prescribed amounts of collateral.³

As noted, MLFSB guaranteed the performance of certain obligations of First Franklin to one or more beneficiaries. The Guarantees were put in place in connection with, and in support of, First-Franklin-originated whole loans or securitizations and total approximately \$[REDACTED]. The Guarantees were not subject to the limitations on transactions between a bank and its affiliates because First Franklin was a subsidiary of MLFSB, and section 23A does not apply to transactions between a bank and its operating subsidiaries. On consummation of the proposed transaction, First Franklin would no longer be a subsidiary of MLFSB and would become an affiliate of MLFSB. As a result, the Guarantees would become guarantees by a bank on behalf of an affiliate, which are covered transactions under section 23A and Regulation W.⁴ MLFSB has requested that the Board grant MLFSB an exemption from section 23A and Regulation W to allow the Guarantees to continue until maturity. No new guarantees would be originated by MLFSB on behalf of First Franklin.

As noted, section 23A and Regulation W specifically authorize the Board to exempt transactions or relationships from the requirements of the statute and rule if the Board finds an exemption to be in the public interest and consistent with the purposes of section 23A. A number of factors support exempting the

¹ 12 U.S.C. § 371c(a)(1); 12 CFR 223.11 and 223.12.

² 12 U.S.C. § 371c(b)(7); 12 CFR 223.3(h).

³ 12 U.S.C. § 371c(c); 12 CFR 223.14.

⁴ 12 CFR 223.3(h)(5).

Guarantees from the requirements of section 23A and Regulation W. First, the Guarantees were not covered transactions at the time they were entered into because First Franklin was not then an affiliate of MLFSB. Nor did MLFSB issue the Guarantees in contemplation of First Franklin becoming an affiliate of MLFSB. It is only as a result of the proposed reorganization that the Guarantees would become covered transactions.

In addition, the proposed reorganization appears to reduce the risk exposure of MLFSB because it would no longer bear the sole risk of the assets of First Franklin. The proposed reorganization also would substantially increase the regulatory capital ratios of MLFSB.

[REDACTED.]

MLFSB has represented that the proposed reorganization is in the public interest because it would improve MLFSB's risk profile and because the cost and operational efficiencies that would result from the reorganization would allow MLFSB to provide more competitive product offerings to its customers. For the reasons stated above, and in light of all the facts you have presented, the transactions appear to be consistent with the public interest and the purposes of section 23A. Accordingly, the Board hereby grants the requested exemption.

Because the proposed transaction would involve the sale by a bank of assets to an affiliate, the transaction must also meet the requirements of section 23B of the Federal Reserve Act,⁵ which requires that financial transactions between a bank and its affiliates be conducted on terms that are at least as favorable to the bank as a similar transaction with a third party. Merrill Lynch has represented that the sale price of First Franklin would be the greater of the fair

⁵ 12 U.S.C. § 371c-1(a)(2).

market value or book value of the company. First Franklin's current book value, \$[REDACTED], exceeds the company's fair market value. A sale at book value appears to be at least as favorable to MLFSB as a sale of First Franklin to a third party and, accordingly, would conform to the requirements of section 23B.

These determinations are specifically conditioned on compliance by Merrill Lynch and MLFSB with all the commitments and representations they made to the Board in connection with the exemption request. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the request and, as such, may be enforced in proceedings under applicable law. These determinations are based on the specific facts and circumstances described in your correspondence and this letter. Any material change in those facts or circumstances or any failure by Merrill Lynch, MLFSB, or any other company relying on the exemption granted in this letter to observe any of their commitments or representations may result in a different conclusion or in a revocation of the exemption. The Board also reserves the right to rescind this exemption if it is used by MLFSB to evade section 23A or Regulation W.

Sincerely yours,

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of New York
Federal Deposit Insurance Corporation
Office of Thrift Supervision