Office of Thrift Supervision
Department of the Treasury

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LEGAL OPINION

TO: John F. Downey
Director of Supervision

FROM: Business Transactions Division

RE: Holding Company Application by the

to Acquire

Trust Powers Application by

DATE: June 26, 1995

I. INTRODUCTION AND SUMMARY CONCLUSION

The ("Applicant") has filed an application ("Holding Company Application") under Section 10(e) of the Home Owners' Loan Act ("HOLA") and the OTS Acquisition of Control Regulations ("Control Regulations"), and related applications, to acquire ("Association"). In addition, the Association has applied under Section 5(n) of the HOLA and the OTS Trust Regulations to exercise trust powers ("Trust Application"). The trust services will be conducted in but will be marketed through the Applicant's broker-dealer subsidiary's registered representatives.

has filed a protest relating to the proposed acquisition, citing several concerns regarding the proposed provision of trust services by the Association.

The Regional Office (the "Regional Office") has reviewed the Holding Company Application and Trust Application ("Applications") and the protest and has recommended approval. We have reviewed the Applications and the protest under applicable statutes and regulations. In our view, the Applications adequately address the issues raised by the protest. We have no legal objection to approval of the Applications, subject to the recommended standard and non-standard conditions. The non-standard conditions would

require (i) that the proposed contract between the Broker and Association (a) have the Applicant as a party to the agreement; (b) provide that the Broker will of the trust operations for at least years, and (c) not be modified without prior OTS approval; (ii) that if the Applicant and Broker fail to provide the the agreement, the Association immediately cease the exercise of trust powers and the Applicant and Broker pay upon the direction of the OTS Regional Office; and (iii) that OTS approve in advance any trust officers. In addition, due to the fact that the Applicant's broker-dealer subsidiary is engaged in the securities business, we have no objection to the imposition of the securities affiliate conditions set forth in Attachment A.

II. BACKGROUND

A. The Parties

1. The Applicant

The Applicant is a Limited Partnership organized under the Partnership Act of the State of . It has General Partners. Each General Partner is a natural person and none controls more than 10% of the Partnership. The Applicant is managed by a committee of General Partners, each of whom has filed biographical and financial information on Form 1393. There are Limited Partners, all of whom are natural persons. None of the Limited Partners holds more than 10% of the limited partnership interests.

The Applicant in calendar years 1994 and 1993 earned approximately million and million on revenues of million and . million, respectively. The Applicant has equity of over million and assets of over million.

The Applicant's principal subsidiary is ("Broker"), which contributes substantially all of the consolidated earnings of the Applicant. The Broker is a full service registered securities broker-dealer headquartered in , with offices in States and , which service over customer accounts. The Broker targets investment accounts for individuals and offers various securities products. The Applicant also owns , which leases buildings and equipment to the Applicant.

The Applicant has branch offices in , where the Association operates, located from one block to seven miles from the Association's office. The Broker does not intend to conduct brokerage operations on the Applicant's premises.

2. The Association

The Association is a SAIF-insured, Federal savings association with located in . Its primary activities are taking deposits and making mortgage loans. As of March 31, 1995, the Association reported total assets of $ million, total liabilities of $ million and total equity of $ million. As of the same date, the Association reported tangible, core and risk based capital of $ million, $ million and $ million, or %, % and %, respectively. For the four quarters ended June 30, 1994, September 30, 1994, December 31, 1994 and March 31, 1995, the Association had net income of and . The Association's outstanding securities consist of shares of Common Stock. In addition, there are shares of Common Stock issuable upon exercise of outstanding stock options. The Applicant does not own any shares of the Association.

According to the OTS Report of Examination completed on , 1994, the Association received a composite "CAMEL" rating of " ". The Association received a " " rating in its OTS Community Reinvestment Act compliance examination of July 1994.

B. The Proposed Transaction

1. Holding Company Acquisition

The Applicant proposes to acquire the Association through a multi-step transaction. The Applicant will organize Interim Bank, F.A. ("Interim"), a wholly-owned subsidiary of the Applicant, pursuant to 12 C.F.R. § 552.2-2. The Association will merge into Interim, with the Association surviving the merger. As a result, the Association will become a wholly-owned subsidiary of the Applicant. Each share of the Association's Common Stock will be converted into the right to receive ("Consideration"). Holders of 1,000 or more shares may elect to receive, in lieu of cash, a check for of the Consideration and an installment note ("Note") for of the Consideration issued by the Applicant and secured by a letter of credit issued by a major bank.

The Association's current directors shall continue to serve in this capacity after the transaction. They will be joined by two additional directors selected by the Applicant.

Prior to closing, the Association will terminate its employment agreement with , the Association's president, and the Applicant will offer Mr. the opportunity to purchase for the financing of which shall be provided by Applicant, a general partnership interest in the Applicant from which he will receive a distribution of the Applicant's profits.

The Applicant states that it will maintain the Association as a separate entity for following the transaction, unless the continuing directors waive this provision. The Applicant does not intend to change the Association's current operating policies.

2. Proposed Trust Services

The Association has filed an application for full trust powers, pursuant to 12 U.S.C. § 1464(n) and 12 C.F.R. Part 550. Immediately after the completion of the transaction, the Association proposes to add to its existing businesses the provision of trust services through an unincorporated division of the savings association ("Trust Department"). The Trust Department will be named Services to be offered include, but are not limited to, estate planning, professional administration of accounts and assets, designing investment strategies, and record keeping systems.

The Trust Department will be located in from the sole office of the Association. Although the Trust Department will be located , the Association plans to market the services to the brokerage customers of the Broker, throughout the United States.

The Broker's registered representatives will work with customers' legal and tax advisors to assist in identifying needs for trust services, and will promote the Trust Department services. They also will participate with the Applicant's in discussing how the Trust Department's services can meet their needs and with Trust Department employees. This team will include attorneys, certified public accountants and other financial professionals.

By letter dated 1995, the Association states that employees of the Trust Department will

The day-to-day administration of the Trust Department's fiduciary activities of reviewing prospective accounts, managing current accounts and determining investment policy will be conducted only in

The Association will establish a Trust Department Administrative Policy Committee, which will consist of individuals, of the Applicant and of the Association. This committee will review all trust and trust-related instruments referred to the Trust Department prior to acceptance of such instruments or agreeing to act in the capacity provided for therein.

The Association will contract with a major trust service bureau to conduct the Trust Department's accounting and recordkeeping and will audit the Trust Department annually by independent auditors.

C. Protest

By letter dated filed a protest ("Protest") regarding the transaction. The Regional Office determined that the protest, which was subject to the procedures set forth at 12 C.F.R. 543.2, pursuant to 12 C.F.R. 563.22(e), was substantial. By letter dated , the responded to the Protest.

The Protest raises four concerns relating solely to the operation of the Trust Department: (1) how the Broker, as marketing agent of the Trust Department, can separate its selling of securities from the Trust Department's fiduciary duties to select securities; (2) the application of law to "marketing agents," out-of-state fiduciaries, and trust operations with no traditions of conservative competent administration; (3) the apparent need for each grantor to hire an attorney in his home state and a second attorney in

to have an appropriate trust agreement; and (4) whether the OTS General Counsel's legal opinion dated June 13, 1994 regarding federal pre-emption has an adequate legal basis.

III. DISCUSSION

A. Holding Company Application

The Regional Office has reviewed the Application and recommended approval. We have reviewed the Holding Company Application under applicable statutes and regulations, and have no legal objection to approval of the Application, subject to the recommended standard conditions.

1. Approval Standards

Under § 10(e)(1)(B) of the HOLA, the OTS must approve the proposed acquisition of one savings association by a company other than a savings and loan holding company unless the OTS finds that the financial and managerial resources and future prospects of the company and association involved are such that the acquisition would be detrimental to the association or the insurance risk of the SAIF.[1] Section 10(e)(1)(B) requires that consideration of the managerial resources of a company or savings association include consideration of the competence, experience, and integrity of the officers, directors, and principal shareholders of the company or association. In addition, the OTS must consider the impact of the acquisition on competition.[2]

2. Financial Resources

The Regional Office has concluded, based on the Applicant's financial position, particularly the Applicant's equity and net income, that the Applicant has the financial resources necessary for the proposed acquisition.

The Regional Office has noted that the Association exceeds all regulatory capital requirements and is a "well capitalized" institution, as that term is defined under the OTS Prompt Corrective Action Regulations.[3] The Regional Office has noted the projections in the Holding Company Application that the Association will continue in capital compliance and be well capitalized.

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1. 12 U.S.C. § 1467a(e)(1)(B); see also 12 C.F.R. § 574.7(c) (1995).

2. 12 U.S.C. § 1467a(e)(2) and 12 C.F.R. § 574.7(c)(2)(1995).

3. 12 C.F.R. § 565.4 (1995).

Based on these facts, there is, in our opinion, an adequate legal basis for the OTS to approve the subject application in light of the financial resources of the Applicant and the Association.

3. **Managerial Resources**

The Regional Office has reviewed the biographical information of the Applicant's management committee and conducted background checks and has not objected to the managerial resources of the Applicant. We have reviewed past and pending securities enforcement matters against the Broker and have not identified any pattern of serious violations that would reflect on the character or competence of the Broker or the Applicant.

With respect to the Association, the Association's directors and management team will continue in their positions, supplemented by directors from the Applicant. The Regional Office notes that the management and directors were found capable of operating the Association in a safe and sound manner at the last examination and rated a " ". The Regional Office has found no basis for objection to the Association's reconstituted board of directors. The Regional Office will approve in advance any trust officers hired to administer the newly granted trust powers.

Based on the above information, it is our view that there is an adequate legal basis for the OTS to approve the subject application in light of the managerial resources of the Applicant and the Association.

4. Future Prospects; Effect on Association and SAIF

The Regional Office has noted that the Applicant is a long-established, profitable, and apparently well-managed entity and that the Association has operated in a safe and sound manner and will continue with its basic operating procedures and philosophy.

In addition, the Regional Office has concluded that the Association's future prospects are acceptable because the Regional Office, pursuant to a recommended condition of approval of the Trust Application, would have authority to approve in advance the individual appointed to direct the trust activities.

Based on the foregoing, in our opinion, there is an adequate legal basis for the OTS to approve the acquisition based on the future prospects of the Applicant and the Association.

5. Competitive Impact

The proposed acquisition will not cause the Association to become affiliated with any other savings association or bank. Therefore, the transaction will not have an impact on competition.

6. Affiliation with a Broker-Dealer

As noted above, the Applicant, through the Broker, engages in a variety of securities activities. The OTS has no regulations addressing affiliations between savings associations and securities firms. Nevertheless, OTS and its predecessor agency have traditionally imposed certain basic safeguards to protect the operations of a holding company's thrift subsidiaries from risks posed by a holding company's securities activities. Where a company seeking to acquire a savings association is engaged in securities activities, approval of the acquisition has been conditioned on compliance with the so-called Statesman conditions

or their equivalent.[4] In our opinion, the Director has the legal authority to condition approval of the subject transaction upon the Applicant's compliance with conditions designed to protect the thrift operations from risks associated with the brokerage operations.

we are recommending conditions that address regulatory concerns underlying the Statesman conditions but that are modified in light of subsequently promulgated regulations and policy statements and agency experience ("Affiliates Conditions"). The Affiliates Conditions are set forth as an Attachment.

7. Formation of Interim and Merger

The Applicant has applied under 12 C.F.R. § 552.2-2 to establish an interim Federal savings Association. The regulatory standards set forth in Section 552.2-2 require the OTS to consider the purpose for which the association will be organized, the form of the proposed transaction, the effect of the transaction on existing associations involved in the transactions and relevant factors specified in Section 552.2-1(b)(1), including the character of the applicants. We have determined that the Applicant has met these standards and that the purpose of establishing the interim association is lawful and will not be detrimental to the Association and that the Applicant has the requisite managerial ability.

In addition, the Applicant has filed an application to merge the interim Federal association into the Association under 12 U.S.C. § 1828(c) and 12 C.F.R. § 563.22(a). In reviewing the proposed merger, the OTS must consider the financial and managerial resources and future prospects of the institutions and the convenience and needs of the communities to be served.[5] The OTS may not approve a merger application if the merger would have certain anticompetitive effects.[6] We have discussed the managerial and financial resources and future prospects of the parties, and the competitive effects of the proposed transaction, in section II.A.2. through II.A.5. above. In our view, approval of the merger is consistent with the convenience and needs of the community based on the Association's satisfactory CRA rating.

4. See Op. CASD (Mar. 11, 1988).

5. 12 U.S.C. § 1828(c)(5); 12 C.F.R. § 563.22(d) (1995).

6. Id.

B. Trust Powers Application

Section 5(n) of the HOLA authorizes the OTS to grant Federal savings associations the power to act as trustee, executor, administrator, guardian or in any other fiduciary capacity permitted for State banks, trust companies, or other corporations which compete with such associations in the state where the Federal association is located.[7]

The Regional Office has not raised a supervisory objection and we have no legal objection to the Trust Application, subject to the recommended conditions.

1. Regulatory Standards

Section 550.2 of the OTS regulations imposes two sets of standards on applications to exercise trust powers. First, 12 C.F.R. § 550.2(b) requires the OTS to consider five factors: (1) the association's financial condition; (2) needs of the community for fiduciary services; (3) general character and ability of the management of the association; (4) nature of the supervision to be given to the fiduciary services; and (5) whether the association has legal counsel available to advise and pass on fiduciary matters as necessary.

The Regional Office has considered these factors and has recommended approval of the application. It is our view that the OTS has a legal basis to approve the Trust Application. As to the Association's financial condition, the Regional Office notes that the Association currently exceeds and after the acquisition will continue to meet all regulatory capital requirements and will be a well capitalized institution.

With respect to the need for fiduciary services, the Regional Office has reviewed the Applicant's data supporting the need for trust services in the . marketing area of the Trust Department and raised no objection.

Regarding management, the Regional Office has noted that the Association's management consistently has been rated " " and can be relied upon to operate the Association in a safe and sound manner. As to the supervision of the fiduciary services, the

7. 12 U.S.C. § 1464(n).

Regional Office has reviewed the qualifications of the members of the proposed trust committee and determined that they possess the experience and knowledge to operate the Trust Division in a safe and sound manner. The trust committee will review proposed trust instruments prior to establishing client relationships. The Regional Office will approve the Association's trust officer prior to his being hired, as a condition of approval, in order to make certain the trust officer has the requisite character and ability. With regard to legal counsel, the Association has retained the law firm in to consult on trust issues.

Second, ten standards set forth in 12 C.F.R. § 550.2(c) must be met either prior to approval or through conditions imposed on the approval. These standards are or will be satisfied. Two of these conditions overlap with the factors set forth in Section 550.2(b) and have met for the reasons stated above (12 C.F.R. § 550.2 (c)(8) and (c)(9)). One condition -- appropriate approvals for trust services provided through a service corporation -- is not relevant here (12 C.F.R. § 550.2(c)(10)). As to the remaining seven, the Regional Office has determined that the financial condition of the Association is sufficient to support the proposed trust operations and the Association meets its regulatory capital requirements (12 C.F.R. § 550.2(c)(1) and (3)). The Regional Office also has found, based on past examinations and other available information, that the Association's management capacity to operate with trust powers and that the overall performance of the Association is satisfactory (12 C.F.R. 550.2 (c)(4) and (5)). The Association has provided legal opinions asserting that it will meet the financial standards prescribed for Missouri chartered fiduciaries and that the proposed trust powers are authorized for state-chartered fiduciaries (12 C.F.R. § 550.2(c)(1) and (2)). The Regional Office will approve the proposed trust officer in advance to make certain that he possesses the requisite qualifications set forth in 12 C.F.R. §§ 550.2(c)(6) and (7).

2. <u>National Marketing Agent for the Trust Department</u>

The Trust Application raises a novel issue regarding the location of the Association for purposes of Section 5(n), since the trust services will be marketed throughout the United States. In response to a request from the Applicant in anticipation of this application, the Chief Counsel provided a legal opinion dated June 13, 1994, opining (i) that the Association would be located for purposes of Section 5(n) only in the state of and not in the various states in which the Broker has its offices and (ii) that the Broker's offices were not offices of the Association. The Chief Counsel noted that the Broker would serve as a marketing agent, in a role similar to a finder. The opinion also points out that by imposing the Affiliates Conditions on any approval, the OTS will assure corporate separateness between the Broker and Association and the prevention of conflicts of interest and transactions with affiliates that would disadvantage the Association through this relationship.

3. Protest by

We have carefully reviewed the concerns raised in the Protest and determined that they do not present facts sufficient to justify a denial of the application. Specifically:

(1) The Protest questions how the Broker, as the marketing agent of the Trust Department, will separate its function of selling securities from the Trust Department's fiduciary duty to select securities in the best interests of the participants and beneficiaries. It is our understanding that the registered representative of the Broker and the trust officer of the Association will be different persons working for different organizations. In their different capacities, each can discharge his responsibilities to his organization without a conflict. In order to make certain that this practice continues, the Affiliates Conditions include a requirement that no employee of the Trust Department concurrently work for the Broker. Also, we note that the Association, in purchasing securities as a fiduciary, will be subject to 12 C.F.R. §§ 563.42(b)(1)(i) and 563.42(b)(1)(ii), which prohibit purchases as fiduciary, respectively, of (i) securities from an affiliate unless the purchase is permitted under the trust instrument or other legal authority and (ii) securities for which the Broker is a principal underwriter.

The Protest also asks whether the Broker will discount its brokerage fees to the Trust Department. The Broker responds that a discount will be offered in its brokerage fees. This discount does not appear to constitute a prohibited or unsafe practice.

(2) The Protest states that the application ignores statutes that restrict "marketing agents" to commercial banks, limit out-of-state fiduciaries from entering , and require a proposed trust officer to have requisite experience and character. Our research indicates that the statute does not contain the term "marketing agents" (as asserted in the protest), but contains the term "originating trustee," which is an institution who opens trust accounts with customers, and a "contracting trustee," which is an institution that has entered a contract with the originating trustee and actually provides the fiduciary services. Since the Broker's personnel will only inform prospective customers of the availability of the trust services, but will not originate trust accounts the Broker would not be an originating trustee under

We agree that of the restricts corporations from acting as trustees in , but conclude that the statute does not apply to this situation. In our view, the Broker will not act as a trustee but will be a marketer of trustee services and, thus, would not be affected by the restrictions set forth in It is our view that the Broker's registered representatives' activities in marketing

the Trust Department's services in other states do not constitute the provision of fiduciary services in (or make the brokerage offices branch offices of the Association).

Although, as the Protest notes, the Association currently has no established tradition of conservative competent administration of trusts, it has not yet begun operations. The Regional Office has recommended a condition of approval, with which we concur, to require the Association to obtain the prior approval of the Regional Office of the persons proposed to be hired to conduct trust activities to make certain prior to the commencement of operations that they have the requisite ability.

(3) The Protest states that each grantor must engage an attorney in his home state to ensure compliance with the fiduciary laws of that state and a second attorney, licensed in because the Trust Department cannot act as counsel to their customers, and seems to imply that the Trust Department does not intend this. However, the Applicant acknowledges that the Trust Department It is accurate to state that each client must hire his own attorney to draft the appropriate trust agreement. Counsel for the Applicant has opined to the OTS, however, that each client would not need an additional attorney in because banks and trusts "readily accept wills and trusts drawn by non- attorneys, without requiring a second review of those instruments by counsel." The Trust Department must administer the trust agreement according to the law specified therein.

(4) Finally, the Protest questions the reasoning and conclusions of the Chief Counsel's June 1994 legal opinion that found "any state law requirement to license or prohibit the performance of such trust powers would conflict with the express authority of the OTS and would be pre-empted," complaining that pre-emption should not be found unless there is Congressional intent for federal law to occupy a given field, and that bankers and the public were not provided with public notice of the laws that would be pre-empted. The staff sees no reason to reject the reasoning or conclusions of the June 1994 opinion and does not believe that any prior public notice of the opinion was required. The Chief Counsel's opinion concludes that there is Congressional intent, evidenced in the statutory grant of trust authority, for federal law to pre-empt such state law.

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