Office of Thrift Supervision
Department of the Treasury
Chief Counsel
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

October 4, 1995

MEMORANDUM TO: [redacted]
ASSISTANT REGIONAL DIRECTOR
[redacted] REGION

FROM: Carolyn J. Buck
Chief Counsel

SUBJECT: Applicability of Section 23A of the Federal Reserve Act to the Origination and Purchase of Loans by [redacted]

I. Introduction and Summary of Conclusions

This responds to your inquiry regarding the application of section 23A of the Federal Reserve Act (the "FRA")[1] and the Federal Reserve Board ("FRB") regulation at 12 C.F.R. § 250.250 (1995) to past and proposed transactions involving [redacted] (the "Association"), and its affiliate, [redacted] (the "Developer").

For the reasons explained fully below, we conclude that the Association's past and proposed purchases of mortgage loans from the Developer are not exempt from section 23A of the FRA under 12 C.F.R. § 250.250. Nevertheless, the Association's past loan purchases will not be deemed to be violations of section 23A of the FRA to the extent that these purchases were authorized under a Federal Home Loan Bank Board ("FHLBB") approval issued pursuant to section 408(d)(6) of the National Housing Act (the "NHA").[2] Until the volume of these transactions is reduced below

[1] 12 U.S.C.A. § 371c (West 1989).

[2] 12 U.S.C.A. § 1730a(d)(6) (West 1989) (repealed 1989).

the statutory aggregate limits, however, the Association is precluded from engaging in additional covered transactions.

In addition, we conclude that the Association's direct loans to purchasers of the Developer's homes are attributed to the Developer under section 23A(a)(2) of the FRA. Because the § 250.250 exemption does not apply to these loans, we conclude that they were made in violation of the quantitative limits of section 23A of the FRA. We defer to the [redacted] Region to respond to the Association's proposal to reduce its loan portfolio to conform to the statute and to determine whether further supervisory or enforcement measures are required.

II. Background

The Developer is a builder of single family homes. It has built more than [redacted] homes since it began operations in 19[redacted] and has been profitable for [redacted] consecutive years. The Developer's net income was approximately $[redacted] million in 1994. On December 31, 1994, it held $[redacted] million in total assets and $[redacted] million in shareholder equity.

The Association is a wholly-owned subsidiary of the Developer. It was formed in [redacted] 19[redacted] to acquire substantially all the assets and to assume substantially all of the liabilities of [redacted] Savings and Loan Association in a FSLIC-assisted acquisition.

In a recent examination of the Developer, OTS examiners raised questions regarding the applicability of the limitations of section 23A of the FRA to various transactions involving purchases by the Association from the Developer and originations of loans by the Association for purchasers of the Developer's housing inventory. These transactions are discussed more fully below. In response to questions raised by the examiners, the Association has submitted a detailed statement of why it believes section 23A of the FRA does not apply to the loan purchases and loan originations. You have requested our opinion.

In addition to the legal arguments described below, the Association asserts that the lending market in which it operates is highly competitive for single-family mortgage loans and that home purchasers have a number of financing alternatives, including some of the largest financial institutions in the country. The Association alleges that loans to purchasers of the Developer's homes represent an important business opportunity for the Association, and that the Developer does not need the Association as a source of funding of its working capital needs.

A. Pre-March 1990 Purchases of Loans from the Developer

As part of the 19[redacted] FSLIC-assisted acquisition, the FHLBB approved the Association's purchase of mortgage loans originated by the Developer. This approval was issued pursuant to section 408(d)(6) of the NHA (the "FHLBB approval").[3] The Association notes that the FHLBB approval was effective until [redacted], 19[redacted], under transition provisions in section 304(b) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA").[4]

The Association commenced purchasing loans from the Developer pursuant to the FHLBB approval in 19[redacted]. The Association purchased $[redacted] million of the Developer's mortgage loans in 19[redacted] and $[redacted] million of its loans in 19[redacted]. The volume of loans purchased from the Developer in 19[redacted] and 19[redacted] is not reported. The Association did not commit to purchase any loans from the Developer after [redacted] 19[redacted], although some purchases were consummated after [redacted], 19[redacted] due to a 90-day purchase delay requirement in the FHLBB approval. On December 31, 1994, the

---

[3] 12 U.S.C.A. § 1730a(d)(6) (West 1989) (repealed 1989). Section 408(d)(6) of the NHA, the FHLBB was authorized to grant prior approval for an association to engage in certain prohibited transactions with affiliates, where the transactions would not be detrimental to the interests of savings account holders or to the insurance risk of FSLIC.

[4] Pub. L. No. 101-73, 103 Stat. 183 (1989).

aggregate unpaid principal balance for these purchased loans on the Association's books was $[redacted] million.[5]

The Association states that it conducted independent credit evaluations on each loan prior to its commitment to purchase the loan and prior to the Developer's decision to fund the loan. As required by the FHLBB approval, the Developer guaranteed the collection of principal and interest on loans purchased by the Association.

B. Direct Loans to Purchasers of the Developer's Homes

In January 19[redacted], the Association began to originate direct loans to purchasers of the Developer's homes. The Association originated loans totalling $21.4 million in 19[redacted]; $[redacted] million in 19[redacted]; $[redacted] million in 19[redacted]; $[redacted] million in 19[redacted]; and $[redacted] million in 19[redacted] The Association has not made a loan to a purchaser of one of the Developer's homes since [redacted] 19[redacted], when the [redacted] Region expressed concerns. On December 31, 1994, the Association's aggregate unpaid principal balance for these direct loans was $[redacted] million.

The Association had no written agreements with the Developer regarding the referral of prospective borrowers. The Association represents that all loans were made on an arm's-length basis and that the decision process for these loans was identical to the process for loans to purchasers of new homes built by non-affiliated builders. In all cases, a credit evaluation was performed prior to the Association's issuance of a loan commitment.

C. Proposed Purchases of Loans from the Developer

The Association and the Developer propose to implement a new loan purchase program. Under the new program, the Developer would create a new division

---

[5] For the purposes of this opinion, we have accepted as true the Association's representations that its pre-[redacted] 19[redacted] loan purchases complied with the terms of the FHLBB approval. We defer to the [redacted] Region to assess whether the purchases, in fact, complied.

("Division") that would originate single-family mortgage loans to purchasers of the Developer's homes. The Division would sell most of these loans to the Association.

Under the contemplated arrangement, the Division would generate loan applications and assemble completed loan files. The Division's employees would review the files for completeness and would preliminarily underwrite each loan under the Association's underwriting guidelines. The Division would not commit to fund the loan until the Association committed to purchase the loan.

An Association employee would review the completed loan file to determine whether the loan would be approved or disapproved under the Association's underwriting guidelines. The Association would commit to purchase the loan only after the Association's underwriter determined that the loan could be approved. Following the Association's commitment to purchase the loan, the Division would commit to fund the loan. Following loan closing, the Division would sell the loan to the Association.

III. Discussion

Section 11(a) of the Home Owners' Loan Act (the "HOLA") applies section 23A of the FRA to savings associations "in the same manner and to the same extent as if the savings association were a member bank" of the Federal Reserve System.[6] Section 23A imposes quantitative restrictions on covered transactions with affiliates.[7] These restrictions generally limit the aggregate amount of covered transactions with any affiliate to no more than 10% of the capital stock and surplus of the savings

---

[6] 12 U.S.C.A. § 1468(a) (West Supp. 1995).

[7] The Developer is an "affiliate" for purposes of Section 23A because it is a company that controls the savings association. 12 U.S.C.A. § 371c(c)(1)(A) (West 1989); see also 12 C.F.R. § 563.41(b)(1)(i) (1995).

association,[8] and limit the aggregate amount of covered transactions involving all affiliates to no more than 20% of the savings association's capital stock and surplus.[9]

Section 23A also imposes qualitative restrictions on covered transactions with affiliates. These restrictions generally prohibit purchases of low quality assets unless certain requirements are met, require covered transactions between a savings association and its affiliates to be on terms that are consistent with safe and sound banking practices, and impose collateral requirements on certain covered transactions.[10]

A. Past and Proposed Purchases of Loans from the Developer

A savings association's purchases of assets from an affiliate are "covered transactions" and are subject to the requirements of section 23A of the FRA.[11] The Association, however, maintains that its pre-19[redacted] loan purchases and its proposed loan purchases from the Developer are eligible for exemption from section 23A under a formal interpretive ruling issued by the FRB and codified at 12 C.F.R. § 250.250 (1995).

Section 250.250 is a narrowly drawn exemption to the section 23A restrictions. In this interpretive ruling, the FRB determined that an institution's purchase of a loan, without recourse, from a mortgage banker affiliate is exempt, provided: (1) the institution performs an independent evaluation of the creditworthiness of the proposed borrower(s) before it commits to purchase the loan or participation; and (2) the institution commits to purchase the loan or participation prior to the time that the affiliate commits to make the loan. The § 250.250 exemption is not available,

---

[8] 12 U.S.C.A. § 371c(a)(1)(A) (West 1989); see also 12 C.F.R. § 563.41(a)(1)(i) (1995).

[9] 12 U.S.C.A. § 371c(a)(1)(B) (West 1989); see also 12 C.F.R. § 563.41(a)(1)(ii) (1995).

[10] 12 U.S.C.A. § 371c(a)(3), (a)(4) and (c) (West 1989); see also 12 C.F.R. § 563.41(a)(5), (a)(6), and (c) (1995). Covered transactions are also subject to FRA § 23B, 12 U.S.C.A. § 371c-1 (West 1989), which, inter alia, requires transactions to be on arms' length terms.

[11] 12 U.S.C.A. § 371c(b)(7) (West 1989); see also 12 C.F.R. § 563.41(b)(7) (1995).

however, if the purpose of the loan purchase is to alleviate working capital needs of the affiliate.[12]

The FRB has not restricted the application of § 250.250 exclusively to transactions with mortgage banking affiliates. For example, the FRB has allowed an institution to purchase participations in secured commercial loans made by an affiliated finance company in reliance on § 250.250.[13] However, the FRB has never authorized § 250.250 to be utilized in situations where the affiliate is both the loan originator and the seller of the underlying property being financed, as is the case here with the Developer. [redacted]

The exemption under § 250.250 is premised upon viewing the exempted transactions essentially as independent transactions with a third party, with the affiliate playing an immaterial, intermediary role.[14] In this regard, there are significant distinctions between the interests of a mortgage banking affiliate described in § 250.250 and an affiliated developer seeking to facilitate the sale of its housing inventory.

A mortgage banker has substantially less at stake in lending and home purchase transactions than does a developer. At the outset of the transaction, the mortgage banker typically will lack any financial interest in the asset that will secure the loan. Moreover, its interest in the loan transaction will be limited to the fees generated from

---

[12] See 12 C.F.R. § 250.250(c) (1995) (exemption not available where an institution is impelled by a improper incentive to alleviate the working capital needs of the affiliate that are directly attributable to excessive outstanding commitments); Op. Bd. of Govs. of the Fed. Res. Sys. (May 2, 1990) (a bank's purchase of assets from an affiliate under the exemption may not be used to finance the activities of the affiliate); Op. Bd. of Govs. of the Fed. Res. Sys. (June 18, 1979) (transactions under the exemption may not constitute an arrangement for the bank to provide working capital to the affiliate).

[13] Op. Bd. of Govs. of the Fed. Res. Sys. (June 18, 1979) ("the rationale of [§250.250] may be extended to encompass loans made by organizations other than a mortgage banking affiliate provided the prerequisites of [§ 250.250] may be fulfilled").

[14] OTS Op. Chief Counsel (July 12, 1990).

the origination, processing and sale of the loan. As a consequence, the risks to the mortgage banker if a transaction is not consummated are limited to the loss of these fees. This modest interest in the individual transaction, coupled with other § 250.250 protections, work to ensure that an institution's decision to purchase a loan from an affiliated mortgage banker will be based on the association's independent assessment of the loan as an investment, rather than any exigencies faced by that affiliate.

By contrast, a developer has a considerable investment in, and liability with regard to, its housing inventory. A developer owns the underlying assets and is responsible for any debts incurred to finance, develop and maintain that inventory. Under these circumstances, the failure of a home purchaser to obtain financing as a result of an association's refusal to purchase the loan would have a greater impact on the developer than on a mortgage broker. In addition to the loss of origination and processing fees, the developer would be deprived of the sale proceeds until another buyer could be found. Such delays may negatively effect the developer's ability to service its debts and create a substantial danger that the association may be influenced by the needs of the developer to sell its inventory, rather than the merits of the investment in the loan. In a highly competitive housing sales market such as [redacted], there may be a significant incentive for an association to relax its judgment and approve loans to marginal or unqualified home purchasers in order to facilitate sales of an affiliated developer's inventory. This dependent relationship is precisely what § 250.250 seeks to avoid.[15]

For these reasons, we believe that the Developer's interest in the underlying sales transactions could create significant pressures on the Association to relax its credit standards. Accordingly, we conclude that the Association's purchases of mortgage loans from the Developer do not fall within § 250.250 exemption and are subject to the quantitative and qualitative restrictions of section 23A of the FRA.[16]

---

[15] See OTS Op. Chief Counsel (Dec. 22, 1992).

[16] There may be additional impediments to the application of the § 250.250 exemption. For example, the § 250.250 exemption is not available if the purpose of the transaction is to alleviate the working capital needs of the affiliate. The Association states that it will purchase "most" of the single family loans originated by the Division. The FRB has not established a specific limit on the volume or percentage of transactions that

The Association, however, argues that the pre-[redacted] 19[redacted] loan purchases continue to be exempt from section 23A pursuant to the FHLBB approval. The Association notes that the transition provision in section 304(b) of FIRREA[17] does not address whether the consummated transactions became subject to section 23A of the FRA upon the expiration of the FHLBB approval on [redacted], 19[redacted], or whether these purchased loans may be retained without regard to section 23A restrictions.

The OTS has established a policy with regard to covered transactions consummated prior to the enactment of FIRREA. We find no basis to treat these purchases of loans differently. The policy was announced in the preamble to the regulations implementing the section 23A requirements. The OTS stated:

> In the interests of safety and soundness, the OTS has determined that institutions should strive to achieve compliance with the limitations of section 23A as soon as feasible, and that transactions entered into prior to the enactment of FIRREA, if they would otherwise be deemed to be outstanding covered transactions, should be included in calculating an association's covered transactions. In the event this results in an

---

would qualify for the exception under 12 C.F.R. § 250.250. However, FRB staff have advised us that, in their view, when an institution buys more than 50% of the affiliate's loan production, the transactions begin to appear to be more of a funding mechanism for the affiliate and less of an investment opportunity for the institution. This percentage is, of course, only one indicia to be considered in assessing whether a transaction operates as a funding mechanism. In certain situations, it is possible that an association's loan purchases could operate as a funding mechanism even though such purchases constitute less than 50% of the affiliate's loan production. OTS Op. by Chief Counsel (Sept. 8, 1995); see also OTS Op. Chief Counsel (Apr. 14, 1993) (institution's purchase of greater than 50% of the loans originated by an affiliate fell within § 250.250 exemption where purchases constituted less than 25% of the affiliate's profit from overall annual business income).

FRB staff have also indicated that the § 250.250 exception may not be available where a substantial percentage of an institution's capital is invested in loans held in portfolio that were originated by an affiliate. OTS Op. Chief Counsel (Sept. 8, 1995); see FDIC Op. by Chavarria (Aug. 29, 1995) (purchases representing 100 percent of the institution's capital raise significant safety and soundness concerns). We do not have sufficient data to analyze this factor for all past periods during which the Association purchased loans from the Developer. However, we note that the Association purchased $[redacted] million of the Developer's loans in 19[redacted] and retained substantially all of these loans in its portfolio at least through December 31, 19[redacted]. On that date, the Association's capital and surplus was approximately $[redacted]. The amount of loans retained in the Association's portfolio was more than 450% of its capital and surplus.

[17] Pub. L. No. 101-73, 103 Stat. 183 (1989).

association's covered transactions exceeding [the applicable section 23A limitations], the OTS expects the association to take steps that are reasonably practical to reduce its covered transactions to permissible levels. The OTS will not deem pre-FIRREA transactions to be violations of section 23A, but an association may not enter into any new covered transactions unless and until its existing covered transactions are reduced below permissible limits, and then, only to the extent allowable under section 23A.[18]

Based on the Association's capital and surplus as of December 31, 1994, the Association states that its 10% limit was $[redacted] million and that its 20% limitation was $[redacted] million. As of December 31, 1994, the aggregate principal balance of the loans purchased under the FHLBB approval totalled $[redacted] million, $[redacted] million in excess of the 10% limitation and $[redacted] million in excess of the 20% limitation.

In accordance with the above discussion, we conclude that the Association is not in violation of the aggregate limits of section 23A of the FRA based on the pre-[redacted] 19[redacted] loan purchases. However, until these transactions (and any other pre-FIRREA covered transactions) are reduced to the aggregate limits permissible under section 23A of the FRA, any additional post-FIRREA covered transactions would violate section 23A of the FRA, unless otherwise exempted. As explained above, future purchases of mortgage loans from the Developer would not be exempt.

---

[18] 56 Fed. Reg. 34005, 34006 (July 25, 1991). The Association asserts that the OTS has concluded that post-FIRREA purchases from affiliates conducted pursuant to waivers issued under section 408(m) of the NHA (12 U.S.C.A. § 1730a(m)(West 1989)(repealed 1989) (Emergency Thrift Acquisitions)) are not included in the calculation of the quantitative limitations under section 23A and cites OTS Op. Deputy Chief Counsel (June 28, 1990), n. 3 at 12 in support of this assertion. The Association argues that transactions subject to section 408(d) approvals should be treated similarly.

The opinion cited by the Association addressed the validity of section 408(d) approvals and section 408(m) waivers following FIRREA. Finding that a specific section 408(m) waiver granted for a ten-year term was unaffected by FIRREA, OTS stated that transactions conducted pursuant to the waiver "could be ignored" for purposes of determining whether other transactions with affiliates were within section 23A quantitative limits. While the opinion unquestionably addressed the treatment of waived transactions during the life of the waiver (i.e., through 1998), it did not address the treatment of transactions following the termination of the waiver. In light of the lack of any discussion of this issue, the OTS does not believe that the cited opinion supports a deviation from the policy encouraging prompt conformance to the Section 23A limits.

B. Direct Loans to Purchasers of the Developer's Homes

In addition to the Association's purchases of mortgage loans from the Developer, the Association commenced making direct loans to purchasers of the Developer's housing inventory in 19[redacted]. Covered transactions under section 23A of the FRA include loans or extensions of credit to an affiliate.[19] Although the purchasers of the Developer's homes are not "affiliates" as defined in the statute,[20] section 23A of the FRA provides that any transaction by a savings association "with any person shall be deemed to be a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that affiliate" (the "Attribution Rule").[21]

The Association argues that the Attribution Rule is not applicable to loans made by the Association to the purchasers of the Developer's housing inventory because the Developer received no benefit from these loans. The Association asserts that "the competitive market for home lending would produce the same result for [the Developer] even if [the Association] were not an affiliate."

In each such transaction, however, the Developer was an indirect recipient of proceeds of a loan supplied by the Association to a home purchaser. Although the home purchaser might have received a loan from another source if the Association had not provided the loan, the Association did provide the loan and, thus, was the source of the proceeds transferred to the Developer. We are unaware of any precedent that would support the Association's contention that an exception should be made to the

---

[19] 12 U.S.C.A. § 371c(b)(7)(A) (West 1989); see also 12 C.F.R. § 563.41(b)(7)(i) (1995).

[20] 12 U.S.C.A. § 371c(b)(1) (West 1989); see also 12 C.F.R. § 563.41(b)(1) (1995).

[21] 12 U.S.C.A. § 371c(a)(2) (West 1989); see also 12 C.F.R. § 563.41(a)(2) (1995). By contrast, section 11(a) of the HOLA, which prohibits a savings association from making loans or extensions of credit to affiliates engaged in impermissible bank holding company activities (e.g., real estate development), does not include an Attribution Rule. 12 U.S.C.A. § 1468(a) (West 1989). The OTS has declined, as a general matter, to graft an Attribution Rule to section 11 of the HOLA. Accordingly, the OTS has determined that loans by a savings association to third party purchasers of real estate owned by an affiliate are not prohibited, provided the third party transactions are bona fide, and not pre-arranged steps in a series of transactions designed to transfer funds to the affiliate. OTS Ops. Chief Counsel (Mar. 13, 1992) and (Dec. 22, 1992).

Attribution Rule in situations where a hypothetical third party might have been willing to make the loan if the Association had not done so.

The Association further argues that the application of the Attribution Rule to these loans is inconsistent with the purpose of section 23A. The Association represents that the Attribution Rule was intended only to prevent sham transactions in which moneys are funneled to an affiliate through a third party in excess of the section 23A limits. The Association also claims that the Attribution Rule does not apply to transactions in which the depository institution makes an independent credit evaluation of a third party borrower.

The OTS, however, does not believe that the purposes of the Attribution Rule are so circumscribed. Rather, the Attribution Rule was intended to limit transactions where "the potential exists that the bank's credit judgment could be affected by its relationship with the affiliate to the detriment of the bank."[22] Thus, the FRB has applied the Attribution Rule in situations where an institution provides funds to a third party borrower to finance the purchase of assets from an affiliate. In such circumstances, the FRB has concluded that a potential exists that an institution may be improperly influenced in the transaction because of the affiliate's need for funds.[23]

The Association cites two interpretive letters issued by the Office of the Comptroller of the Currency (the "OCC") in support of its argument that the Attribution Rule should not apply where the Association has made an independent credit evaluation of a third party borrower. We do not agree, however, that the Association's argument accurately reflects the OCC's interpretations of the Attribution Rule.

The OCC has long held the view that a fair reading of section 23A(a)(2) requires transactions between an institution and a third party to be attributed to the

---

[22] Op. Bd. of Govs. of the Fed. Res. Sys. (Mar. 21, 1988) (proceeds of a bank's loan to an unaffiliated third party used to acquire an affiliate's ownership interest in a subsidiary corporation).

[23] Id.

institution's affiliate if the affiliate receives the proceeds or the benefit of the proceeds of the transaction.[24] The OCC has applied this principle where, as here, an institution has made a loan to a third party for the purpose of purchasing assets or services from its affiliate.[25]

Moreover, the OCC interpretive letters cited by the Association are distinguishable. Under the facts reported in one OCC letter, a bank affiliate provided settlement services on credit cards issued by the bank.[26] When a cardholder purchased goods from a merchant, the affiliate reimbursed the merchant for the purchase price and received a servicing fee from the merchant. The affiliate, in turn, obtained reimbursement of the purchase price from the bank, which debited the cardholder's account. Although the OCC noted that the bank conducted an independent credit evaluation of the cardholders, its analysis focused primarily on the lack of a direct relationship between the affiliate and the cardholder. As a result, the OCC concluded that there was little danger that the institution would be pressured by the affiliate to relax its sound credit judgment to extend credit to particular cardholders. In addition, we note that the affiliate's participation in the transactions was limited to the ministerial act of advancing money to merchants on behalf of the bank upon the consummation of credit card transactions, and the receipt of a service fee from the merchants for the clearing house services. In this intermediary capacity, it is highly unlikely that the affiliate could receive preferential treatment from the bank or, absent fraudulent collusion with merchants or others, cause any harm to the bank.[27] By contrast, for the reasons stated above with regard to loan purchases, the

---

[24] OCC Unpublished Interpretative Letter by Marsico (Oct. 18, 1989).

[25] OCC Interpretative Letter No. 656, reprinted in Fed. Banking L. Rep. (CCH) ¶ 83,604 (Mar. 13, 1995) (loan to a third party for the purpose of financing commissions owed to a bank affiliate); OCC Unpublished Interpretative Letter by Marsico (Oct. 18, 1989) (loan to a third party ESOP for the purpose of purchasing shares of a bank affiliate). Neither interpretive letter hints that the practice of conducting a independent credit evaluation of a borrower would exempt transactions from the Attribution Rule.

[26] OCC Interpretive Letter 565, reprinted in Fed. Banking L. Rep. (CCH) ¶ 83,319 (Nov. 27, 1991).

[27] See also OCC Interpretive Letter 266, reprinted in Fed. Banking L. Rep. (CCH) ¶ 85,430 (July, 28, 1983). This interpretive letter involved a bank's issuance of a standby letter of credit backing a third party's guarantee of the repayment of a loan made by the bank's affiliate to a subsidiary of the third party. In this

likelihood that the Association would be pressured by the Affiliate to give preferential treatment is substantial where third party loans support the sale of the affiliate's inventory.

Finally, the Association claims that the Attribution Rule should not be applicable here because its loans were economically identical to, and subject to the same protections as, transactions exempted from section 23A limitations under § 250.250. We have already concluded above that the transactions proposed by the Association would not be exempt under § 250.250 even if structured as loan purchases instead of loan originations. Thus, we need not consider whether an exemption could be provided for loan originations that would meet the requirements of § 250.250, but for the fact that they are not structured as purchases.

We conclude, therefore, that the Association's loans to purchasers of the Developer's housing inventory must be attributed to the Developer under section 23A(a)(2) of the FRA. As stated above, the Association is under a continuing obligation to reduce the $[redacted] million balance on pre-[redacted] 19[redacted] loan purchases. Because the remaining unpaid principal balance on these covered transactions, at all times subsequent to [redacted] 19[redacted], exceeded the 10% and 20% limits in section 23A, the Association was also prohibited from making any additional covered transactions. Consequently, all of the Association's loans to the purchasers of the Developer's homes violated the quantitative limits of section 23A of the FRA.[28]

The Association represents that it has commenced efforts to reduce its loan portfolio and has already sold, or packaged as mortgage-backed securities for sale, approximately $[redacted] million of these loans. To enable it to reestablish compliance in a safe and sound manner, the Association requests that it be permitted until December

---

interpretive letter, the OCC concluded that the danger of abuse by the affiliate was minimal because the obligor on the letter of credit issued by the bank was an unrelated third party, not the affiliate.

[28] Additionally, it is unclear whether the other requirements of Section 23A and 23B of the FRA were met by these loans. E.g., Section 23A requires that loans to affiliates that are collateralized by real property must be secured by collateral having a market value equal of at least 130% of the amount of the loan. 12 U.S.C.A. § 371c(c)(1)(D) (West 1989).

31, 19[redacted] to conform its loan portfolio to the section 23A limitations. We defer to the [redacted] Regional Office to assess the reasonableness of the Association's proposed schedule for conforming its portfolio to section 23A and to determine whether further supervisory or enforcement measures would be appropriate.

In reaching the conclusions set forth herein, we have relied upon the representations contained in the Association's written submissions, as supplemented by the Region, as summarized herein. Our conclusions depend upon the accuracy and completeness of those representations. Any material change in circumstances from those described herein might require different conclusions.

If you have any questions regarding the foregoing, please feel free to call Karen Osterloh, Counsel (Banking and Finance), at (202) 906-6639.

cc: All Regional Directors
All Regional Counsel