

indirectly, exercises a controlling influence over the management or policies of the other company. 12 CFR 223.3(g)(1).

Regulation W also includes specific provisions addressing ownership or control of shares as a fiduciary, securities by a subsidiary, convertible instruments, and nonvoting equity securities. *See* 12 CFR 223.3(g)(2)–(5).

Until today, OTS's transactions with affiliates regulation included a more expansive concept of control than prescribed by the FRB in final Regulation W. Specifically, OTS's prior rule stated that a company or shareholder has control over another company if the company or shareholder, directly or indirectly, or acting through one or more other persons owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the other company or if the company or shareholder would be deemed to control another company under § 574.4(a) or presumed to control the company under § 574.4(b). *See* 12 CFR 563.41(b)(3) (2002). OTS also applied its own concepts of control to define a subsidiary of a savings association. 12 CFR 563.41(b)(4)(2002). This definition stated that a subsidiary of a savings association is a company that is controlled by a savings association within the meaning of part 574.

The major substantive difference between the control definitions in the prior OTS rule and final Regulation W involved the application of certain OTS rebuttable presumptions of control from part 574. For example under these control presumptions, a company will control another if it owns between 10 percent and 25 percent of any class of a company's voting stock and one or more control factors is present.<sup>7</sup> Regulation W does not have similar provisions.<sup>8</sup>

The interim final rule continued to incorporate OTS concepts of control, but requested comment on whether the OTS definition of control was appropriate. One commenter addressed this issue and urged OTS to conform its rule more closely to Regulation W.

<sup>7</sup> 12 CFR 574.4(b)(1)(i). The eight control factors are described at 12 CFR 574.4(c) and include situations where an acquiror would: (1) be one of the two largest holders of any class of voting stock; (2) hold more than 25 percent of the total stockholders' equity; or (3) hold more than 35 percent of the combined debt securities and stockholders' equity.

<sup>8</sup> OTS's rule is more expansive in other ways. For example, under 12 CFR 574.4(b)(1)(ii) an acquiror has rebuttable control of a company if it directly or indirectly owns more than 25 percent of any class of stock and is subject to a control factor listed at 12 CFR 574.4(c). FRB does not have a similar provision.

When OTS originally promulgated its transactions with affiliates rule in 1991, FRB had promulgated no rules interpreting the meaning of control under sections 23A and 23B. In the absence of such guidance, OTS defined control for transactions with affiliates consistently with other OTS rules addressing similar concepts. At the time, part 574 represented OTS's most current and comprehensive analysis of control issues. Most savings associations had some familiarity with the control concepts in part 574.

Now that FRB has issued final rules interpreting the definition of control for sections 23A and 23B it is difficult to articulate any regulatory purpose that would be furthered by continuing to prescribe a different definition. Applying part 574 control concepts to transactions with affiliates restricts savings associations in two ways. First, it broadens the application of the section 23A and 23B restrictions for thrifts in comparison to similarly situated member banks. OTS does not believe that savings association transactions with the additional "affiliates" reached by the OTS control definitions raise safety and soundness concerns that necessitate treating them differently from similarly situated member banks. Indeed, the application of the OTS definition of control leads to anomalous results because a company with identical relationships to a bank and a savings association in the same bank holding company structure could have been an affiliate of the savings association under the OTS interim rule, but not an affiliate of the member bank under Regulation W.

Second, the application of the part 574 control concepts also expands the scope of the additional prohibitions imposed under section 11 of the HOLA. These prohibitions apply only to savings associations engage in a greater range of activities than affiliates of banks, which may expose the savings association to greater risk.<sup>9</sup> There is no indication that Congress was concerned about the risks posed by relationships with companies that do not meet the definition of affiliate in section 23A. Indeed, the statute appears to contemplate that OTS would use the same definitions of "control" and "affiliate" as set forth in section 23A and Regulation W.<sup>10</sup> Accordingly, to

promote consistency and equal treatment of insured depository institutions to the maximum extent possible, OTS has revised the final rule to use Regulation W control concepts.

Certain companies will no longer be considered to be savings association affiliates under the revised definitions in the final rule. OTS may, nonetheless, continue to treat such a company as an affiliate if it has a relationship with a savings association or any affiliate of the savings association such that covered transactions by the savings association with the company may be affected by the relationship to the detriment of the savings association, or where the company presents a risk to the safety and soundness of the savings association.<sup>11</sup>

While certain companies will no longer be subject to the full range of restrictions and prohibitions under section 11 of the HOLA, some restrictions will continue to apply. For example, transactions between a savings association and a non-affiliate are subject to the "market terms" standards under section 23B, if an affiliate of the savings association has a financial interest in the non-affiliate. Thus, the market terms requirements will continue to apply to these entities.

As a related matter, OTS has identified an area where the OTS control rules may not have been as rigorous as final Regulation W. The definition of control in final Regulation W includes two provisions, not specifically addressed in section 23A, which discuss the treatment of convertible securities and nonvoting equity securities.<sup>12</sup> While the OTS control rules address similar concepts, the two rules are not identical.<sup>13</sup> As a

savings association were a member bank (as such term is defined in such Act) shall be deemed to be an affiliate of such savings association for purposes of [section 11(a)(1) of the HOLA].

<sup>11</sup> Final rule at paragraph (b)(3), which incorporates 12 CFR 223.2(a)(12).

<sup>12</sup> 12 CFR 223.3(g)(4) and (5).

<sup>13</sup> Specifically, Regulation W creates a rebuttable presumption that states "[a] company or shareholder that owns or controls instruments (including options or warrants) that are convertible or exercisable, at the option of the holder or owner, into securities" will be deemed to control the securities. 12 CFR 223.3(g)(4). Options or warrants are subject to the rebuttable presumption even though the holder may not exercise the option or warrant immediately. 67 FR 76560, at 76568. OTS's comparable provision at 12 CFR 574.2(u)(3) includes convertible securities as voting stock where the holder has "the preponderant economic risk in the underlying voting stock."

In addition, final Regulation W establishes a rebuttable presumption that control includes ownership or control of 25 percent or more of a company's "equity" capital. 12 CFR 223.3(g)(5). The comparable references to ownership of equity capital in OTS's rules either: (1) Refer to the contribution of more than 25 percent of the capital

<sup>9</sup> H.R. Rep. No. 101-122, at 408 (1989).

<sup>10</sup> Section 11(a)(3) states: Any company that would be an affiliate (as defined in sections 23A and 23B of the Federal Reserve Act [12 U.S.C. 371c and 371c-1]) of any savings association if such