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the eligible affiliated mutual fund securities that would serve as collateral for the loan. Under the attribution rule in § 223.16, the member bank must treat the loan to the nonaffiliate as a loan to an affiliate, and, because securities issued by an affiliate are ineligible collateral under § 223.14, the loan would not be in compliance with § 223.14.

Subpart D—Other Requirements Under Section 23A

§ 223.31 How does section 23A apply to a member bank's acquisition of an affiliate that becomes an operating subsidiary of the member bank after the acquisition?

(a) *Certain acquisitions by a member bank of securities issued by an affiliate are treated as a purchase of assets from an affiliate.* A member bank's acquisition of a security issued by a company that was an affiliate of the member bank before the acquisition is treated as a purchase of assets from an affiliate, if:

(1) As a result of the transaction, the company becomes an operating subsidiary of the member bank; and

(2) The company has liabilities, or the member bank gives cash or any other consideration in exchange for the security.

(b) *Valuation.* (1) *Initial valuation.* A transaction described in paragraph (a) of this section must be valued initially at the greater of:

(i) The sum of:

(A) The total amount of consideration given by the member bank in exchange for the security; and

(B) The total liabilities of the company whose security has been acquired by the member bank, as of the time of the acquisition; or

(ii) The total value of all covered transactions (as computed under this part) acquired by the member bank as a result of the security acquisition.

(2) *Ongoing valuation.* The value of a transaction described in paragraph (a) of this section may be reduced after the initial transfer to reflect:

(i) Amortization or depreciation of the assets of the transferred company, to the extent that such reductions are consistent with GAAP; and

(ii) Sales of the assets of the transferred company.

(c) *Valuation example.* The parent holding company of a member bank contributes between 25 and 100 percent of the voting shares of a mortgage company to the member bank. The parent holding company retains no shares of the mortgage company. The member bank gives no consideration in exchange for the transferred shares. The mortgage company has total assets of \$300,000 and total liabilities of \$100,000. The mortgage company's assets do not include any loans to an affiliate of the member bank or any other asset that would represent a separate covered transaction for the member bank upon consummation of the share transfer. As a result of the transaction, the mortgage company becomes an operating subsidiary of the member bank. The transaction is treated as a purchase of the assets of the mortgage company by the member bank from an affiliate under paragraph (a) of this section. The member bank initially must value the transaction at \$100,000, the total amount of the liabilities of the mortgage company. Going forward, if the member bank pays off the liabilities, the member bank must continue to value the covered transaction at \$100,000. If the member bank, however, sells \$15,000 of the transferred assets of the mortgage company or if \$15,000 of the transferred assets amortize, the member bank may value the covered transaction at \$85,000.

(d) *Exemption for step transactions.* A transaction described in paragraph (a) of this section is exempt from the requirements of this regulation (other than the safety and soundness requirement of § 223.13 and the market terms requirement of § 223.51) if:

(1) The member bank acquires the securities issued by the transferred company within one business day (or such longer period, up to three months, as may be permitted by the member bank's appropriate Federal banking agency) after the company becomes an affiliate of the member bank;

(2) The member bank acquires all the securities of the transferred company that were transferred in connection with the transaction that made the

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company an affiliate of the member bank;

(3) The business and financial condition (including the asset quality and liabilities) of the transferred company does not materially change from the time the company becomes an affiliate of the member bank and the time the member bank acquires the securities issued by the company; and

(4) At or before the time that the transferred company becomes an affiliate of the member bank, the member bank notifies its appropriate Federal banking agency and the Board of the member bank's intent to acquire the company.

(e) *Example of step transaction.* A bank holding company acquires 100 percent of the shares of an unaffiliated leasing company. At that time, the subsidiary member bank of the holding company notifies its appropriate Federal banking agency and the Board of its intent to acquire the leasing company from its holding company. On the day after consummation of the acquisition, the holding company transfers all of the shares of the leasing company to the member bank. No material change in the business or financial condition of the leasing company occurs between the time of the holding company's acquisition and the member bank's acquisition. The leasing company has liabilities. The leasing company becomes an operating subsidiary of the member bank at the time of the transfer. This transfer by the holding company to the member bank, although deemed an asset purchase by the member bank from an affiliate under paragraph (a) of this section, would qualify for the exemption in paragraph (d) of this section.

§ 223.32 What rules apply to financial subsidiaries of a member bank?

(a) *Exemption from the 10 percent limit for covered transactions between a member bank and a single financial subsidiary.* The 10 percent quantitative limit contained in § 223.11 does not apply with respect to covered transactions between a member bank and a financial subsidiary of the member bank. The 20 percent quantitative limit contained in § 223.12 does apply to such transactions.

(b) *Valuation of purchases of or investments in the securities of a financial subsidiary.* (1) *General rule.* A member bank's purchase of or investment in a security issued by a financial subsidiary of the member bank must be valued at the greater of:

(i) The total amount of consideration given (including liabilities assumed) by the member bank in exchange for the security, reduced to reflect amortization of the security to the extent consistent with GAAP; and

(ii) The carrying value of the security (adjusted so as not to reflect the member bank's pro rata portion of any earnings retained or losses incurred by the financial subsidiary after the member bank's acquisition of the security).

(2) *Carrying value of an investment in a consolidated financial subsidiary.* If a financial subsidiary is consolidated with its parent member bank under GAAP, the carrying value of the member bank's investment in securities issued by the financial subsidiary shall be equal to the carrying value of the securities on parent-only financial statements of the member bank, determined in accordance with GAAP (adjusted so as not to reflect the member bank's pro rata portion of any earnings retained or losses incurred by the financial subsidiary after the member bank's acquisition of the securities).

(3) *Examples of the valuation of purchases of and investments in the securities of a financial subsidiary.* The following are examples of how a member bank must value its purchase of or investment in securities issued by a financial subsidiary of the member bank. Each example involves a securities underwriter that becomes a financial subsidiary of the member bank after the transactions described below.

(i) *Initial valuation.* (A) *Direct acquisition by a member bank.* A member bank pays \$500 to acquire 100 percent of the shares of a securities underwriter. The initial carrying value of the shares on the member bank's parent-only GAAP financial statements is \$500. The member bank initially must value the investment at \$500.

(B) *Contribution of a financial subsidiary to a member bank.* The parent