

## OFFICE OF THRIFT SUPERVISION

### Approval of Service Corporation Application

**Order No. 2002-29**

**Date: August 5, 2002**

**Re: Docket No. 4149**

Eaton Federal Savings Bank, Charlotte, Michigan (Savings Bank) has applied to the Office of Thrift Supervision (OTS), pursuant to 12 U.S.C. § 1828(m) and 12 C.F.R. Part 559, to make a cash investment, through its existing first-tier Michigan-chartered service corporation, Discovery Financial Service Corporation (Service Corporation). The Service Corporation will place funds in a "protected cell" sponsored by a Vermont-chartered reinsurance company (Insurance Company) to reinsure private mortgage insurance on loans originated by the Savings Bank. (The foregoing is referred to as the Application.)

The Insurance Company was formed under Vermont's "Sponsored-Cell" legislation, in order to enter into reinsurance arrangements with various entities. For each entity with which the Insurance Company does business, the Insurance Company establishes a separate "cell." Each cell has financial responsibility, under Vermont law, only for reinsurance arrangements pertaining to that cell.<sup>1</sup> Funds in the Service Corporation's cell could not be used to satisfy liabilities of other cells or of the Insurance Company.

The Service Corporation, through the protected cell, will reinsure a portion of losses on private mortgage insurance written on mortgages originated by the Savings Bank for which mortgage insurance has been provided by an affiliate of the Insurance Company (Mortgage Insurer). In consideration for the protected cell assuming certain reinsurance risks, the Mortgage Insurer will cede a portion of its premium.

Under the terms of the reinsurance agreements, the Insurance Company will administer the protected cell, and related funds. In connection with the agreements, the Mortgage Insurer will deposit ceded premiums in a trust established by the Insurance Company for the benefit of the Mortgage Insurer. The purpose of the trust is to secure the reinsurance obligations of the protected cell by holding premiums ceded by the Mortgage Insurer.

OTS regulations, at 12 C.F.R. § 559.4(a), provide that a service corporation of a federal association may engage in "any activity that all federal savings associations may conduct directly, except taking deposits." OTS has concluded that federal associations may engage in activities of the type contemplated in the Application, pursuant to their incidental authority.<sup>2</sup>

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<sup>1</sup> Vt. Stat. Ann. Tit. 8, § 6021.

<sup>2</sup> See Op. C. C. (March 11, 1999).

Section 5(c)(4)(B) of the Home Owners' Loan Act provides that a federal association may make investments in the capital stock, obligations, or other securities of any corporation organized under the laws of the State in which federal savings association's home office is located, if such corporation's entire capital stock may be purchased only by savings associations of such state and federal associations with their home office in the state. The Savings Bank's Service Corporation is chartered under Michigan law. The Savings Bank's home office is located in Michigan, and the Savings Bank owns all of the Service Corporation's stock. Accordingly, the Application meets these section 5(c)(4)(B) requirements.

Federal savings associations may invest up to three percent of assets in service corporations, provided that any investment in excess of two percent of assets must serve primarily community, inner city, or community development purposes.<sup>3</sup> In addition, OTS may, at any time, limit a savings association's investment in a service corporation, or may limit or refuse to permit any activities of a service corporation, for supervisory, legal, or safety and soundness reasons.

The Savings Bank's total investment in service corporations will be within the statutory and regulatory limits. Based on the Application, OTS concludes that the proposed Service Corporation investment is not objectionable on safety and soundness or supervisory grounds, provided that the Savings Bank and the Service Corporation satisfy the conditions set forth below, which are intended to ensure that the proposed activities do not raise supervisory concerns, in a manner satisfactory to the Regional Director, or his designee (together, the Regional Director).

For the reasons set forth above, OTS has determined that the Application satisfies all applicable approval standards and criteria, and the Application is hereby approved, subject to the following conditions:

1. The Service Corporation must commence the activities proposed in the Application within 120 calendar days from the date of this Order. This time period may be extended for up to 120 calendar days, for good cause, by the Regional Director;
2. The Savings Bank must obtain written clearance from the Regional Director prior to approving any material deviation from the activities, facts, representations or level of investment described in the Application;
3. While the Service Corporation is a subsidiary of the Savings Bank, the portion of reinsurance risk assumed by the Service Corporation attributable to the Savings Bank must be considered: (i) in determining the loan-to-value ratio for loans on the Savings Bank's books for purposes of determining whether such loans exceed the Supervisory Loan-to-Value Limits set forth in the Appendix to 12 C.F.R. § 560.101, and (ii) in determining whether such loans are "Qualifying Mortgage Loans" for risk-weighting purposes set forth in 12 C.F.R. Part 567;

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<sup>3</sup> 12 C.F.R. § 559.5.

4. While the Service Corporation is conducting the proposed insurance activity, the Savings Bank, for purposes of calculating its regulatory capital as provided in 12 C.F.R. § 567.6(b), must treat the amount of the Service Corporation's maximum reinsurance obligation on any loan that the Savings Bank has sold as a loan sold with recourse; and
5. Before commencing the reinsurance operation, the Savings Bank's counsel must provide a reasoned legal opinion, satisfactory to the Regional Director, concluding that the proposed reinsurance activity is permissible under § 8 of the Real Estate Settlement Procedures Act (RESPA). The opinion must include an analysis of the factors considered in the letter of August 6, 1997, on captive reinsurers issued by the Office of the Assistant Secretary for Housing-Federal Housing Commissioner, Department of Housing and Urban Development.

By order of the Director of the Office of Thrift Supervision, or his designee, effective

August 5, 2002.



Scott M. Albinson  
Managing Director  
Office of Supervision