

OFFICE OF THRIFT SUPERVISION

Approval of Service Corporation Application

Order No. 2003-10

Date: March 28, 2003

Re: Docket No. 13558

The Hometown Bank, Asheville, North Carolina, a federal savings bank (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, for its existing first-tier North Carolina-chartered service corporation, Western North Carolina Service Corporation (Service Corporation), to make a cash investment in, and enter into a mortgage reinsurance arrangement with, a Vermont-chartered reinsurance company (Insurance Company), to reinsure private mortgage insurance on loans originated by the Savings Bank. In addition, the Savings Bank has applied to establish the Insurance Company as a lower-tier entity within the scope of 12 C.F.R. Part 559. (The foregoing is referred to as the Application.)

The Insurance Company is a Vermont-chartered insurance company that will enter into reinsurance arrangements with various entities. Under the proposed reinsurance arrangement, which complies with Vermont law, the Service Corporation will purchase one share of common stock of the Insurance Company, and the Service Corporation will enter into a shareholder agreement with the Insurance Company.

The Service Corporation, through the structure of obligations created by the shareholder agreement and a reinsurance agreement, 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 Service Corporation assuming certain reinsurance risks, the Mortgage Insurer will cede a portion of the premium it receives to the Service Corporation.

OTS regulations, at 12 C.F.R. § 559.3(e)(2), provide that a service corporation of a federal association may, subject to OTS approval, engage in an "activity reasonably related to the activities of financial institutions." Under this standard, OTS has previously determined that a service corporation of a federal association may reinsure private mortgage insurance issued by third parties for loans originated or purchased by the association, its mortgage lending subsidiaries, or its mortgage lending affiliates.¹ Accordingly, the Service Corporation's proposed activity is permissible.

The Insurance Company, however, through various agreements with several institutions, will reinsure loans issued by other depository institutions that also have

¹ See, Op. C.C. (Nov. 2, 1998).

purchased stock of the Insurance Company. OTS has permitted similar arrangements.² In this case, the Insurance Company will be engaged exclusively in mortgage reinsurance activities, pursuant to discrete agreements with each participating institution, which will be similar to the proposed agreement with the Service Corporation. The stock investment of each participating institution will be nominal, and one participant's exposure to losses incurred by another participant will be minimal. Although the Insurance Company will contractually be subject to some level of reinsurance risk, the structure of obligations created by the shareholder agreements and reinsurance agreements are intended to minimize this risk, and the Insurance Company's primary role in these arrangements is establishing and administering the relationship with the relevant participant. The Insurance Company's role, then, is similar to the historic function of service corporations, of enabling depository institutions to provide services on a coordinated basis. Based on the foregoing, OTS concludes that the Insurance Company's activities are permissible.

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 a 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 Service Corporation is chartered under North Carolina law. The Savings Bank's home office is located in North Carolina, 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.³ 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 activity, and establishment of the Insurance Company as a lower-tier subsidiary, 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.

For the reasons set forth above, OTS has determined that the Application satisfies all applicable approval standards and criteria, provided that the following conditions are complied with in a manner satisfactory to the Southeast Regional Director, or his

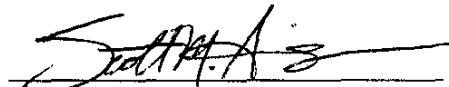
² See, Op. C.C. (March 11, 1999), and OTS Orders No. 2001-09 and 2001-10 (April 4, 2001).

³ 12 C.F.R. § 559.5.

designee (together, the Regional Director). Accordingly, 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; and
4. While the Service Corporation maintains its relationship with the Insurance Company, the Savings Bank, for purposes of calculating its regulatory capital as provided in 12 C.F.R. § 567.6(a)(2)(i)(C), 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.

By order of the Director of the Office of Thrift Supervision, or his designee,
effective March 28, 2003.



Scott M. Albinson
Managing Director
Office of Supervision