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Letter from Robert deV. Frierson (Deputy Secretary of the Board of Governors of the Federal Reserve System) to Wachtell, Lipton, Rosen & Katz

Robert deV. Frierson

Federal Reserve System: Board of Governors

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 24, 2008

Richard K. Kim, Esq.
Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, New York 10019

Dear Mr. Kim:

This is in response to your letter of December 18, 2008, on behalf of GMAC Bank, Midvale, Utah, requesting an exemption from section 23A of the Federal Reserve Act and the Board's Regulation W¹ to permit the bank to lend to consumers to enable them to purchase automobiles from unaffiliated dealers in the United States that obtain floorplan financing from affiliates of GMAC Bank.

Section 23A and Regulation W limit the amount of "covered transactions" between a bank and any single affiliate to 10 percent of the bank's capital stock and surplus and limit the amount of covered transactions between a bank and all its affiliates to 20 percent of the bank's capital stock and surplus.² "Covered transactions" include the purchase of assets by a bank from an affiliate and a bank's extension of credit to an affiliate.³ The statute and regulation also require a bank to secure its extensions of credit to, and certain other covered transactions with, affiliates with prescribed amounts of collateral.⁴

In addition, section 23A and Regulation W contain an attribution rule. The attribution rule provides that a transaction between a bank and a third party will be treated as a transaction between the bank and an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate of the bank.⁵ The attribution rule is intended, among other things, to prevent a bank from evading the restrictions in the statute and rule by using intermediaries and to limit the exposure that a bank has to customers of its affiliates.⁶

¹ 12 U.S.C. § 371c; 12 CFR part 223.

² 12 U.S.C. § 371c(a)(1) and 12 CFR 223.11 and 223.12.

³ 12 U.S.C. § 371c(b)(7) and 12 CFR 223.3(h).

⁴ 12 U.S.C. § 371c(c) and 12 CFR 223.14.

⁵ 12 U.S.C. § 371c(a)(2); 12 CFR 223.16.

⁶ See 67 Federal Register 76576 (Dec. 12, 2002).

Section 23A and Regulation W also specifically authorize the Board to exempt, in its discretion, transactions or relationships from the requirements of the statute and rule if the Board finds such exemptions to be in the public interest and consistent with the purposes of section 23A.⁷ The Board previously has indicated that the twin purposes of section 23A are (i) to protect against a depository institution suffering losses in transactions with affiliates and (ii) to limit the ability of an institution to transfer to its affiliates the subsidy arising from the institution's access to the federal safety net.⁸

Until General Motors Corporation ("GM") completes its divestiture of GMAC LLC ("GMAC"), GM and GMAC Bank are affiliates for purposes of section 23A.⁹ Moreover, GMAC and GMAC Bank are affiliates. The automobile dealers, though franchisees of GM, are not affiliates of GMAC Bank for purposes of section 23A because the dealers are independently owned and operated, and the ultimate purchasers of the automobiles are not affiliates of GMAC Bank. Loans by GMAC Bank to consumers for the purchase of GM automobiles from unaffiliated dealers that obtain floorplan financing from GMAC are covered transactions under section 23A and Regulation W only by virtue of the attribution rule. The attribution rule applies to those loans because most of the funds that would be lent by GMAC Bank to purchasers of automobiles are transferred by the consumer to the dealer and from the dealer to GMAC in repayment of the dealer's floorplan loan. Thus, the proceeds of GMAC Bank's retail automobile loans are transferred through third parties to the bank's affiliate.

As noted, section 23A and Regulation W limit the amount of covered transactions between a bank and any single affiliate to 10 percent of the bank's capital stock and surplus and limit the amount of covered transactions between a bank and all its affiliates to 20 percent of the bank's capital stock and surplus. As of September 30, 2008, GMAC Bank's capital stock and surplus was approximately \$3.9 billion, which would limit the bank's covered transactions with a single affiliate to \$390 million and with all affiliates to \$780 million. GMAC Bank proposes to engage in up to [] in covered transactions that would not meet the collateral requirements of section 23A and Regulation W. Accordingly, GMAC Bank has requested an exemption from the quantitative limits and collateral requirements of section 23A and Regulation W for these proposed transactions.

Although GMAC Bank may have an incentive to make retail automobile loans to customers to support GM's sales and improve GMAC's liquidity, there are some significant mitigating factors in this proposal. The proposed automobile loans would expose GMAC Bank to the diversified credit risk of thousands of unaffiliated borrowers rather than the credit risk of a single affiliate. Moreover, the proposed loans would be secured by automobiles, which would partially offset the credit risk associated with the loans. In addition, the exemption would be subject to a number of conditions discussed below that are designed to limit the risk to the bank.

⁷ 12 U.S.C. § 371c(f)(2); 12 CFR 223.43(a).

⁸ 67 Federal Register 76560 (Dec. 12, 2002).

⁹ 12 U.S.C. § 371c(b)(1)(A); 12 CFR 223.2(a)(1) and (2).

The exemption would be subject to the following set of conditions that would limit the riskiness of the individual retail automobile loans made under the exemption:

- GMAC Bank may make loans only to customers with a credit bureau risk (FICO) score of [] or higher.¹⁰
- GMAC Bank may not rely on this exemption to make loans to customers of GM dealers that are affiliates of the bank.
- GMAC Bank may rely on the exemption only for loans that have a maturity of [] years or less, are for no more than \$[] to any one customer, are for purchases (not leases) of automobiles, and are new originations.
- Exempt loans may be for no more than [] percent of the purchase price of the vehicle.¹¹

These conditions should help guard against high-risk loans by GMAC Bank that only support its affiliates.

In addition, the exemption would be subject to the following conditions that provide GMAC Bank with additional protections:

- The proposed exemption is limited to the lesser of either [] percent of GMAC Bank's capital stock and surplus or \$[] billion.¹²
- GMAC, will make either (i) a cash payment to GMAC Bank equal to the book value at the end of each calendar quarter, plus write-downs during that quarter by GMAC Bank, of any exempt loan that becomes a low-quality asset during that quarter or (ii) quarterly purchases from GMAC Bank (or its operating subsidiaries) of any exempt loan that becomes a low-quality asset during that quarter at a price equal to the book value at the end of that quarter plus previous write-downs by GMAC Bank of any such asset. GMAC will make the cash payment or will purchase the assets within 30 days after the end of each calendar quarter.
- For the purposes of calculating GMAC Bank's commitment to be well capitalized, if GMAC makes a cash payment to GMAC Bank, GMAC Bank will hold an amount of risk-based capital equal to the book value of any exempted credit that becomes a

¹⁰ The Board's SR Letter implementing the Expanded Interagency Guidance for Subprime Lending Programs provides that loans to customers with a credit bureau risk (FICO) score of 660 or below are generally associated with a relatively high default probability. SR Letter 01-04, Guidance on Supervision of Subprime Lending, January 31, 2001.

¹¹ It is customary for automobile loans to include the cost of taxes, title and license fees, and warranties.

¹² GMAC Bank must compute compliance with the [] percent limit on the basis of the aggregate outstanding principal amount of exempt loans made by the bank (excluding such loans that are sold or otherwise transferred in a manner that constitutes an effective disposition for purposes of Regulation W).

low-quality asset so long as GMAC Bank (or any operating subsidiary) retains ownership or control of such credit. For example, under this dollar-for-dollar capital requirement, the risk-based capital charge for each exempted asset that becomes a low-quality asset would be 100 percent (equivalent to a 1250 percent risk weight), rather than the 8 percent requirement (equivalent to a 100 percent risk weight) that would apply to a similar defaulted loan asset that is not a part of the exempted asset pool.

- In support of GMAC's obligation, GMAC must pledge to GMAC Bank collateral that is acceptable to the Federal Reserve in an amount equal to 10 percent of the aggregate covered transaction amount for the life of the exemption. If a decline in value of the collateral causes GMAC to breach the 10 percent collateral requirement, additional collateral must be pledged to return GMAC to compliance with the requirement.
- GMAC Bank and GMAC, on approval of its application to become a bank holding company, must remain well capitalized, as defined in the prompt corrective action regulation of Federal Deposit Insurance Corporation ("FDIC") and the Board's Regulation Y, respectively.¹³
- Before any exempt loans are originated, a majority of GMAC Bank's directors will review and approve the exemption request.

Finally, GMAC Bank intends to provide a below-market interest rate to customers. Because GMAC Bank would rely on GM to compensate the bank for the below-market interest rate that the bank would offer to customers, the incentive arrangements between GM and GMAC Bank must meet, in the opinion of FDIC and Federal Reserve staff, the market-terms requirement in section 23B.¹⁴ [

] Because GM compensates GMAC Bank for the difference between the market-based support rate and the subvented rate, the transactions appear to be consistent with section 23B.

The Board also notes that granting the exemption would benefit the public because it would allow GMAC Bank to extend credit to a greater number of retail customers. In addition, the exemption would provide an important source of financing for U.S. retail purchases of GM vehicles from independent dealers and avoid further disruption in the credit market for such purchases.

Accordingly, the exemption appears to be in the public interest and consistent with the purposes of section 23A. The Board, after consultation with staff of the FDIC, hereby grants the requested exemption.

¹³ 12 CFR 325.103; 12 CFR 225.2(r).

¹⁴ Section 23B of the Federal Reserve Act generally requires that transactions between a bank and its affiliates be on terms that are at least as favorable to the bank as the terms of comparable transactions between the bank and third parties. 12 U.S.C. § 371c-1(a)(1).

This determination is specifically conditioned on compliance by GMAC Bank and GMAC with all the conditions discussed in this letter and all the commitments and representations made to the Board in connection with the exemption request. These conditions, commitments, and representations are deemed to be conditions imposed in writing in connection with granting the exemption and, as such, may be enforced in proceedings under applicable law. This determination is based on the specific facts and circumstances surrounding the proposed transactions and may be revoked in the event of any material change in those facts or circumstances or any failure by GMAC Bank and GMAC to observe any of their commitments or representations. Granting this exemption does not represent a determination concerning the permissibility of any other transactions engaged in by GMAC Bank and GMAC that are subject to section 23A and Regulation W.

Sincerely yours,

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of Richmond
Federal Deposit Insurance Corporation