

OFFICE OF THRIFT SUPERVISION

Approval of Bank Merger Act Application and Related Applications

Order No.: 2006-28
Date: July 14, 2006
Re: OTS No. 14460

Merrill Lynch Trust Company, FSB, Pennington, New Jersey (Association), seeks the Office of Thrift Supervision's (OTS) approval: (i) to acquire Merrill Lynch Bank & Trust Co., Plainsboro, New Jersey (Bank), pursuant to Section 18(c) of the Federal Deposit Insurance Act (Bank Merger Act or BMA); (ii) to establish three operating subsidiaries and one service corporation, under 12 C.F.R. Part 559; (iii) to include an issuance of subordinated debt in regulatory capital, pursuant to 12 C.F.R. § 563.81; (iv) to make a capital distribution of a wholly owned subsidiary to Merrill Lynch Group, Inc., New York, New York (Holding Company), under 12 C.F.R. § 563.143; (v) to change its name to Merrill Lynch Bank & Trust Co., FSB, under 12 C.F.R. §§ 543.1 and 552.4; and (vi) to re-designate its home office from Pennington, New Jersey to New York, New York, under 12 C.F.R. §§ 545.95 and 552.4. In connection with the subordinated debt filing, the Association has requested a waiver of the indenture and trustee requirements in 12 C.F.R. § 563.81(d)(4). Collectively, the foregoing filings are referred to herein as the Applications.

The Parties

The Association is a Deposit Insurance Fund (DIF)-insured, trust-only federal savings association and is a direct subsidiary of the Holding Company and a second-tier subsidiary of Merrill Lynch & Co., Inc., New York, New York (Parent).

The Bank is a DIF-insured, New Jersey-chartered bank and is a direct subsidiary of the Holding Company and a second-tier subsidiary of the Parent. The Bank's wholly owned subsidiary, Financial Data Services, Inc., Jacksonville, Florida (FDS), is a registered transfer agent. FDS wholly owns Merrill Lynch Mortgage Holdings, Inc., Plainsboro, New Jersey (Mortgage Co.), which invests in residential mortgage loans and mortgage-backed securities.

Merrill Lynch Bank USA (MLBank), a wholly owned subsidiary of the Parent, is a DIF-insured, Utah-chartered industrial loan company. MLBank's wholly owned subsidiary, Merrill Lynch Credit Corporation, Jacksonville, Florida (Credit Corp) engages in the residential mortgage business.

Merrill Lynch Community Development Company, LLC, Plainsboro, New Jersey (Community Development Co.) is also a wholly owned subsidiary of MLBank, and engages in community development activities. Community Development Co. provides support to underserved communities by establishing strategic partnerships with business

and community organizations to develop projects that benefit low- and moderate-income areas and individuals.

The Parent, a Delaware corporation, is the top-tier holding company for several subsidiaries that provide investment, financing, advisory, insurance and related products and services. The Holding Company, also a Delaware corporation, is a wholly owned subsidiary of the Parent.

The Proposed Transaction

The proposed transactions are part of a corporate reorganization of several of the Parent's subsidiaries. The reorganization includes, among other things: (i) the merger of the Bank into the Association, with the Association being the surviving institution; (ii) the Association's acquisition of FDS and Mortgage Co. as subsidiaries; (iii) the formation, by MLBank and the Association, of Merrill Lynch Mortgage and Investment Corporation (Investment Co.) as a new Delaware corporation that will initially be a second-tier operating subsidiary of the Association; (iv) Investment Co.'s acquisition, from MLBank, of the Credit Corp and Community Development Co.; (v) FDS' dividend of Investment Co.'s stock to the Association thereby making Investment Co. a first-tier operating subsidiary of the Association; and (vi) the Association's dividend of all of the issued and outstanding shares of FDS to the Holding Company.

Prior to the consummation of the merger of the Bank and the Association, the Bank plans to issue \$230 million in subordinated debt to the Parent. The Association will assume the subordinated debt in the merger. The Association has filed a notice to include this subordinated debt in its Tier 2 capital and has requested an additional \$120 million of subordinated debt that it may sell to the Parent in the future also be included in Tier 2 capital when sold.

Bank Merger Act Application

In evaluating a BMA application, OTS is required to consider the effect of the transaction on the capital of the resulting association; the financial and managerial resources of the constituent institutions; the future prospects of the constituent institutions; the effect of the transaction on competition; the convenience and needs of the community; conformance to applicable law, regulation, and supervisory policy; and factors relating to fairness of and disclosure concerning the transaction.¹ Also, the BMA requires the responsible agency to take into consideration, in its evaluation of the BMA application, the effectiveness of any insured depository institution in combating money-laundering activities.² Under 12 C.F.R. § 563e.29, OTS must consider the constituent savings associations' record of performance under the Community Reinvestment Act (CRA).

¹ 12 U.S.C. § 1828(c)(5)(B); 12 C.F.R. § 563.22(d) (2006).

² 12 U.S.C. § 1828(c)(11).

Capital

Both the Bank and the Association are “well-capitalized,” and the Association will remain “well-capitalized” after the merger. Accordingly, we conclude that this approval standard is satisfied.

Managerial Resources

The current senior executive officers of the Association will continue to manage the Association’s trust business. With respect to other management officials, a number of individuals who will serve in the senior positions at the Association have performed the same functions successfully at MLBank, the Bank and their subsidiaries. OTS received no adverse information regarding any of the Association’s proposed directors or officers in connection with routine background reviews. The Association, however, has not yet submitted the biographical report and fingerprint cards for one of the Association’s proposed officers. We are imposing condition 7 below to enable OTS to ensure that the Association will be operated properly and by qualified personnel. We conclude that the managerial resources of the Association are consistent with approval, subject to the condition being imposed.

Financial Resources and Future Prospects

The Association is projected to be profitable and “well-capitalized” after the merger. The Bank will cease to exist after the transaction. The expansion of the Association’s business activities will strengthen the Association’s financial condition. Highly experienced individuals will be transferred to the Association to manage the new activities. In order to ensure that the Association operates its new activities safely and soundly, we are imposing condition 5 below. Also, because the Association probably would not be required to file branch applications with OTS after the proposed transaction,³ in order to monitor the Association’s plans regarding branch offices, condition 5 includes a provision requiring the Association to obtain prior, written non-objection of the Northeast Regional Director or his designee (Regional Director) of any proposal to open retail branch offices. In addition, in order to monitor the Association’s future plans with respect to cross-marketing of products and services of the Association and affiliates, as well as any changes to the Association’s delivery systems, condition 5 includes a provision requiring the Association to obtain prior approval regarding any changes to its current cross-marketing arrangements. Lastly, because the Association is expected to have transactions with its affiliates, and will share certain management officials with its affiliates, OTS is imposing condition 11 to provide that the Association’s board of directors has members with sufficient independence to ensure the Association oversees its operations appropriately and operates safely and soundly.

³ The Association should be eligible for the exception set forth at 12 C.F.R. §545.93(b)(3)(2006).

Based on the foregoing, we conclude that the financial resources and future prospects of the Association and the Bank are consistent with approval, subject to the condition.

Convenience and Needs of the Community

With respect to the convenience and needs of the community, the Association will continue its trust operations, and will expand its business and operations to include offering loans and accepting deposits on a nationwide basis. The Association will continue the Bank's existing operations, except for the business of the Bank's subsidiary, FDS, which business will ultimately be transferred to MLBank. Accordingly, we are not aware of any basis for objection to the BMA application based on convenience and needs considerations.

Competitive Impact

The proposed transaction will not cause the Association to become affiliated with any previously unaffiliated depository institution. Accordingly, the transaction is not objectionable on anti-competitive grounds.

Community Reinvestment Act

As for the CRA, the Association, as a trust-only federal savings association, has no prior CRA record. The Bank currently has an "Outstanding" CRA rating. OTS has received no comments from the public objecting to the proposed transaction. Accordingly, we conclude that approval of the BMA application is consistent with the CRA.

Conformity With Law; Anti-Money Laundering

As for conformance to law, regulation and supervisory policy, OTS' review of the BMA application did not indicate any violation of law or regulations, or non-compliance with supervisory policies, in connection with the proposed transaction. Based on the foregoing, OTS concludes that approval of the proposed transaction is not objectionable based on conformity of the proposed transaction to applicable law, regulation, and supervisory policies.

OTS must also review the constituent institutions' records of compliance with money laundering statutes and regulations as part of the analysis of any BMA transaction. OTS' compliance examination includes an evaluation of a savings institution's compliance with the Bank Secrecy Act (BSA). OTS has reviewed the Association's compliance record, which took no exceptions to the Association's compliance with the BSA or any other anti-money laundering laws or regulations. Similarly, the Bank's most recent compliance examination did not object to the Bank's compliance with such laws. Therefore, we conclude that the criteria for approval under the BMA have been met.

Fairness and Disclosure

Because the transaction is an internal corporate reorganization of wholly owned subsidiaries of the Parent, the transaction does not raise issues regarding fairness and disclosure.

Notice to Establish Operating Subsidiaries and Service Corporation

The Association plans to establish Investment Co. as a first-tier operating subsidiary, to establish the Credit Corp and Mortgage Co. as second-tier operating subsidiaries, and to establish Community Development Co. as a second-tier service corporation.

Operating Subsidiaries

Generally, a federal association may invest in an operating subsidiary only if: (1) the federal association owns, directly or indirectly, more than 50 percent of the voting shares of the operating subsidiary; (2) no person or entity other than the federal association exercises effective operating control over the operating subsidiary; and (3) the operating subsidiary engages only in activities permissible for federal associations to engage in directly.⁴ In addition, OTS may object to the establishment of an operating subsidiary on supervisory grounds.

With respect to Investment Co., the Association will hold 85 percent of Investment Co.'s common stock. No party other than the Association will have effective operating control over Investment Co.'s operations. Investment Co. will not conduct any operations directly, but will engage solely in holding operating subsidiaries and a service corporation, which are permissible activities for federal savings associations.

With respect to the Credit Corp, Investment Co. will hold all of the Credit Corp's common stock. Credit Corp will contract with other entities to carry out certain activities. However, the Credit Corp will retain ultimate authority with respect to such operations. Accordingly, the Association, through Investment Co., will have effective operating control over Credit Corp and no other party will have such control. The Credit Corp's proposed activities, mortgage lending, construction-to-permanent financing and home equity lending, are permissible for federal savings associations.

With respect to Mortgage Co., Investment Co. will hold all of Mortgage Co.'s outstanding common stock.⁵ The Association, through Investment Co., has the power to conduct Mortgage Co.'s operations. No party other than the Association will have effective operating control over Mortgage Co. Mortgage Co.'s proposed activities,

⁴ 12 C.F.R. §§ 559.2, 559.3(c)(1) and (e)(1) (2006).

⁵ Third parties will hold all of Mortgage Co.'s nonvoting preferred stock.

investing in residential mortgage loans and mortgage-backed securities, are permissible for federal savings associations.

OTS does not object to the proposed activities of the three operating subsidiaries on supervisory grounds. The Association submitted a preliminary independent valuation indicating the estimated aggregate fair market value of the stock of the Credit Corp and Mortgage Co. Because the final valuation is not yet available, we are conditioning approval on the requirement that the Association submit to OTS for review the final independent valuation of the Credit Corp and the Mortgage Co. to help ensure that the Association values these entities appropriately. In addition, in order to monitor the three operating subsidiaries' activities and to ensure that the Association operates in a safe and sound manner, we are imposing condition 9 below.

Service Corporation

In considering whether a proposed investment in a service corporation by a federal association is permissible, the OTS must consider whether the activity is permissible, whether the amount of the investment is permissible, the state of incorporation of the proposed service corporation and the nature of the investors, and whether there are any supervisory or safety and soundness reasons to limit or refuse to permit the investment.

OTS has reviewed each of Community Development Co.'s proposed activities, and has concluded that they are preapproved for service corporations of federal associations because either: (i) the activities are permissible for federal savings associations to engage in directly, and thus are preapproved under 12 C.F.R. § 559.4(a); or (ii) the activities are among the activities listed in 12 C.F.R. §§ 559.4(g) and 559.4(h).

Community Development Co., as a second-tier service corporation of the Association, is not subject to restrictions regarding the types of entities that may hold its shares, and the state in which it is incorporated.⁶

Section 559.5(a) provides that federal savings associations may invest up to 3 percent of assets in service corporations, provided that any investment in excess of 2 percent of assets must "serve primarily community, inner city, or community development purposes." In addition, under 12 C.F.R. § 559.5(b), a federal savings association may lend additional amounts to a service corporation to the extent that the federal savings association has authority to make such loans under other provisions of section 5(c) of the Home Owners' Loan Act (HOLA). Based on the Association's most recent pro forma balance sheet, at the closing of the reorganization, the total investment by the Association in Community Development Co. is well within the applicable limitations.

⁶ See 12 C.F.R. § 559.3(f)(1)(ii)(2006).

OTS does not object to the proposed activities of Community Development Co. on supervisory grounds. OTS is imposing a condition requiring that the Association submit to OTS for review the final independent valuation of Community Development Co., in order to help ensure that the Association values Community Development Co. appropriately. In addition, in order to monitor Community Development Co.'s activities and to ensure that the Association operates in a safe and sound manner, we are imposing condition 9 below.

Subordinated Debt Notice

The Association seeks OTS approval pursuant to 12 C.F.R. § 563.81 (Sub Debt Regulation) to include an issuance of subordinated debt in its regulatory capital computation (Subordinated Debt Notice). The Association has requested a waiver of the indenture and trustee requirements in 12 C.F.R. § 563.81(d)(4).

In evaluating a savings association's application for subordinated debt to be eligible for inclusion in regulatory capital, OTS must consider whether: (i) the issuance is authorized by applicable law and not inconsistent with any provision of the association's charter or bylaws; (ii) the overall policies, condition and operations of the association afford a supervisory basis for objection for inclusion in regulatory capital; and (iii) the issuance will result in a transfer of risk from the DIF to parties other than savings associations.⁷

In addition, the Sub Debt Regulation requires that the form of certificate (of the note) include certain legends.⁸ The maturity or required redemption of the instrument may not be less than seven years.⁹ The instrument may not be sold to certain types of entities without prior OTS approval.¹⁰

The issuance of subordinated debt is authorized by the HOLA, and is not inconsistent with the Association's charter or bylaws. The proposed transaction will transfer risk from the DIF to other parties in a manner that is consistent with the regulation, because the subordinated debt will be placed with the Parent.¹¹ Based on the terms of the subordinated note and representations, the other requirements of the Sub Debt Regulation are met, with the exception of the provision for which a waiver has been requested.

The Sub Debt Regulation requires that the issuer use an indenture that provides for the appointment of a trustee other than the issuer or an affiliate of the issuer and

⁷ 12 C.F.R. § 563.81(b)(1)-(3) (2006).

⁸ 12 C.F.R. § 563.81(d)(1) (2006).

⁹ 12 C.F.R. § 563.81(d)(2) (2006).

¹⁰ 12 C.F.R. § 563.81(d)(3) (2006).

¹¹ See 12 C.F.R. § 563.81(d)(3)(ii), which expressly permits subordinated debt to be sold to corporate affiliates of the issuer.

provides for certain collective enforcement rights and remedies for security holders.¹² The Association proposes that the provisions that would otherwise be included in an indenture be added to an existing agreement between the Parent and the Bank.¹³ The Association asserts that an indenture is not necessary with respect to the proposed debt offering, because the debt will be acquired in a non-public sale solely by the Parent for investment purposes and not for resale or distribution and that the Parent does not need the protections provided by an indenture.

OTS may waive the applicability of any regulation for good cause, to the extent permitted by statute.¹⁴ The regulatory provision in question is not set forth in any statute.

The Trust Indenture Act of 1939,¹⁵ which generally requires indentures for debt issuances, does not require an indenture (and qualification of an indenture) where an exemption from registration of the underlying securities under the Securities Act of 1933 (Securities Act) is available.¹⁶ The sale of the securities is exempt under section 4(2) of the Securities Act because the sale does not involve a public offering. OTS has waived the requirement for an indenture in several similar situations.

Based on the foregoing, OTS concludes that good cause exists to grant the requested waiver of 12 C.F.R. § 563.81(d)(4) and to permit the subordinated debt to be included in the Association's capital.

Capital Distribution

The Association has requested OTS approval, pursuant to 12 C.F.R. § 563.143(a)(2), to make a capital distribution of all of the issued and outstanding shares of FDS' stock to the Holding Company.

OTS' regulations provide that a capital distribution notice may be denied if, generally, the proposed capital distribution would: (i) cause the institution to become undercapitalized; (ii) raise safety and soundness concerns; or (iii) violate any statute, regulation, agreement with OTS or condition of approval.¹⁷ The proposed distribution does not raise safety and soundness concerns, and will not violate any prohibition contained in law, agreement with OTS, or condition of approval. The Association will acquire FDS in one of the steps of the reorganization, and will own FDS for only a moment in time before the distribution occurs. Moreover, the Association will remain "well-capitalized" after the distribution. Therefore, we conclude that the proposed capital distribution is permissible.

¹² 12 C.F.R. § 563.81(d)(4)(2006).

¹³ Upon consummation of the proposed merger, the Association will assume the Bank's obligations under the agreement.

¹⁴ 12 C.F.R. § 500.30(a) (2006).

¹⁵ 15 U.S.C. § 77aaa-77bbbb.

¹⁶ 15 U.S.C. § 77ddd.

¹⁷ 12 C.F.R. § 563.146 (2006).

Other Related Applications

The Association has filed the following: (i) a notice pursuant to 12 C.F.R. §§ 543.1 and 552.4 to change its name to Merrill Lynch Bank & Trust Co., FSB; and (ii) a notice pursuant to 12 C.F.R. §§ 545.95 and 552.4 related to the re-designation of the Association's home office from Pennington, New Jersey to New York, New York. We do not object to either notice.

Conclusion

Based on the Applications and the foregoing analysis, OTS concludes that the Applications satisfy the applicable approval standards, provided that the following conditions are complied with in a manner satisfactory to the Regional Director. Accordingly, the Applications are hereby approved, subject to the following conditions:

1. The Association and the Bank must receive all required regulatory approvals, and submit copies of all such approvals to the Regional Director, prior to consummation of the proposed transaction;
2. The proposed transactions must be consummated within 120 calendar days from the date of this Order;
3. On the business day prior to the date of consummation of the proposed transactions, the chief financial officers of the Association, the Bank and MLBank must certify in writing to the Regional Director that no material adverse changes have occurred with respect to the financial condition or operation of the Association, the Bank, and MLBank, respectively, as disclosed in the Applications. If additional information having a material adverse bearing on any feature of the Applications is brought to the attention of the Association, the Parent, the Holding Company, the Bank, MLBank or OTS since the date of the financial statements submitted with the Applications, the transactions must not be consummated unless the information is presented to the Regional Director, and the Regional Director provides written non-objection to the consummation of the transactions;
4. The Association must, within 5 calendar days after the effective date of the proposed transactions: (a) advise the Regional Director in writing of the effective date of the proposed transactions; and (b) advise the Regional Director in writing that the transactions were consummated in accordance with all applicable laws and regulations, the Applications and this Order;
5. The Association must operate within the parameters of its three-year business plan. The Association must submit any proposed major deviations or material changes from the plan (including, but not limited to any proposals to open retail

- branch offices and changes relating to cross-marketing) for the prior, written non-objection of the Regional Director. The request for change must be submitted no later than 60 calendar days prior to the desired implementation date;
6. For its first three fiscal years of operations following the date it commences operation as a full service federal savings association, the Association must submit to the Regional Director within 45 calendar days after the end of each calendar quarter, a business plan variance report detailing the Association's compliance with the business plan and an explanation of any deviations;
 7. Any new proposed board members and senior executive officers of the Association, referenced in the Applications, who have not submitted background information must submit such background information as required by the Regional Director and take such action as directed by the Regional Director if the background investigation of the individual reveals adverse information;
 8. No later than 30 calendar days after the consummation of the proposed transactions, the Association must submit to the Regional Director for review, the final independent valuation of the Credit Corp, Mortgage Co., and Community Development Co.;
 9. The operating subsidiaries and service corporation (Investment Co., the Credit Corp, Mortgage Co., and Community Development Co.) must not materially deviate from any of the activities, facts, or representations described in the Applications, except with prior written non-objection of the Regional Director;
 10. No later than 30 calendar days after: (i) the transfer of the subordinated debt sold by the Bank, and (ii) any subsequent sale of the subordinated debt securities, the Association must submit to the Regional Office the following items:
 - a. Certification of compliance with all applicable laws and regulations in connection with the offering, issuance, sale and transfer of the securities;
 - b. A written report stating the total dollar amount of securities sold or transferred, and the amount of net proceeds received by the Association. The report must clearly state the amount of subordinated debt, net of all expenses, that the Association intends to be counted as regulatory capital;
 - c. Three copies of an executed form of the securities issued pursuant to the Subordinated Debt Notice and a copy of the Agreement governing the issuance of the securities; and
 11. At least 40 percent of the Association's board of directors must be individuals who are not officers or employees of the Holding Company or its affiliates and who have not otherwise been determined by the Regional Director to lack sufficient independence; and at least one member of the Association's board of directors must be an individual who is not an officer, director or employee of the

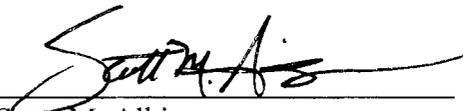
Holding Company or its affiliates and who is not an officer or employee of the Association, and has not otherwise been determined by the Regional Director to lack sufficient independence. At least 50 percent of any audit committee established by the Association must be directors who are not officers or employees of the Association, the Holding Company or its affiliates and have not otherwise been determined by the Regional Director to lack sufficient independence.

Further, based on the foregoing, OTS concludes that there is good cause to waive the indenture and trust requirements of 12 C.F.R. § 563.81(d)(4). Accordingly, the Savings Bank's requested waiver of § 563.81(d)(4) is hereby approved, pursuant to 12 C.F.R. § 500.30(a).

The Regional Director may, for good cause, extend any time period specified herein for up to 120 calendar days.

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

July 14, 2006.



Scott M. Albinson
Managing Director
Office of Examinations, Supervision
and Consumer Protection