

SAB 42 - Dec. '81

Talman meeting
on Friday 10/21

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September 28, 1983

Mr. John J. Huber
Director, Division of
Corporate Finance
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

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OFFICE OF THE DIRECTOR
CORPORATION FINANCE

Dear Mr. Huber:

We are counsel for The Talman Home Federal Savings and Loan Association of Illinois, a federally chartered mutual savings and loan association (the "Association"). We request a pre-filing conference with you and appropriate members of the SEC staff at your earliest convenience to discuss a proposed reorganization of the Association which would involve the Association's issuance of securities subject to the jurisdiction of the Federal Home Loan Bank Board (the "Bank Board") and the contemporaneous issuance of securities by a limited partnership of which a wholly-owned subsidiary of the Association will be general partner. Since this is an involved and complicated transaction presenting problems of an unusual nature and since the transaction will require resolution of jurisdictional matters and the coordination of disclosure policies between the SEC and the Bank Board, we feel that a pre-filing conference would be very useful. The Bank Board is scheduled to consider this transaction on October 12th and the staff of the Bank Board has urged us to meet with the SEC at the earliest practicable moment prior to that date. We request that representatives from the Bank Board attend the pre-filing conference as observers and to answer any questions which may arise.

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27th

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Background

The Talman Home Federal Savings and Loan Association of Illinois had total assets at June 30, 1983 of \$6,355,646,000. It is the largest savings and loan association in Illinois and among the ten largest savings and loan associations in the United States. In 1982, it acquired, with financial assistance from the Federal Savings and Loan Insurance Corporation ("FSLIC"), four troubled savings and loan associations of substantial size in Illinois. In the agreement providing financial assistance to the Association, FSLIC imposed numerous controls upon the Association, including the power to approve officers and directors. Six out of eleven directors of the Association are currently appointees of FSLIC.

With the active support and encouragement of FSLIC, the Association retained the investment banking firm of Salomon Brothers Inc to formulate a comprehensive restructuring plan to raise additional capital and improve the net worth of the Association. This plan consists of three principal elements: (1) the conversion to a federally chartered stock savings and loan association and the sale of common stock of the converted Association in a subscription offering to members, directors, officers and employees and subsequently to the public; (2) the provision of very substantial additional financial assistance by FSLIC in the form of a contribution to capital and the purchase of two series of preferred stock of the converted Association and a warrant to purchase common stock of the converted Association and (3) the organization of a limited partnership which will issue both bonds collateralized by mortgages and limited partnership interests. The first two elements of the restructuring plan do not involve SEC registration because such securities are clearly exempt from registration under Section 3(a)(5) of the Securities Act of 1933. The limited partnership offering, however, seems to present unique issues of jurisdictional overlap between the SEC and the Bank Board.

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The Limited Partnership

It is contemplated that an Illinois limited partnership will be formed to be known as Talman Home Equity and Mortgage Investors ("THEMI"). The general partner will be a wholly-owned subsidiary of the Association. It is expected that the initial limited partner will be the Association. The Association will contribute to the subsidiary, and the subsidiary will contribute to the limited partnership, up to \$800 million face value of mortgage loans, including some mortgage loans which, as a result of purchase accounting, are recorded on the books of Talman Home, in accordance with generally accepted accounting principles, at a discount from their face value. The Association will also contribute to the subsidiary, and the subsidiary will contribute to THEMI, warrants to purchase common stock of the converted Association. The warrants will be exercisable within one year after the dissolution of THEMI. It is expected that THEMI would be dissolved no later than ten years after its organization. The exercise price of the warrants will be equal to the public offering price of the common stock of the Association at the time of conversion.

After the organization of THEMI and the contribution of mortgage loans to THEMI, THEMI will issue, possibly in several stages, up to \$600 million in bonds collateralized by the contributed mortgages. The sale of the bonds by THEMI will precede any offering of common stock of the Association and the offering of limited partnership interests by THEMI. The net proceeds of the bond sale will flow up to the Association. The public offering of the limited partnership interests by THEMI is expected to be contemporaneous with the offering of common stock by the Association, although there will, of course, be separate prospectuses for each offering.

In view of the contemporaneous offering of the limited partnership interests by THEMI and the offering of common stock by the Association, it will be highly desirable, in order to avoid misleading investors, that the information relating to the Association contained in both offering documents be identical. Since the limited partnership offering by THEMI would apparently be subject to the jurisdiction of the SEC and the common stock offering by the Association is subject to the jurisdiction of the Bank Board, it is clear that we, and the two concerned regulatory agencies, must have an early consensus as to any issues which might cause disclosures to be other than identical.

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It will be helpful to analyze the type of disclosure which we believe will be required in the limited partnership offering. Since the general partner of THEMI is a subsidiary of the Association, financial statements of the general partner would be included in the THEMI prospectus by reason of the requirements set forth in Item 21(h) of Form S-18 (which we understand that the staff applies on an informal basis to filings on Form S-11) and Rule 3-13 of Regulation S-X. Since the Association has not committed to increase or maintain the general partner's capital, there is no requirement that the financial statements of the Association be set forth in the THEMI prospectus by reason of Item 21(h)(2) of Form S-18. Since the warrants of the Association included in the assets of THEMI will not have a book value or market value of 20% or more of the aggregate amount of the mortgage-backed bonds, there is no requirement that the financial statements of the Association be included in any THEMI prospectus by reason of Rule 3-10 of Regulation S-X.

The only basis for the inclusion of the Association's financial statements in the THEMI prospectus is that it is useful to provide the investors with material information concerning the value of the warrants of the Association and such material information would include the financial statements of the Association. However, if the Association had offered the warrants directly to the investors, such information would be provided in an offering circular in accordance with the requirements of the Bank Board since a warrant of a savings and loan association is an exempt security within the meaning of Section 3(a)(5) of the Securities Act of 1933. It is our position that where information concerning the issuer of an exempt security is being included in a prospectus subject to SEC jurisdiction not as the result of a specific disclosure requirement of an SEC form, but in order to provide information which may be material to a prospective investor's decision, the issuer, the underwriters and their respective counsel should be permitted to exercise their judgment as to the appropriate method of disclosure.

Therefore, we intend to file with the SEC a Form S-11 Registration Statement relating to the offering of the THEMI limited partnership interests containing all required information concerning the partnership and its general partner and wrapping around the offering circular relating to the offering of common stock of the Association. Using the "wrap around" approach, the THEMI investors

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will be furnished with all material information concerning the issuer of the warrants. Moreover, identical disclosure is assured in connection with the contemporaneous offerings by THEMI and by the Association.

The Association's Financial Statements

The Association's financial statements are prepared in accordance with generally accepted accounting principles and are audited by Ernst & Whinney. The four acquisitions in 1982 and a small acquisition in 1981 were accounted for as purchases. The accounting and financial reporting employed in regard to these acquisitions and in subsequent financial statements is discussed in a separate memorandum submitted herewith.

Generally, the SEC has taken the position that financial statements which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate. See Rule 4-01(a)(1), Regulation S-X. As stated above, the Association's financial statements have been prepared in accordance with GAAP. We are aware that the accounting staff of the SEC in some cases has taken a more stringent position in regard to amortization of intangibles arising from purchase accounting acquisitions by thrift institutions than is required by generally accepted accounting principles. See SEC Staff Accounting Bulletin No. 42. The Bank Board has regularly permitted the financial statements contained in offering circulars pertaining to the sale of securities of savings and loan associations to be presented on a GAAP basis which involves purchase accounting identical to the Association's method of accounting.

Moreover, Section 12(i) of the Securities Exchange Act of 1934 provides that in respect of any securities issued by institutions the accounts of which are insured by FSLIC, the powers, functions and duties vested in the SEC to administer and enforce Section 12 of the 1934 Act are vested in the Federal Home Loan Bank Board. Thus, any annual or quarterly reports of the converted Association under the 1934 Act are made to the Bank Board. It would certainly mislead investors if any financial statements of the Association included in the THEMI prospectus were presented in accordance with SEC requirements which differ from GAAP while the Association's financial statements contained in subsequent periodic

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reports under the 1934 Act were presented in accordance with GAAP and the Bank Board's requirements. The continuing reports required to be made by THEMI to the SEC would not be required to include the financial statements of the Association.

We wish to emphasize that the Association intends to make detailed textual disclosure in the offering documents as to its accounting for acquisitions and the effects of such accounting upon the reporting of present and future net income of the Association. However, the Association believes it would be inherently misleading to investors if there were a public offering of common stock of the Association in which the financial statements in the offering circular were presented in accordance with GAAP and the requirements of the Bank Board and there was a contemporaneous offering of limited partnership interests by THEMI in which different disclosure were made concerning the Association. In particular, it would be inconsistent, misleading and create serious problems if the Association were required to restate its financial statements in order to comply with requirements of the SEC which varied from GAAP.

The Section 3(a)(5) Exemption under the 1933 Act

We have carefully analyzed the question as to whether the securities to be issued by THEMI can properly be regarded as exempted securities pursuant to Section 3(a)(5) of the Securities Act which provides an exemption from registration for any security issued by "a savings and loan association...or similar institution, which is supervised and examined by state or Federal authority having supervision over any such institution..." THEMI will be regulated and supervised in the following ways: (1) The Association itself is extensively regulated by the Bank Board and FSLIC and the investment in THEMI requires the express approval of both regulatory bodies; (2) THEMI will be an "affiliate" of Talman Home and subject to examination by examiners appointed by the Bank Board, 12 U.S.C. § 1730(m)(1); (3) THEMI will be licensed and regulated by the State of Illinois, S.H.A. ch. 17, § 2301 et seq.; (4) The restructuring plan, which includes the conversion to a stock association and offering of THEMI securities, is regulated by the Bank Board, 12 U.S.C. § 1464; and (5) THEMI is regulated pursuant to agreements with FSLIC entered into pursuant to Section 406(f) of

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the National Housing Act, 12 U.S.C. § 1729(f). A more detailed memorandum on these matters accompanies this letter.

As the accompanying memorandum makes evident, there is a substantial basis for believing that the THEMI securities are exempted securities, but the law is not entirely clear on this point. Therefore, we and underwriters' counsel, Cleary, Gottlieb, Steen & Hamilton, believe that the prudent course of action will be to register any public offering of mortgage-backed bonds and limited partnership interests with the SEC.

Timing Considerations

Because of the interrelationship of the offering of the THEMI securities and the offering of common stock by the Association and the fact that the additional FSLIC assistance is expressly conditioned upon the completion of such offerings, it is vitally important to FSLIC and to us that these offerings proceed contemporaneously and promptly. Any delay on one offering will delay the other offering. We also wish to avoid the possibility that the two regulatory agencies would follow different or inconsistent disclosure policies with respect to the information and financial statements contained in the respective offering documents. We believe that the "wrap around" approach to the disclosure of information concerning the Association in any THEMI prospectus provides a constructive solution which is consistent with the requirements of SEC forms and regulations. If you would like to discuss further any of the matters mentioned in this letter, we would be most willing to participate in a pre-filing conference.

Very truly yours,


Richard G. Clemens

cc: Mr. A. Clarence Sampson
Chief Accountant

Peter J. Romeo, Esq.
Chief Counsel, Division of Corporate Finance

Mr. A. Richard Tow
Assistant Director, Division of Corporate Finance

Mr. Howard P. Hodges, Jr.
Chief Accountant, Division of Corporate Finance