



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

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 9, 2009

Jennifer M. Dirkin, Esq.
Senior Attorney
Northern Trust Corporation
50 South LaSalle Street (M-9)
Chicago, Illinois 60603

Dear Ms. Dirkin:

This is in response to the request by The Northern Trust Company (“Bank”) for an exemption from section 23A of the Federal Reserve Act and the Board’s Regulation W to allow Bank to purchase up to \$600 million of auction-rate securities (“ARS”) from its parent, Northern Trust Corporation (“NTC”), both of Chicago, Illinois.

Bank proposes to purchase ARS from NTC largely because of ongoing dislocations in the ARS market. Principally as a result of the ongoing turmoil in financial markets, ARS auction failures became endemic in early 2008, and ARS became largely illiquid.

For years, Bank and NTC’s other subsidiary depository institutions purchased ARS directly for the discretionary accounts of their trust clients,¹ and NTC’s subsidiary broker-dealer, Northern Trust Securities Inc. (“Securities Affiliate”), sold ARS to other nontrust customers. As an accommodation to its clients, NTC has offered to purchase from clients, at par, certain eligible ARS in an amount up to \$600 million. Bank seeks an exemption from section 23A and Regulation W to enable it subsequently to purchase the ARS from NTC. The ARS proposed to be purchased by Bank include municipal

¹ Those NTC institutions are Northern Trust, NA, Northern Trust Company of Delaware, and Northern Trust FSB.

auction-rate securities, student loan auction-rate securities, and auction-rate preferred securities that NTC purchases from its customers (collectively, “Eligible ARS”).

Section 23A and Regulation W limit the aggregate 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 aggregate 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, the extension of credit by a bank to an affiliate, the issuance of a guarantee by a bank on behalf of an affiliate, and certain other transactions.³ The statute and regulation also require a bank to secure its extensions of credit to, and guarantees on behalf of, affiliates with prescribed amounts of collateral.⁴

Because NTC controls Bank, NTC is an affiliate of Bank for purposes of section 23A and Regulation W. Accordingly, the purchases of Eligible ARS by Bank from NTC are covered transactions under the statute and rule. The aggregate amount of the covered transactions is up to approximately \$600 million, the Bank’s estimated purchase price for the Eligible ARS.

Bank has requested an exemption from the quantitative limits of section 23A and Regulation W in connection with its purchases of Eligible ARS from NTC to provide the bank with additional flexibility to engage in covered transactions with its affiliates. Section 23A and Regulation W specifically authorize the Board to exempt transactions or relationships from the requirements of the statute and rule if the Board finds such an exemption to be in the public interest and consistent with the purposes of section 23A.⁵ 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.⁶

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(f)(2) and 12 CFR 223.43.

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

Bank believes that granting the requested exemption would have public benefits because it would facilitate the provision of liquidity by NTC to customers holding unexpectedly illiquid securities as a result of dislocations in the ARS market.

The exemption would be subject to the following limits and conditions that are designed to protect the safety and soundness of Bank in connection with the proposed transactions:

- Bank's purchases of Eligible ARS would be limited to an aggregate amount of \$600 million, which represents approximately 12 percent of Bank's capital stock and surplus.
- All Eligible ARS purchased by Bank must be externally rated investment grade by a nationally recognized statistical rating organization ("NRSRO"), and a majority of the Eligible ARS purchased by Bank must be rated in one of the two highest investment grade rating categories by an NRSRO.
- Bank must purchase the Eligible ARS from NTC at fair market value.
- NTC must repurchase from Bank, on a quarterly basis, any Eligible ARS that become low-quality assets (as defined in Regulation W).
- NTC must compensate Bank promptly for any losses on Eligible ARS that NTC repurchased from customers of Securities Affiliate.
- NTC must repurchase from Bank all Eligible ARS that were repurchased from customers of Securities Affiliate on or before July 31, 2010, at the price paid by the bank for the ARS plus any accrued but unpaid interest.
- Bank and NTC must remain "well capitalized" as defined in the Board's Regulation H and Regulation Y, until NTC repurchases the Eligible ARS from Bank.⁷

In light of these considerations, the covered transactions between Bank and its affiliate, NTC, appear to be consistent with the purposes of section 23A and in the public interest. Accordingly, the Board hereby grants the requested exemption, subject to the conditions and limits discussed above.

⁷ See 12 CFR 208.43(b)(1) and 12 CFR 225.2(r), respectively.

This determination is specifically conditioned on compliance by NTC and Bank with all the commitments and representations they made to the Board in connection with this exemption request. These commitments and representations are deemed to be conditions imposed in writing by the Board in connection with granting the request and, as such, may be enforced in proceedings under applicable law. This determination is based on the specific facts and circumstances described in your correspondence and this letter. Any material change in those facts or circumstances or any failure by NTC or Bank to observe any of their commitments or representations may result in a different conclusion or in revocation of the exemption.

Very truly yours,

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

cc: Burl Thornton, Assistant Vice President
Federal Reserve Bank of Chicago
Federal Deposit Insurance Corporation