

OCC Inter. Ltr. 1123 (O.C.C.), 2009 WL 5652584

Office of the Comptroller of the Currency (O.C.C.)
Interpretive Letter

Banking Research Digest (c) BRG, Inc.
Interpretive Letter No. 1123
September 18, 2009

Re: Exchange of interest in real property acquired DPC for interest in an entity which would dispose of the real property

Dear [* * *]:

*1 This is in response to your request for a legal opinion addressing the proposal by [*Bank, City and State*] (“Bank”), to exchange its participation interest in other real estate owned (“OREO”) acquired in satisfaction of a debt previously contracted (“DPC”) for an interest in a limited liability company which would manage, market, and sell the DPC real property. For the reasons discussed and subject to the representations and conditions set forth herein, we believe that the Bank's proposal is permissible under [12 U.S.C. §§ 24](#)(Seventh) and 29.

Proposal

In 2006, the Bank participated in a syndicated loan to two related residential real estate developers, [*Borrower1*] and [*Borrower2*] (collectively, the “Borrowers”).¹ The Borrowers' collateral for the loan consisted of eleven residential developments, comprising in total approximately [* * *] completed houses and [* * *] residential lots, located in [*State1*] and [*State2*]. The Borrowers filed for bankruptcy in 2008, and the syndicate recently foreclosed upon four of the developments (“OREO Properties”). The banks are evaluating their options with respect to the remaining collateral, although the Bank states that foreclosure remains likely.

For the four current OREO Properties, rather than having each participating bank hold a partial interest in each OREO Property, the lending banks propose to establish a limited liability company (“LLC”) to hold, manage, and dispose of the properties. Each of the banks would exchange its participation interest in the OREO Properties for an equivalent interest in the LLC.² Accordingly, the LLC would aggregate all the outstanding DPC interests in the OREO Properties and, thus, would be able to convey complete ownership of the properties to a purchaser. Moreover, the LLC structure would permit the lending banks to ensure the efficient day-to-day operation and management of the OREO Properties, to be carried out by the LLC's managing member.³

The Bank represents that the LLC will hold, manage, and dispose of the OREO Properties within the guidelines for national banks' OREO activities.⁴ The Bank further represents that it expects the OREO Properties to be sold (or the LLC itself sold) within five years of its initial acquisition of the OREO Properties. Distributions of revenue and income from disposal of the OREO Properties would be allocated, and costs relating to the complex would be borne, in relation to the members' ownership interests.

Discussion

Pursuant to [12 U.S.C. § 29](#), a national bank may “purchase, hold and convey real estate ... such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.”⁵ Once it has acquired property in satisfaction of a debt previously contracted, a national bank must dispose of such property within the time frames specified by [section 29](#). [Section 29](#) does not require immediate disposal, nor does it permit the bank to hold onto the DPC property

speculatively.⁶ Instead, as it does in other instances, [section 29](#) recognizes that once a national bank permissibly acquires real property, the bank may act in good faith with respect to that property as would any other prudent owner, subject only to the requirement that the bank dispose of the DPC property within five years plus one possible five-year extension.⁷

*2 Through analogy to [section 29](#), the courts have interpreted the incidental powers of national banks granted in [12 U.S.C. § 24](#) (Seventh) to authorize the acquisition and holding of personal property, such as stock, in satisfaction of debts previously contracted.⁸ Moreover, the OCC has long recognized that a national bank, pursuant to [sections 24](#) (Seventh) and 29, may exchange permissibly acquired DPC property for other types of real or personal property.⁹ In Interpretive Letter No. 395, the OCC permitted a national bank to exchange DPC real property for preferred stock in a publicly-traded real estate company. The letter reasoned that, because national banks were permitted to exchange DPC real property for other real property and because national banks could acquire stock or other personal property interests DPC, national banks permissibly could swap OREO for an equity interest in the entity acquiring the OREO. The letter approved the exchange on the condition that the bank's board must determine that the exchange would be in the best interests of the bank and its ability to recover its loan loss.

Similarly, the OCC recently concluded that a national bank may exchange an interest in DPC real property for an equity interest in an entity which would manage, market, and dispose of the property, where doing so would improve the ability of the bank to recover, or otherwise limit, its loan loss. In Interpretive Letter No. 1118, the national bank's DPC real property interest consisted of approximately one-quarter of a townhouse apartment complex. Other financial institutions, also through foreclosure, had acquired interests in the remainder of the complex. The institutions proposed to create a limited liability company to collect their DPC interests which, in total, comprised the entire complex. By aggregating their interests, the institutions would enhance their ability to dispose of the property and also recognize cost savings in managing and marketing the complex, both of which would improve the bank's ability to recover its loan loss.

The linchpin of OCC precedent authorizing an exchange of OREO for an equity interest, which would allow the bank to more effectively achieve recovery on the underlying debt than if the bank simply continued to hold the OREO, is a good faith undertaking by the bank to improve its ability to recover, or otherwise limit, its loan loss on DPC property. In other words, the exchange cannot be made for the purpose of speculation or the expectation of profit. Just as a national bank has no authority to take DPC property for purely speculative purposes,¹⁰ transactions involving DPC property “must be compromises in good faith.”¹¹ The determination of such good faith necessarily will be specific to each DPC property and the associated exchange.

In the instant proposal, the Bank proposes to exchange its participation interest in the OREO Properties for an interest in the LLC. Each of the other participating banks would exchange its interest, too, and in doing so the Bank believes that it, and the other banks, would be better able to recover the loan loss and dispose of the properties. Most significantly, the Bank represents that it likely would be unable to dispose of its interest in OREO Properties apart from an agreement by all of the lending banks to jointly sell their interests. The Bank believes that an interest in the LLC would be more marketable, enabling the Bank to dispose of its interests prior to the LLC's ultimate disposition of the OREO Properties. By improving its ability to dispose of the property, the Bank in turn improves its ability to recover its loan loss.¹² Also, rather than managing the OREO Properties according to the complex and burdensome terms of the loan documents, aggregating the participation interests in the OREO Properties in the LLC permits the lending banks to designate one institution, the LLC's managing member, to address the day-to-day responsibilities of holding, managing, and negotiating the disposal of the OREO Properties. The Bank represents that it would recognize substantial cost savings through these efficiencies.

*3 Because the power to hold the LLC interest arises from the DPC authority in [sections 24](#) (Seventh) and 29, it necessarily follows that such power is subject to the limitations contained in [section 29](#) and [12 C.F.R. Part 34](#). As described above, [section 29](#) specifically limits the holding period for DPC property to five years, with the possible

extension of up to five additional years with approval from the OCC. The OCC has applied, by analogy, similar holding limitations and divestiture requirements to personal property acquired DPC under [section 24](#)(Seventh).¹³ For purposes of measuring compliance, the Bank's holding period for its interest in the LLC must be measured from the date legal title to the OREO Properties was initially acquired by the Bank.¹⁴

Conclusion

Accordingly, in consideration of the foregoing analysis, based upon the facts and representations provided by the Bank and subject to the conditions below, we conclude that the Bank may exchange its DPC interest in the OREO Properties for an ownership interest in the LLC.¹⁵ The authority to engage in this exchange is [12 U.S.C. §§ 24](#)(Seventh) and 29, and is subject to the following conditions:

(1) Prior to making the exchange, the Bank's directors must determine that the exchange is in the best interests of the Bank and would improve the ability of the Bank to recover, or otherwise limit, its loan loss. The basis for such determination must be documented.

(2) Prior to making the exchange, the Bank must notify its Examiner-in-Charge, in writing, of the proposed exchange and must receive written notification of supervisory non-objection, based on an evaluation of the adequacy of the Bank's risk management and measurement systems and controls to enable the Bank to exchange for, hold, and dispose of the LLC interest in a safe and sound manner, and an evaluation of any other supervisory considerations relevant to the exchange.

(3) The Bank may not further exchange the LLC interest for an interest in any other real or personal property. Such property would be too far removed from the Bank's original DPC interest in the OREO Properties to be considered DPC property.

(4) The Bank must ensure that the LLC complies with the provisions of the OCC's OREO regulation, 12 C.F.R. Part 34, Subpart E, including obtaining a current appraisal on the OREO Properties.

(5) Consistent with the limitations in [12 U.S.C. § 29](#) and 12 C.F.R. Part 34, the Bank must dispose of its interest in the LLC no later than five years from the date it initially acquired title to the OREO Properties, unless granted an extension by the OCC.

These conditions are conditions “imposed in writing by a Federal banking agency in connection with any action on any application, notice, or other request” within the meaning of, and enforceable under, [12 U.S.C. § 1818](#). Our conclusions herein are specifically based on the Bank's representations and written submissions describing the facts and circumstances of the subject transactions, and any change in facts or circumstances could result in a different conclusion.

***4** This approval and the activities and communications by OCC employees in connection with this approval, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, the United States, any agency or entity of the United States, or any officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory, and examination authorities under applicable law and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

If you have any questions concerning this letter, please contact Steven V. Key, Special Assistant to the Deputy Chief Counsels, at (202) 874-5200.

Sincerely,

Julie L. Williams

First Senior Deputy Comptroller and Chief Counsel

Footnotes

- 1 There are five banks, including the Bank, in the lending group. One of the other banks in the lending group is the syndication agent.
- 2 The Bank would acquire an [* * *]% interest in the LLC.
- 3 The loan's syndication agent, [Bank2], would serve as the managing member of the LLC, responsible for day-to-day operational decisions for the LLC, with major LLC decisions reserved to the members. The LLC will employ one or more third parties to act as managing agents for the OREO Properties. In the absence of the LLC, operational decisions affecting the operations and disposal of the OREO Properties would be made according to the terms of the loan documents.
- 4 Section 1.4 of the LLC Agreement would provide that so long as any member of the LLC is subject to regulation, supervision, or examination by any federal or state bank regulatory agency, the LLC may not engage in any activity that is impermissible under any federal or state banking law, regulation, or regulatory agency opinion applicable to such member. Further, the Bank represents that the LLC would be subject to OCC supervision and examination.
- 5 [12 U.S.C. § 29](#)(Third). The authority of a bank to acquire DPC property is a necessary power for banks that has been recognized since the earliest days of our country. Among other provisions relating to the power to hold real property included in the charter of the First National Bank was the power to hold property “conveyed to it in satisfaction of debts previously contracted in the course of its dealings.” 1 Stat. 191, 1st Cong., Chap. 10, 1st Sess. (Feb. 25, 1791). A similar provision was included in the charter of the Second Bank of the United States. 3 Stat. 266, 14th Cong., Chap. 44, 1st Sess. (Apr. 10, 1816). The authority of a bank to acquire DPC property was included among those powers granted in the National Currency Act of 1863, 12 Stat. 665, 37th Cong., Chap. 58, 3rd Sess. (Feb. 25, 1863).
- 6 See Conditional Approval No. 895 (Mar. 31, 2009) (DPC authority only applies to facilitate loan recovery); Interpretive Letter No. 518, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) § 83,226 (Apr. 6, 1990) (same).
- 7 See [12 C.F.R. § 34.82\(a\)](#) (national bank must dispose of other real estate owned “at the earliest time that *prudent judgment* dictates, but not later than the end of the holding period (or an extension thereof) permitted by [12 U.S.C. § 29](#)” (emphasis added)).
- 8 See *First Nat'l Bank of Charlotte v. Nat'l Exch. Bank of Baltimore*, 92 U.S. 122, 127 (1875) (“In the honest exercise of the power to compromise a doubtful debt owing the bank, it can hardly be doubted that stocks may be accepted in payment and satisfaction, ... Such a transaction would not amount to a dealing in stocks.”); *Atherton v. Anderson*, 86 F.2d 518, 525 (6th Cir. 1936), *rev'd on other grounds*, 302 U.S. 643 (1937); *Morris v. Third Nat'l Bank*, 142 F. 25, 31 (8th Cir. 1905) (“A national bank may lawfully do many things in securing and collecting its loans, in the enforcement of its rights and the conservation of its property previously acquired, which it is not authorized to engage in as a primary business.”).
- 9 E.g., Interpretive Letter No. 1118 (Jul. 2, 2009) (to be published); Interpretive Letter No. 395, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,619 (August 24, 1987); Interpretive Letter No. 349, *reprinted in* [1985-1987 Binder] Fed. Banking L. Rep. (CCH) ¶ 85,519 (September 12, 1985) (permitting an exchange of DPC for other real property). The proposition that a national bank may exchange OREO for property of some other form goes back at least as far as 1936. See Letter from G. Lyons (January 6, 1936) (unpublished) (permitting an exchange of DPC property for other real property).
- 10 *Atherton*, *supra*, at 525.
- 11 *First Nat'l Bank of Charlotte*, *supra* at 128.
- 12 Section 29 does not prohibit a national bank from recovering more than the amount of its loan loss upon the disposition of OREO property. Rather, the principles underlying the restrictions in [section 29](#) are designed to prevent banks from engaging in impermissible real estate speculation in order to recover more money. See *id.*; *Union Nat'l Bank v. Matthews*, 98 U.S. 621, 626 (1879). Therefore, as long as a bank's actions are made in good faith and not for speculative purposes, recovery of more than its loan loss is permissible.
- 13 Conditional Approval No. 895, *supra*; Interpretive Letter No. 395, *supra*.
- 14 The Bank represents that, if any of the remaining seven residential developments serving as collateral for the syndicated loan subsequently are foreclosed upon and placed into the LLC, the Bank will nonetheless dispose of its LLC interest within the [section 29](#) timeframe as measured from the date legal title to the four OREO Properties was initially acquired by the Bank.
- 15 Alternatively, the Bank at its discretion may follow the procedures in [12 C.F.R. § 5.36](#) to acquire a non-controlling interest in the LLC.

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