OCC No-Obj. Ltr. 89-01 (O.C.C.), Fed. Banking L. Rep. P 83,009, 1989 WL 448179

Office of the Comptroller of the Currency (O.C.C.)
No-Objection Letter

DEBT/EQUITY SWAP IN HONDURAS. EXTENDS 12 U.S.C. 29 TREATMENT OF REAL PROPERTY TO STOCK ACQUIRED DPC.

No-Objection Letter No. 89-01
January 25, 1989

***1** Joseph P. Sverchek, Esq.
Hornsby & Whisenand
Attorneys At Law
1110 Brickell Avenue—Penthouse
Miami, Florida 33131

Dear Mr. Sverchek:
This is in response to your letter of December 23, 1988, in which you seek a no-objection letter from the Office of the Comptroller of the Currency to a proposed debt/equity swap involving the Miami National Bank (the 'Bank'), and the Government of Honduras. The Bank, through an operating subsidiary, wishes to participate in a transaction, whereby the Honduran government will facilitate an exchange of the Bank's Argentine debt (the 'Debt') into qualified Honduran debt which will be converted into local Honduran currency, and ultimately used to purchase an equity interest in a steel jobbing foundry project in Honduras. The Bank proposes to enter into this transaction under its authority to hold property in satisfaction of debts previously contracted (DPC). Based upon my analysis of the facts as set forth in your proposal, and prior Office precedent, I would not object to the Bank's entering the proposed debt/equity swap transaction.

The Proposed Transaction

The Honduran foundry in which the Bank seeks to acquire an equity interest consists of a partially completed plant located on a 32 acre site with access to nearby port facilities. The foundry will produce steel castings made to customers' specifications. As such, the foundry will not maintain an inventory of steel products. The facility, while not completed, already has in place the essential heavy equipment needed to produce the steel used in the casting process.

The foundry, which will ultimately be owned by the Bank, is currently owned by a quasi-public corporation (the 'Selling Entity'), controlled by the Government of Honduras. In an effort to 'privatize' the foundry, and make it operational, the Honduran Government has recently approved the sale of the foundry by the Selling Entity to a United States investment group (the 'Group') unrelated to the Bank.

The Swap Mechanics

As described in your proposal, the transaction will proceed in the following manner. The Bank has arranged to exchange its existing Argentine external debt holdings for Honduran external debt through an intermediary. With the approval of the Central Bank of Honduras, the Honduran debt will then be converted into Honduran local currency (lempiras) at 100% of the face value of the Debt. In addition to ensuring that the conversion will occur at 100% of face value, the Honduran Government has authorized the transfer of one million lempiras to the foundry project to provide working capital. The Honduran Government has also arranged for a series of investment incentives and low cost local financing to the project in order to insure adequate funds to complete foundry construction and commence operations.

Bank Contribution to the Transaction

***2** After the Bank's debt has been converted into local Honduran currency, the funds will be exchanged for an interest in an existing Honduran Corporation (the 'Honduran Corporation'). Under the agreement, in exchange for the debt contribution, the Bank will receive 100% of the preferred nonvoting stock ($US 2,000,000) of the Honduran Corporation. The preferred shares will be held by a wholly owned subsidiary of the Bank. To complete the transaction the Honduran Corporation will then have transferred from the Group the right to acquire the foundry. In consideration for this right, the Group, through a Florida Corporation (the 'Florida Corporation') will receive 100% of the common stock of the Honduran Corporation. The Honduran Corporation as assignee of the Group's option to purchase will exercise its right to buy the foundry from the Selling Entity using the funds received from the Bank's purchase of the company's nonvoting preferred stock. Upon the purchase of the foundry from the Selling Entity, the Bank, through its ownership of the preferred shares, will have effectively swapped its Argentine Debt for an equity interest in the Honduran Corporation.

Provisions to Minimize Risk to Bank

Under the proposed agreement, the preferred stock held by the Bank will produce an annual cumulative return of 10%. The stock will be redeemable at the option of the holder at any time following the seventh (7th) anniversary of the date of the issuance of the preferred stock. Should the stock not be redeemed by the holder, the issuer is required to redeem such stock by no later than the tenth (10th) anniversary date of its issuance.

While the owner of the Florida Corporation (wholly owned by the principal of the Group) will own 100% of the voting common stock of the Honduran Corporation, a number of mechanisms have been put in place to insure that the financial interests of the Bank are adequately protected. First, the owner of the Florida Corporation will enter into a pledge agreement with the Bank under which the common stock of the Florida Corporation will be pledged to the Bank pending the repayment in full of the principal amount of the preferred stock. During the pledge period the Bank will have full discretionary authority with respect to the voting rights of the common stock. Second, to further protect the Bank's interests, the Honduran Corporation will establish during the third year of operations an account at the Bank which will serve as a 'sinking fund' for the redemption of the preferred stock. Contributions in the amount of 20% of the face value of the preferred stock will be paid into the fund on an annual basis for the next five (5) years. Third, an additional means by which the parties intend to reduce the Bank's risk exposure is through the purchase of insurance coverage. Specifically, a 'key man' life and disability policy in the amount of $US 2,000,000 shall be obtained by either the Florida Corporation or the Honduran Corporation on the principal of the Group. The Bank will be named beneficiary of said policy. The Florida Corporation is also exploring obtaining insurance coverage against events such as expropriation, natural disasters, and other events of loss.

***3** Accordingly, under the terms of the agreement, the Bank will be in a position to control the operations of the Honduran Corporation by means of its ability to vote the common stock of the entity during the time prior to the redemption in full of the preferred stock. In addition, the Bank will have the power to sell both the preferred stock and common stock, provided such sale is permissible under Honduran law, in the event such sale is required for the Bank to recoup its investment in the project.

Regulatory Considerations

The investment, as structured, is similar to earlier debt/equity swaps approved by this Office. See OCC No-Objection Letter No. 88-7 (May 20, 1988), reprinted in Fed Banking L. Rep. (CCH) ¶84,047; OCC No-Objection Letter No. 87-10 (November 27, 1987), reprinted in Fed Banking L. Rep. (CCH) ¶84,039. As in the earlier transactions, three specific legal questions arise when such transactions are contemplated. The first issue is whether the transaction qualifies as a proper use of the DPC authority contemplated under 12 U.S.C. § 24 (Seventh) and 12 U.S.C. § 29. The second question is whether the investment, which involves the taking of third party property, may properly be accepted by the Bank. Finally, the transaction raises the issue of whether the swap transaction meets the divestiture requirements enunciated in 12 U.S.C. § 29.

Application of DPC Authority

The Bank seeks to engage in the aforementioned transaction pursuant to its DPC authority. The statutory origin for the DPC authority is based upon 12 U.S.C. § 29 and 12 U.S.C. § 24 (Seventh). Under 12 U.S.C. § 29 (Third), 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.'

Similarly 12 U.S.C. § 24 (Seventh), which addresses the incidental powers of national banks, has been interpreted by the courts, and through analogy to 12 U.S.C. § 29, to authorize the holding of equity securities by national banks in satisfaction of debts previously contracted.

The transaction envisioned by the Bank seeks to obtain an equity interest in a Honduran corporation in satisfaction of debts previously contracted. Both 12 U.S.C. § 24 (Seventh) and 12 U.S.C. § 29 contemplate a national bank's use of its DPC authority in the performance of the business of banking. Further, this Office has sanctioned the use of DPC authority as a vehicle for collecting on otherwise doubtful foreign sovereign debt, See, supra, OCC No-Objection letter No. 87-10 and OCC No-Objection Letter No. 88-7.

DPC authority is limited in scope. It may not be used by an institution as a vehicle to engage in unauthorized activities or for speculative purposes. Courts have consistently held, however, that national banks may acquire corporate stock in satisfaction of a debt previously contracted or in settlement of a disputed claim, reasoning that such an acquisition is authorized as being incidental to the business of banking. See, e.g., First National Bank of Charlotte v. National Exchange Bank, 92 U.S. 122 (1876). See also 12 C.F.R. § 1.12. This result permits banks to recover their costs and reduce their risk relating to the original extension of credit. This Office has approved such DPC activity as incidental to the business of making and collecting loans. See, e.g., OCC Staff Interpretive Letter No. 395, 5 Fed Banking L. Rep. (CCH) ¶85,619 (August 24, 1987). In the present situation, the loans have been rescheduled on several occasions, and have been nonperforming in the repayment of principal or interest for approximately one year.

***4** The Bank need not demonstrate that the loans are in default to exercise its DPC authority. It is sufficient if the Debt was subject to a recent rescheduling or has a documented history of poor performance. In addition, the Bank has determined that under the terms of the proposal it will have considerably more control over the activities of the Honduran Corporation via its stock ownership and powers under the stock pledge agreement. Further, the transaction projects an immediate ten percent (10%) return on investment, and potentially full return on investment after seven (7) years. Thus, in the exercise of good faith business judgment, the Bank has determined that participating in the foundry project is superior to the continued holding of the nonperforming and rescheduled Debt.

Third Party Property

As in earlier debt/equity transactions this proposal involves the Bank accepting unrelated third party property in satisfaction of the Debt. Under 12 U.S.C. § 29 there is no requirement that the property taken DPC be collateral securing the loan, or for that matter, be property owned by the debtor. See OCC No-Objection letter No. 87-10 (November 27, 1987), reprinted in Fed Banking L. Rep. (CCH) ¶84,039, and letters cited therein. The current proposal, consistent with the logic expressed in earlier OCC precedent addressing debt/equity transactions involving sovereign debt, endeavors to place the Bank in a better position to recover the amounts lent. This Office, therefore, has no objection to the taking of third party property in satisfaction of a debt under DPC authority.

Holding Period Limitations

Earlier debt/equity swap transactions considered by this Office in the context of no-objection letters have included various 'put' options insuring that the Bank be afforded an opportunity to divest its interest within the stated five year period. In contrast, this transaction indicates that the Honduran Corporation is required to redeem the Bank's shares only at the end of seven (7) years.

Traditionally, the holding period for DPC property has been limited under 12 U.S.C. § 29 to five years. This Office has consistently applied the same five year holding period to stock acquired DPC as to real estate acquired DPC. See Comptroller's Handbook for National Bank Examiners, Section 203.1 (February 1982). An amendment to 12 U.S.C. § 29, (Pub.L. 96-221, Title VII, § 701(a), 94 Stat. 186 (1980)), permits the Comptroller to approve, upon application, the possession of real property for a period longer than five years, but not to exceed an additional five year term. Since the currently applicable five year holding period applied to stock acquired DPC is based on an analogy to the holding period restrictions originally applicable to real property, this Office is inclined to extend the analogy to requests for holding period extensions under 12 U.S.C. § 29 to stock acquired DPC. As in the real estate context, extension of the five year period would be dependent upon a showing by the association that it has made a good faith attempt to dispose of the DPC property (be it stock or real property) within the five year period, or that disposal within the initial five year period would be detrimental to the association.

***5** In the present situation, the structure of the proposal suggests that the Bank may seek to retain its stock interest in the foundry project for a period in excess of the five year ceiling normally the pledge agreement to sell both the common and preferred shares of the Honduran Corporation prior to the slated seven (7) year of the Honduran Corporation prior to the slated seven (7) year redemption period, it is foreseeable that a willing buyer for the shares may not be readily available. This is due to the fact that the sinking fund contributions which will be used to redeem the preferred shares will not be fully funded until after the initial five year holding period. Potential buyers, therefore, may be reluctant to purchase the stock at a price that would be favorable to the Bank. The same holds true for any contemplated sale of the Bank's domestic subsidiary prior to the seventh year. It may be in the Bank's best interest to retain ownership of the shares until the sinking fund is fully funded, and potential buyers may be attracted on more favorable terms. This is not to say, however, that the Bank is released from its obligation to make a good faith effort to dispose of its interest within the standard five year holding period. This is because it is also possible that economic circumstances in this industry may make it possible to sell the stock at an advantageous price within the five year period. This Office, therefore, need not address at that juncture whether or not an extension of the holding period for stock acquired DPC is warranted. Should such a determination be necessary, it will be considered by this Office upon application by the Bank at the expiration of the initial five year holding period.

Conclusion

The decision not to object to this proposal is premised on your description of the transaction summarized above and the facts set forth in detail in your letter of December 23, 1988. As a condition of this Office's non-objection to the transaction, the Bank will be expected to adhere to the applicable laws and regulations regarding the manner in which the transaction is conducted, and with any future OCC policy guidelines addressing DPC authority. Further, appropriate accounting and reporting standards must be adhered to by the Bank in completing the transaction. See, e.g., AICPA Practice Bulletin No. 4 (1988) (accounting for debt/equity swaps); OCC Banking Circular 200 (May 22, 1985) (accounting for exchange of loans). Additionally, the Bank will ensure that it will execute the transaction in a prudent manner, consistent with safe and sound banking practices, and subject to the OCC's supervisory authority.

I emphasize that the analysis provided herein is not intended as a departure from earlier applications of DPC authaority with regard to debt/equity swaps. Nor should it be interpreted as modifying the conditions under which national banks are permitted to acquire DPC property under existing precedent when the borrower is not a sovereign. Finally, my position is based upon the facts as represented in your December 23, 1988 letter. Any departure from the terms of the proposal as stated may affect this Office's position. Additionally, my review is based upon current law and may be subject to revision as circumstances warrant. This Office further reserves the right to modify the position taken herein or provide additional guidance in the future.

***6** Very truly yours,

Peter Liebesman
Assistant Director
Legal Advisory Services Division

attachment(s)

INCOMING LETTER FOR NO OBJECTION LETTER NO. 89-01
December 23, 1988

VIA OVERNIGHT COURIER

Mr. Peter Liebesman

Assistant Director

Legal Advisory Services Division

Office of the Comptroller of the Currency

490 L'Enfant Plaza, 5th Floor

Washington, D.C. 20219

Re: Miami National Bank Request for Issuance of Non-Objection Letter to Proposed Debt/Equity Swap in Honduras

Dear Mr. Liebesman:

Miami National Bank (the 'Bank') hereby requests the issuance of a Non-Objection Letter by the Office of the Comptroller of the Currency ('OCC') to the proposed debt/equity swap in Honduras in which the Bank wishes to engage. This request for nonobjection, together with the attachments hereto, sets forth the reasons why the Bank believes the OCC should issue such a letter.

As explained below, this transaction has already been appoved by the Central Bank of Honduras and by other relevant agencies of the Government of Honduras and must be consummated by no later than January 23, 1989. Although an extension from the Central Bank of Honduras is possible, particularly if supported by the OCC, it cannot be anticipated that a request for extension would be granted if it were made.

THE DEBT

This proposed transaction is the Bank's considered response to the pressure which the Bank has been receiving from the OCC and from its auditors to resolve its foreign debt exposure problem. As of November 30, 1988, the value of the Bank's foreign sovereign debt portfolio was approximately 225% of the total capital of the Bank. The current face value of the Argentine external debt which is the subject of the proposed swap (the 'Debt'), and which is descrribed in Confidential Annex A hereto, exceeds the capital of bank. Making the proper choices with respect to this Debt is therefore a critical necessity for Bank.

This foreign debt problem was one which the present owners of Bank inherited when they purchased the bank two years ago. Virtually all of the foreign sovereign debt obligations held by Bank have been rescheduled several times and, in the case of the Debt, have been non-performing in the repayment of principal or interest for approximately one year. Due to the current financial conditions in Argentina and the status of current rescheduling agreements, it may be well over twenty years before the bank can expect to recover any substantial amount of the Debt. As a very small bank creditor caught up in these international reschedulings, the bank has virtually no power to cause the debt to be repaid at an earlier time. The Bank must therefore wait until the rescheduled maturity date of the loans (assuming no further reschedulings, moratoria or repudiations) in order to receive any substantial repayment of these loans.

As a consequence of this unhappy situation, the Bank resolved to evaluate all of its alternatives with regard to its foreign debt (including the Debt) and to make some important decisions. One alternative for Bank was to continue to hold the debt. This alternative was not attractive to Bank because holding the debt would not produce any 'return' (i.e., interest or repayment of principal) to bank for the foreseeable future. Moreover, if Argentina in the future decides to repudiate the Debt or to continue an indefinite moratorium on repayment, it is possible that Bank may have to register the Debt as a total loss in its loan portfolio. The Bank therefore would not gain from continued holding of the Debt, and it could lose this important asset altogether.

***7** Another alternative for Bank was to sell the Debt on the international secondary market, where one can currently buy or sell Argentine debt at approximately 20% of the U.S. dollar face value of such debt. If Bank were to do so, however, it would have to absorb a loss of 80% of the face value of the Debt. The impact of this loss would consume over 90% of the Bank's current capital accounts. Since the Bank is not going to lose 90% of its capital by selling the Debt at the very low levels at which this type of debt is traded in the international secondary market, this 'selling' alternative is not a viable one for Bank.

The Bank has spent considerable time and effort in the past two years investigating other possibilities for effectuating the maximum prudent recovery of the Debt. It has been attentive to the prounciations of former U.S. Secretary of the Treasury (and soon to be new Secretary of State) James Baker regarding reinvestment in Latin America under the so-called 'Baker Plan.' It has seen numerous U.S. and foreign banking institutions engage in various debt/equity swaps in the countries of such region. And it decided to explore whether any opportunities existed for the Bank in any of the countries which welcome debt/equity swap investments.

THE PROJECT

As a result of its lengthy investigation, the Bank has identified a good opportunity to acquire, through a debt/equity swap, an interest in a steel jobbing foundry project currently owned by the Government of Honduras (the 'Project'). A 'jobbing foundry is one which produces castings to customers' specifications and does not maintain an inventory of steel products. The Project consists of a partially completed 24,000 square foot plant located on a 32-acre site in Honduras (with easy access to nearby port facilities) which contains a 15-ton electric arc furnace, a 30-ton overhead crane, 2 large compressors and numerous other items of heavy equipment. Attached hereto as Confidential Composite Annexes D1, D2 and E are, respectively: (i) a brief description of the history of the Project; (ii) an appraisal of the plant and equipment (Spanish-language full version along with English-language translation of the executive summary of the appraisal conducted by the Honduran Government); and (iii) various site and plant photographs.

This steel foundry is owned by a quasi-public corporation owned and controlled by the Government of Honduras (the 'Selling Entity'). In an effort to 'privatize' this foundry and to make it operational, the Government of Honduras recently approved the sale of the Project by the Selling Entity in favor of a U.S. investment group (the 'Group') unrelated to the Bank. Honduras is very receptive to foreign investment. See Annex I hereto.

A brief history of this debt/equity swap and copies of the relevant approvals are included in Confidential Composite Annex J hereto. The Honduran Government desires that the steel jobbing foundry become a source of high quality, competitively priced carbon and manganese steel castings which can be exported to trackwork manufacturers and other industrial customers outside of Honduras. Jobbing foundries are among the most labor intensive type of foundries in the industry. For this reason, the average employee wage of $2.03 per hour with fringe benefits in Honduras, as compared with the average U.S. foundry wage of $20.62 per hour with fringe benefits, provides a significant competitive advantage for the sale of Honduran steel products.

***8** Since this will be the first Honduras privatization to be carried out through a debt/equity swap, the Honduran Government has approved the proposed investment by the Group under very favorable conditions. First, the Honduran Government approved the conversion of Honduran external debt into Honduran local currency (lempiras) at 100% face value of the debt, as opposed to charging a discount for the conversion (other countries charge discounts ranging from 10% to 60% of face value of the debt to be converted). Second, the Honduran Government authorized the transfer of 1 million lempiras to the Project to provide for local-cost working capital. Third, the Honduran Government has arranged for a series of investment incentives and low-cost local financing to be made available to the Project in order to provide the additional funds needed to complete the construction of the steel foundry and to commence operations.

STRUCTURE OF THE PROPOSED SWAP INVESTMENT

As noted above, the rights to make the swap investment in Honduras belonged to the Group, and not to Bank. A few weeks ago, the Group approached the Bank to interest it in participating in the proposed investment. What the Bank has agreed to, subject to OCC nonobjection, is that it would exchange the Debt for an interest in an existing Honduran corporation (the 'Honduran Corporation'). A copy of the Articles of Incorporation of the Honduran Corporation are attached hereto as Confidential Composite Annex K. A copy of the agreement between the Bank and the Group is attached hereto as Confidential Annex L (the 'Agreement'), and its particulars are discussed further below.

Under the Agreement, the Bank's interest will consist of 100% of the preferred nonvoting stock (US$2 million face value) of the Honduran Corporation. All of the common stock of the Honduran Corporation would be owned by a Florida corporation (the 'Florida Corporation') that would be owned by the same shareholders of the Group. In essence, the Group would transfer all of its rights to the Project to the Honduran Corporation (receiving in exchange 100% of the Honduran Corporation's common stock), which would then make the swap investment with Honduras.

What the Bank has to contribute, of course, is the Debt, which consists of Argentine external indebtedness. Through an arrangement with an intermediary and the Central Bank of Honduras, the Bank will contemporaneously: (i) transfer the Debt to the intermediary; (ii) receive Honduran debt from the intermediary; (iii) contribute the Honduran debt to the Honduran Corporation; and (iv) receive the preferred shares of the Honduran Corporation. The Honduran Corporation would then take the place of the Group and effectuate the swap investment transactions contemplated in the documents attached hereto as Confidential Composite Annex J. This transaction must occur on or before January 23, 1989 according to the approvals granted by the Honduran Government to the Group.

***9** At the conclusion of this transaction, therefore, the Bank will own 100% of the preferred nonvoting stock of the Honduran Corporation (100% of the common stock will be held by a Florida Corporation owned and controlled by the shareholders of the Group) which will own a steel foundry in Honduras with a substantial amount of working capital and other financing. It is likely that the Bank will not own such preferred shares directly, but rather through 1 or 2 wholly owned operating subsidiaries. See the letter sent to the OCC Atlanta office regarding the establishment of these operating subsidiaries under 12 C.F.R. § 5.34. Annex N.

Relevant confidential background information on the participants in this transaction, such as Group, the Honduran Corporation and others, is found in Confidential Annex F hereto. Also attached as Confidential Annex G hereto is an organizational chart describing the structure of the investment and the relationship of the various participants.

PURPOSE OF THE SWAP INVESTMENT

The Bank has no expertise in the operation of a steel jobbing foundry and desires to invest in the Project utilizing its salvage powers under the debts previously contracted ('DPC') exception to the traditional limits on investments by banks. As a result, the Bank will engage in the Project with Group, whose representatives have vast expertise and contacts in the U.S. and foreign foundry business.

Bank's sole purpose in making this investment is to effectuate a maximum recovery of the amounts due under the Debt, and not to speculate or diversify into steel fabrication in a foreign country. As noted above, the Debt has not been producing any income for Bank and is more apt to produce losses rather than gains for Bank in the future. In order to assure itself that it was making the correct decision in pursuing this investment opportunity, the Bank consulted with various recongized advisors and thoroughly explored the commercial viability of the Project before entering into the Agreement and seeking to obtain OCC clearance of this proposed investment.

Attached hereto as Confidential Annex B is a business plan/feasibility study (the 'Business Plan') prepared by two distinguished business consultants affiliated with the University of Miami in Coral Gables, Florida. The major findings of the Business Plan are:

1. The steel foundry products market in the U.S. is a mature market which is very sensitive to cost differences. Jobbing foundries in the U.S. are becoming less cost-competitive when producing products that have matured and become standardized.

2. Barriers are low to the entry of new steel foundry producers. Competitive cost and quality levels are not difficult to maintain.

3. Many foreign producers of steel foundry products have grown noncompetitive over time due to rising exchange rates and other factors. Significant cost advantages can be achieved without sacrificing essential quality by producing steel foundry products in Honduras.

***10** 4. The proposed Project, even if operating at full capacity, will only require 0.15% of the U.S. ferrous castings market.

5. The marketing efforts and marketing plans of the Honduran Corporation to sell its ferrous castings in the U.S. should ensure sufficient market opportunities for such products. See Confidential Composite Annex M hereto for copies of letters of intent by various U.S. industrial companies to purchase the products to be manufactured by the Honduran Corporation.

6. An analysis of the expected costs and revenues over the first eight years of the Project reveals the following information:

(a) Once the plant is in operation for several years, the gross margin of profitability should be approximately 44%.

(b) In the first year of operation, there will be an operating loss of $760,000 due to start-up expenses.

(c) Notwithstanding the initial losses, there will be an adequate cash flow throughout the early years of the Project; the profitability expected should yield an 'ending cash balance' of US$18 million by the end of the eighth year of operation.

(d) In the most likely scenario, the Project should be profitable by the end of the second year of operation; yielding a net income of US $2,511,000.

(e) The highest profitability should occur at the end of the fifth year of operation, when net income should be approximately US$4,714,000.

(f) Even in the worst case scenario, net income for the Project should average approximately US$1 million per year.

7. Consequently, even under adverse operating conditions, the Project will generate the cash flows needed for its success and for permitting the full redemption of the US$2 million preferred stock to be held by Bank in the Honduran Corporation.

8. The management team selected to develop and operate the steel foundry project is an experienced and talented team of professionals. See Confidential Composite Annexes H1 (Board of Directors and Officers) and H2 (operational plant management) hereto.

Based on the findings of the Business Plan, the same business consultants also conducted a comparative analysis of the economic merits of Bank keeping the debt in its portfolio versus investing in the Project. According to their analysis, which is found in Confidential Annex C hereto:

1. The Debt is presently carried on the books of the Bank at par and is officially classified as 'substandard' and is on a nonaccrual basis. Given the current posture of Argentina's rescheduling, if the Bank were to continue to hold the Debt, it would be reasonable to assume cash inflows for an extended period of time would be zero.

2. By investing in the preferred shares of the Honduran Corporation, the Bank will be gaining an investment in a business with reasonable risks and with a high potential for cash generation. Specifically, under the most likely scenario, the Bank stands to receive approximately US$3.4 million in cash inflows over the next seven years as a result of this swap transaction.

RIGHTS OF THE BANK UNDER THE AGREEMENT

***11** The Bank will establish one or more operating subsidiaries (the 'MNB Subsidiaries') to which the Bank will contribute the Debt to be exchanged for the cumulative preferred shares of the Honduran Corporation which will own the Project once the debt/equity swap in Honduras has been completed. This preferred stock will consist of US$2 million face value preferred stock which will produce an annual cumulative return of 10%. This preferred stock will be redeemable at the option of the holder at any time following the seventh (7th) anniversary of the date of the issuance of such preferred stock. If such stock is not redeemed by the holder, the issuer is required to redeem such stock by no later than the tenth (10th) anniversary date of its issuance.

The Florida Corporation (wholly owned by the principals of the Group) will own 100% of the common stock of the Honduran Corporation. However, in order to protect the interests of the Bank, the owners of the Florida Corporation will enter into a pledge agreement with the Bank pursuant to which the common stock of the Florida Corporation will be pledged to the Bank pending the repayment in full of the principal amount of the preferred stock. During the time that the common stock is pledged, the Bank will have full discretionary authority with respect to the voting of such shares.

In addition, in order to further protect the interests of the Bank, the Honduran Corporation will be required to establish during the third year of operations an account at the Bank which will serve as a 'sinking fund' for the redemption of the preferred stock. The Honduran Corporation will be required to contribute an amount equal to 20% of the face value of the preferred stock into such sinking fund on an annual basis during each of the next five (5) years.

Thus, the Bank will have its investment protected both by means of the cumulative preferred stock which the Bank can require be paid in full at the end of seven (7) years and which, during such period, will generate an annual return of 10%. The Bank will control the operations of the Honduran Corporation by means of its power to vote the common stock of such entity during the time prior to the redemption in full of the preferred stock. In addition, the Bank will have the power to sell both the preferred stock and common stock, provided such sale is permissible under Honduran law, in the event such sale is required for Bank to recoup its investment in the Project.

OTHER PROTECTION FOR BANK'S INVESTMENT

One important feature of the Project is that the Bank and the Florida Corporation intend to obtain insurance coverage against the loss of their investment from one or more sources, such as the U.S. Overseas Private Investment Corporation (OPIC) and/or the International Finance Corporation (IFC). Because the Project is in a country in the Caribbean Basin area and because it is a highly visible and well-supported project in Honduras, it is expected that some form of insurance coverage will be obtained against events such as expropriation, natural disasters and a great number of other events of loss.

***12** The Bank is currently exploring these alternatives and, if it is able to obtain a commitment in the near future from such an insurer, it will communicate this information to the OCC.

In addition, a ‘key man’ life and disability policy in the amount of $2,000,000 shall be obtained on the principal of Group. The Bank will be a named beneficiary of this policy.

REQUEST FOR CONFIDENTIALITY

This request for non-objection contains information which is customarily confidential and is not generally made public. As a result, the Bank requests, pursuant to Section (b)(4) of the Freedom of Information Act, 5 U.S.C. § 522 et. seq. (‘FOIA’), confidential treatment of certain information contained in the Annexes hereto. This confidential business information is of the type which is generally exempt from disclosure under Section (b)(4) of the FOIA. The purpose of the exception provided in this section is to prevent unwarranted disclosure of confidential financial and commercial information, i.e., information of the type which would not be customarily released to the public and the disclosure of which would cause substantial competitive injury to the person from whom the information was obtained. Comstock International, Inc. v. Export-Import Bank of the United States, 464 F. Supp. 804 (DDC 1979); National Parks & Conservation Association v. Morton, 498 F.2d 765 (D.C. Cir. 1974).

The information contained in the Confidential Annexes is of the type not normally released to the public since the status of particular loans, their terms and repayment conditions is generally held confidential by lenders. In addition, the Bank believes that public disclosure of information such as the background of the parties involved, the terms of the proposed acquisition of the Project, the financial background of the Project, and the details of the proposed business plan and anticipated results of the other participants in the Project would likely result in substantial harm to the competitive position of the Bank and of the Project and would be an unnecessary intrusion into the private business affairs of such companies and their shareholders.

REGULATORY JUSTIFICATION

The Bank believes that it has the inherent authority under 12 U.S.C. 24 and the principles set forth in other non-objection letters issued by the OCC to other national banks located in Miami which have worked to make various types of debt/equity investments. See, No Objection Letter No. 87-10, Office of the Comptroller of the Currency (November 27, 1987), reprinted in CCH Fed. Bank. L. Rep. ¶84.039; No Objection Letter of the Office of the Comptroller of the Currency issued to the International Bank of Miai, N.A. (May 20, 1988). In an abundance of caution, however, the Bank is requesting a non-objection letter from the OCC regarding the proposed transaction.

The Bank has the inherent banking power under 12 U.S.C. 24 to reconfigure its loan portfolio and to trade one type of asset for another. The swap of the (Argentine) Debt for Honduran debt is therefore permissible without question and national banks in the United States engage in such transactions on a daily basis.

***13** Once the debt swap has been completed, the Bank would, through the MNB Subsidiaries, swap such debt under the Honduran debt/equity swap program for a preferred stock interest in the Honduran Corporation which will own the Project. The purpose of such a swap is to effectuate the immediate conversion of what is essentially a non-performing asset, the Debt, into a performing asset which is anticipated to generate substantial returns over the near future to permit the Bank to effect a maximum salvage of the Debt.

As in other similar transactions, there are certain legal issues raised by the proposed swap investment. The first is whether the use of 'DPC' authority may be properly invoked in this type of situation; the second is whether the 'DPC' authority extends to property obtained not directly from the debtor, but from another party; and third, whether the proposed holding period of the preferred shares is consistent with the divestiture requirements applicable to 'DPC' acquisitions. If there are any other issues which you believe are applicable, we would be glad to address these issues with you.

A. Condition of the Loan.

The Debt held by the Bank consists of the sovereign obligations of Argentina which have been rescheduled on a number of occasions and have been non-performing for over one year. This Debt would be traded by the Bank, under its inherent banking powers, for Honduran debt, which qualifies under the Honduran debt/equity swap program. In the exercise of good faith and sound business judgment, and after an exhaustive analysis by its business consultants, the Bank has determined that holding an interest in the Project is superior to the continued holding of the Debt. The rescheduled and non-performing condition of the Debt is clear evidence of a change in the financial capacity of the original borrowers sufficient such that the Bank may properly invoke its 'DPC' authority under 12 U.S.C. 24 which, along with judicial precedent and analogies to 12 U.S.C. 29, authorizes the holding of equity securities by national banks in satisfaction of debts previously contracted. The Bank's reliance on its 'DPC' authority in this situation is therefore proper.

B. Taking of Third Party Property.

Nothing in 12 U.S.C. 24 or 12 U.S.C. 29 requires that property taken by a bank under 'DPC' principles be collateral which secured the loan or which is even property owned by the debtor. As noted in the non-objection letters previously cited, there is significant precedent in support of this position.

Nothing in 12 U.S.C. 24 or 12 U.S.C. 29 requires that the Bank and the borrower have originally been in privity of contract with each other. That is, a bank may acquire a loan from another bank, and this assignee bank may then proceed to enforce its rights against such borrower as if it had originally made the loan. The fact that the Bank will trade its Argentine debt for Honduran debt is therefore immaterial to the Bank's intention to immediately convert the Honduran debt into an investment in Honduras under 'DPC' principles. The acquisition by Bank of such Honduran debt is merely an intervening step required to permit the Bank to effect a debt/equity swap in Honduras and thereby acquire a preferred stock interest in the Honduran Corporation which will own the Project.

***14** The critical question in determining whether such exchange of the Debt for the preferred shares are in the best interests of the Bank is based upon an analysis of whether the Bank is in a better position to recover the amounts which it has lent than it was prior to the making of such exchange. As demonstrated by Confidential Annex C, the anticipated return from the Project is dramatically greater than that which is anticipated from continued holding of the Debt. In addition, if the Project performs as expected, the Bank should receive a full return on its investment well within seven (7) years. Only in the sheerest flight of fantasy could Bank ever imagine it would receive a similar repayment of the Debt.

C. Divestiture Requirements.

The preferred stock has been structured in such a manner so as to provide that the Bank can receive a full and complete payout of its investment in a minimum of seven years from the date of issuance of such shares (and a maximum of ten years). The establishment of the 'sinking fund' described above and the Bank's pledge over the shares of the Florida Corporation will ensure the redemption of the preferred shares, if economically possible, by the seven-year mark. Of course, the Bank is free to dispose of its investment in the Honduran Corporation or in the MNB Subsidiaries at any time assuming it found a willing buyer for its interest in the preferred shares. Although, initially, interested buyers may be hard to find, there is no question that if the Project is successful, there should be plenty of would-be purchasers.

D. Use of Operating Subsidiary.

Under 12 C.F.R. § 5.34(d)(1), a national bank may form one or more operating subsidiaries to conduct any activities in which the bank itself may lawfully engage. The use of an operating subsidiary is common and, subject to notification to the OCC as required by 12 C.F.R. § 5.34(d)(1), is permissible.

The appropriate notification letter for the Bank to establish the MNB Subsidiaries is attached hereto as Annex N.

E. Conclusion.

The proposed investment in the Project will not worsen the position of the Bank and has many features that will allow the Bank to recover the sums due under the Debt far in advance of the time in which it could realistically expect to receive full payment from the sovereign debtors. Indeed, if the Project fulfills the reasonable expectations described in the Business Plan, the Bank will receive full repayment of the amount of the Debt, while enjoying an important and positive rate of the return on the investment. Even in the worst case scenario envisioned in the Business Plan, the Project ought to be a relative commercial success and ensure that the Bank will effect a maximum recovery of its investment. As noted earlier, this is the 'proper choice' that Bank believes it must make with respect to the Debt.

If you have any questions, please do not hesitate to contact the undersigned. If you also believe it would assist you and your staff in your deliberations, we would also welcome meeting with you in Washington, D.C. in the near future. Please call us to arrange a time for such a visit.

***15** Very truly yours,

Saturnino E. Lucio, II
Joseph P. Sverchek

OCC No-Obj. Ltr. 89-01 (O.C.C.), Fed. Banking L. Rep. P 83,009, 1989 WL 448179

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