



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

July 2, 2009

Interpretive Letter #1118
July 2009
12 USC 29
12 USC 24

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

Dear []:

This letter is in response to your request on behalf of your client, [], [*City, State*] (“Bank”), for a legal opinion addressing the authority of the Bank to exchange its 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 exchanged DPC property and adjacent, related DPC properties acquired from other banks. For the reasons described below, and subject to the representations and conditions set forth herein, we believe the proposed exchange is permissible under 12 U.S.C. §§ 24(Seventh) and 29.

Facts

In 2004, the Bank purchased participations in two loans made by [] (“*CORP*”) to an individual borrower. In each instance, the loan was secured by [] townhouse units in a townhouse apartment complex located in [*City, State*]. Around the same time, [*CORP*] made additional loans to the borrower, secured by additional townhouse units in the same complex, and sold participations in all or some of these loans to other financial institutions. Four financial institutions, including the Bank, acquired interests in loans to the borrower secured by units in the townhouse complex. [*CORP*] also borrowed funds from a fifth, unrelated financial institution, pledging a security interest in the townhouse complex. None of the loans were cross-collateralized.

The borrower subsequently defaulted and, in October 2008, the loans were foreclosed upon by [*SubCORP*] (a subsidiary of [*CORP*]). The financial institutions determined that it would be more economical to manage the townhouse complex as a whole rather than each institution managing the individual units in which it holds a collateral interest.

The financial institutions also decided that, rather than competing against each other to sell individual units, it would be more prudent to market and sell the complex as a whole.

The financial institutions formed [] (“LLC”), to manage, market, and sell the townhouse complex. [*SubCORP*] deeded the DPC property interests of all five financial institutions, comprising the entire townhouse complex, to the LLC. Accordingly, the LLC will be able to aggregate all the outstanding DPC interests in the complex and will be able to convey complete ownership to a purchaser. Each institution’s membership interest in, and initial capital contribution to, the LLC was based upon its outstanding loan amounts due at the time of foreclosure.¹ The Bank’s outstanding loan amount is approximately \$[], which will result in the Bank’s acquiring a 22.7% interest in the LLC.²

The Bank represents that the LLC will manage, market, and attempt to dispose of the townhouse complex within the guidelines for national banks’ OREO activities.³ The LLC will employ a property manager to oversee the operation of the townhouse complex. The members of the LLC have appointed [], a President of one of the members to make routine, day-to-day operational decisions for the LLC, with major decisions reserved to the members. Distributions of revenue and income from the complex will be allocated, and costs relating to the complex will 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.”⁴ 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.⁵ 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

¹ The financial institutions agreed to allocate membership interests in the LLC based upon outstanding loan amounts due at the time of foreclosure in order to resolve several outstanding disputes about collateral interests in the townhouses. Resolution of these disputes is an additional benefit of the exchange of the Bank’s DPC interests for an interest in the LLC.

² The Bank’s LLC interest currently is being held pro rata by the other four institutions. The LLC Agreement provides that the Bank will acquire its interest upon receipt of regulatory approval.

³ The LLC has agreed to be supervised and examined by the OCC.

⁴ 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).

⁵ 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).

requirement that the bank dispose of the DPC property within five years plus one possible five-year extension.⁶

As described above, the Bank proposes to exchange its DPC property interests (“DPC Interests”) for an interest in the LLC, which will hold and aggregate both the DPC Interests and the DPC property interests of the other participating entities (“Adjacent DPC Interests”).

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.⁷ 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.⁸ For example, 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. To ensure that such an exchange is made in good faith, OCC precedent – including Interpretive Letter No. 395 – have required that the exchange for other property must improve the ability of the Bank to recover, or otherwise limit, its loan loss.⁹ Such determinations necessarily will be specific to each DPC property and the associated exchange.

In this case, by exchanging the DPC Interests for an interest in the LLC, which would wholly own the property interests making up the entire townhouse complex, the Bank believes that it would be better able to recover its loan loss and to dispose of the property. The LLC would operate and maintain the complex as a whole, rather than each individual bank’s bearing responsibility to operate and maintain its individual units in the townhouse complex, providing each of the banks with cost savings through efficiencies. In addition, the Bank represents that for

⁶ 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)).

⁷ 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.”).

⁸ E.g., 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).

⁹ *Id.* As the courts have noted, a national bank has no authority to take DPC property for purely “speculative purposes,” *Atherton, supra*, at 525, and DPC transactions “must be compromises in good faith.” *First Nat’l Bank of Charlotte, supra* at 128.

purposes of disposing of the complex, all parties believe that the most prudent course of action would be to aggregate the DPC Interests and the Adjacent DPC Interests in order to market the townhouse complex as a whole. In doing so, the Bank believes it would improve its ability to dispose of the property, which in turn improves its ability to recover its loan loss.¹⁰

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 temporal 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).¹¹ 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 DPC Interests was acquired by the Bank.

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 Interests for an ownership interest in the LLC. 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 Supervisory Office, 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 Interests 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 townhouse complex property.

¹⁰ 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.

¹¹ Conditional Approval No. 895, *supra*; Interpretive Letter No. 395, *supra*.

- (5) Consistent with the temporal 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 acquired title to the DPC Interests, 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. Any change in the facts or circumstances could result in different conclusions.

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. Our opinion is based on the bank’s representations, submissions, and information available to the OCC as of this date. Any material change in the information on which the OCC has relied may result in a different opinion. 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,

signed

Julie L. Williams
First Senior Deputy Comptroller
and Chief Counsel