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Thomas M. Stevens, CRB, CRS, GRI
President

February 16, 2006

Julie L. Williams, Esq.
First Senior Deputy Comptroller
and Chief Counsel
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Dear Ms. Williams:

Thank you for your letter of January 31, 2006, responding to my letter of January 27, 2006, to Comptroller Dugan concerning rulings of the Office of the Comptroller of the Currency (OCC) that were issued in December 2005.[1] After carefully reviewing your letter, we continue to believe that the rulings inappropriately expand the powers of national banks to engage in real estate development and merchant banking. Moreover, we have concluded that the arguments you present reinforce our belief that the OCC rulings are inconsistent with Federal statute, OCC regulations, and OCC precedents and underscore our concern that the letters will inevitably lead to an irreparable breach in the wall separating banking and commerce.

I. INTRODUCTION

Your assertion that the letters have nothing to do with real estate brokerage by national banks miscomprehends the nature of our concerns. We firmly believe that the letters set in motion a process that will result in the OCC authorizing national banks to engage in real estate brokerage, an activity that we believe is impermissible under the National Bank Act. As you indicated in your reply letter, the Condominium Letter provides that the residential condominiums developed by the bank will be sold through a real estate broker. However, nothing in the letter indicates that the bank must use a broker, or that the use of a broker is required as a matter of law by the National Bank Act or OCC regulations. It is simply a statement of fact which a national bank could decide is not applicable to it. Such a position could be regarded by a national bank as consistent with the OCC's view that national banks may sell bank assets. *See* OCC Interpretive Letter No. 388 (June 16, 1987) ("More generally, this transaction involves the sale of bank assets, which is fully permitted under the national banking laws. . . . Thus, there is no doubt that national banks may sell their mortgage assets or any other lawfully acquired assets.")

[1] OCC Interpretive Letter No. 1044 (December 5, 2005) (Condominium Letter); OCC Interpretive Letter No. 1045 (December 5, 2005) (Hotel Letter); OCC Interpretive Letter No. 1048 (December 21, 2005) (Windmill Letter).

When combined with the OCC's position that state licensing laws are pre-empted and do not apply to national banks if they "obstruct, impair or condition a national bank's ability to fully exercise federally-authorized powers,"[2] we can envision the OCC, in its continuing march to expand national bank powers, permitting national banks to develop residential and commercial real estate under the rubric of "bank premises" and allowing banks to simply post a "For Sale" sign in order to sell such assets without the need of a licensed real estate professional. Ultimately, the OCC may string together such authority with rulings that permit national banks to participate in negotiating sale transactions on behalf of real estate investors[3] and authorize national banks to engage in full service real estate brokerage free from any controls and protections established by state and local laws. We think such a result does not serve consumers and businesses well, breaches the separation of banking and commerce and is not in the public interest.

Your letter provides that the limits contained in the OCC letters, based on the limits on national banks' authority, preclude the consequences we anticipate will be forthcoming. You also indicate that the OCC fully recognizes these limits and will apply them consistently to all national banks. Our concern is that the letters lack any meaningful limitations on national bank real estate activities. Rather than imposing limitations on the real estate powers of national banks, the letters lay out a roadmap for the continued expansion of national banks to develop and sell commercial and residential real estate. Indeed, in our view the OCC has opened the door to the possibility of widespread real estate development that could lead to the wholesale breach of the separation of banking and commerce.

II. THE CONDOMINIUM AND THE HOTEL LETTERS

You also suggest that the authority of national banks to hold and develop real estate used for the bank's activities is subject to "substantial" limits and constraints. You then cite as limits conditions such as the purchase of the real estate must be in furtherance of the bank's banking operations and that the OCC looks to the percentage of use or occupancy of the property in conjunction with the bank's business as a measure of good faith use of the property for banking purposes. A review of the letters indicates that the OCC failed to apply these criteria in respect of the Condominium Letter.

The Condominium Letter indicates that the proposed premises will consist of 12 floors of office space, five floors of hotel space and four floors of condominiums. The letter indicates that the bank will occupy a "small" percentage of the office space. The letter does not define in numerical terms what constitutes a "small" percentage. Eventually, the bank asserts, it will occupy 25 percent of the office space. However, no deadline is specified for achieving this goal. It seems illogical and inappropriate for the OCC to suggest that this transaction is consistent with

[2] 12 C.F.R. §§ 7.4007(b)(2)(vi); 7.4008(d)(2)(i).

[3] OCC Interpretive Letter No. 880 (December 16, 1999). (". . . a bank's involvement in the sale of [the real estate] could entail . . . participating in the structuring of the transaction (including negotiations with the buyer) . . . Competitors in the real estate advisory and management business offer such negotiation services. Your letter states that unless banks can offer the same range of services requested by clients, clients will search for an alternative provider of such services.")

prior OCC precedents when the bank itself admits that it will occupy only a "small" percentage of the space and will within some unspecified time occupy only 25 percent of the office space. The OCC can conclude that such an open-ended statement is consistent with prior OCC precedents only by ignoring the law and precedents. If the test the OCC applied were based on the percentage of use or occupancy in determining a national bank's good faith use for banking purposes, we do not understand how it could conclude that an occupancy percentage that is characterized as "small," and an open-ended assertion that the bank will occupy a specified percentage of the premises at some unspecified date constitutes "good faith" use of the premises. Under such circumstances, it appears that the OCC will accept any percentage of occupancy as an indication of a national bank's good faith. Accordingly, we must conclude that in practice a bank's occupancy percentage is irrelevant to the OCC's determination.

We believe that the statement that the bank will occupy 25 percent of the office space is also defective in that it splits the analysis of the office building from that of the hotel the bank is also developing. The Condominium Letter indicates that the bank will occupy 10 percent of the hotel's available room-nights. A proper analysis suggests that the bank's percentage of space it will occupy should combine the office, hotel and residential condominium spaces. On an aggregate basis, the bank will occupy no more than 16 2/3 percent of the total building (25 percent of 12 floors of office space (i.e., 3 floors); 10 percent of five floors of hotel space (i.e., ½ floor), and 0 percent of four floors of residential condominiums). This level of occupancy will be reached only at some unspecified future time. How the OCC can justify such a low occupancy that is not assured until well into the future is not readily apparent.

We believe that your attempt to justify the Condominium Letter by reference to *Wingert v. First National Bank of Hagerstown*, 175 F. 739 (4th Cir. 1909) is misplaced. We think it is important to review the facts of *Wingert* in order to understand the court's holding. In *Wingert*, a bank that had an existing three-story building on its property sought to tear down the existing building and replace it with a six story building. The bank proposed to occupy one floor and rent the remaining five stories for offices and places of business. The court noted that the property had belonged to the bank since its organization. The court stated that the question presented was "simply a question whether or not the bank which is and has been for many years the rightful owner of a lot of ground improved by its bank building can alter and enlarge the improvement on it so as to furnish better accommodation for the business of the bank and at the same time provide offices which can be rented to tenants." *Wingert* at 741.

The facts set forth in the Condominium Letter are quite different from those in *Wingert*. The bank in *Wingert* was replacing a building that it had long occupied. There is no indication in the Condominium Letter that the property upon which the building would be placed was property that the bank had long held as bank premises nor that an existing building that the bank occupied was to be replaced. The Condominium Letter indicates only that the property was "currently" held as bank premises. The bank in *Wingert* would rent excess office space to other businesses. In the Condominium Letter, the bank's proposal to develop and sell residential condominiums hardly resembles renting office space to businesses. Finally, the bank in *Wingert* had already occupied one of the six floors of the building. In the Condominium Letter, the bank starts off with a "small percentage" of the office space, eventually occupying no more than 16 2/3 percent of the total building space. As a result, the bank will not achieve even the level of

occupancy initially achieved by the bank in *Wingert* for many years, indeed, if ever. These distinctions suggest that the OCC's reliance on *Wingert* is inappropriate.

You also suggest that the *Wingert* court's discussion of the facts was irrelevant to its discussion of the National Bank Act. It is difficult to see how the facts of the case were not relied upon by the court when the section of the decision which discusses the National Bank Act makes explicit reference to the testimony presented by the parties, which presumably involved the history of the bank's involvement in erecting and occupying the building. Finally, because the court in *Wingert* considered only the facts of the case before it, we believe it is incorrect for you to conclude that the court's holding is applicable to every transaction involving bank premises.

Your letter asserts that *Wirtz v. First National Bank and Trust Company*, 365 F.2d 641 (10th Cir. 1966), "recognized the authority of national banks to occupy space in bank premises and lease excess premises to third parties." *Wirtz* does not support your statement. As your letter acknowledges, the issue decided in *Wirtz* was whether the minimum wage requirements of the Fair Labor Standards Act covered employees of a national bank's subsidiary which operated and maintained a building complex owned by the national bank.[4] While the case stated that the bank occupied 20.7 percent of the total space, contrary to the OCC's statement, there is nothing in the ruling to suggest that it was "recognizing" the bank's authority to occupy the space and lease the remaining space. The court's holding that the act applied to the operating subsidiary's employees cannot in any manner be construed as the court recognizing the authority of a national bank to occupy a certain percentage of space as bank premises since that was not at issue. Moreover, in our view, your reference to *Brown v. Schleier*, 118 F. 981 (8th Cir. 1902) does nothing to advance your position. The issue considered by the court in *Brown* was whether a national bank's surrender to the property owner of a building it had erected on leased property should be cancelled because the lease entered into by the bank with the property owner was *ultra vires*. The court simply concluded that national banks may purchase or lease property needed for their business. The opinion makes no mention of what percentage the bank occupied of the four-story building which it had built. Accordingly, we continue to believe that the OCC letters are not supported by the cases you cite.

In our view, the Condominium Letter represents an OCC determination to expand the ability of national banks to develop commercial and residential real estate under the guise of "bank premises." You indicate that the OCC permitted the bank in the Condominium Letter to develop four floors containing 32 residential condominiums because the bank demonstrated that it needed to sell a small number of residential condominiums to establish the required space in an economically feasible manner. To us this sound like a bootstrap justification that enables a national bank to justify virtually any type of real estate development project on the basis that the bank's equity investment is necessary to yield the desired economic result. It seems strange to us that the OCC would permit a national bank to breach limitations imposed by the National Bank Act simply to achieve a target return on its investment. Such a rationale will inevitably lead to permitting national banks to engage in virtually any type of commercial activity that enables national banks to achieve a reasonable economic return, if there is some physical or temporal relationship to bank premises.

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[4] *Wirtz* at 643-644.

You also suggest that the Hotel Letter is consistent with OCC regulations and that perhaps we have misread the regulation. We believe that a review of the language of the regulation and of the regulatory history of the OCC's rulemaking in this matter indicates that we have read the regulation precisely as the OCC originally intended. The rule proposed by the OCC in 1995 provided that a national bank may invest in real estate that is necessary for the transaction of its business. 60 *Fed. Reg.* 11924, 11934 (March 3, 1995). Among the types of real estate which the OCC proposed as necessary for the transaction of a national bank's business was commercial lodging where suitable lodging is not readily available. The proposal read as follows:

> (a) *Bank Premises*- (1) *General.* Under 12 U.S.C. 29, a national bank may invest in real estate that is necessary for the transaction of its business.
> (2) *Type of real estate.* This real estate includes, but is not limited to:
>
> * * *
>
> (iv) Property for the use of bank officers, employees, or customers or for the temporary lodging of such persons in areas where suitable commercial lodging is not readily available, provided that the purchase and operation of the property qualifies as a deductible business expense for Federal tax purposes.[5]

When the proposed rule was adopted by the OCC in 1996, the provision was altered to read as follows:

> (a) *Investment in real estate necessary for the transaction of business*-
> (1) *General.* Under 12 U.S.C. 29(First), a national bank may invest in real estate that is necessary for the transaction of its business.
> (2) *Type of real estate.* For purposes of 12 U.S.C. 29(First), this real estate includes:
>
> * * *
>
> (v) Property for the use of bank officers, employees, or customers, or for the temporary lodging of such persons in areas where suitable commercial lodging is not readily available, provided that the purchase and operation of the property qualifies as a deductible business expense for Federal tax purposes.[6]

The final rule contains two significant changes from the proposal. The OCC added the caption "Investment in real estate necessary for the transaction of business" in the title to § 7.1000 in addition to retaining it in the body of the rule to underscore the importance and significance that a national bank may invest in real property only if it is necessary for the transaction of its business. The rule clearly means that it is necessary to provide temporary lodging when suitable commercial lodging is not readily available. It would be illogical to conclude that it is also necessary to provide such facilities when suitable commercial lodging is readily available. If that were the case, there would have been little reason to adopt the rule with

[5] Proposed § 7.100(a)(1)(2)(iv). 60 *Fed. Reg.* at 11934.
[6] 61 *Fed. Reg.* 4849, 4862 (February 9, 1996).

any restriction at all. Nothing in the Hotel Letter or the Condominium Letter reflects consideration by the OCC of whether suitable commercial lodging is readily available such that the projects are "necessary" for the transaction of the bank's business.

The final rule also deleted the phrase "but is not limited to" from the proposal. This suggests to us that the use of the term "includes" was intended to circumscribe the outer contours of what types of property are acceptable investments for national banks. Your letter means that the limitation in § 7.1000(a)(2)(v), as well as the other limitations set forth in the rule, which restricts a national bank's investment in hotel facilities to instances where "suitable commercial lodging is not readily available," is a meaningless restriction that OCC may choose to ignore. Having adopted a rule imposing a restriction on operating a hotel, the OCC has effectively chosen to ignore its own regulatory limitation. Indeed, your letter suggests that the other limitations in § 7.1000(a)(2) may be ignored as well. Under the rule of statutory construction of *ejusdem generic*, when a general term follows a specific one, the general term should be understood as a reference to subjects similar to the ones enumerated. *Norfolk & Western R. Company v. Train Dispatchers*, 499 U.S. 117, 129 (1991); *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114-115 (2001). The Hotel and Condominium Letters ignored this principle by permitting national banks to engage in an activity (hotel development) that is broader than the activities permitted by the OCC's regulation. As a result, the OCC has, in effect, amended its rule to delete the requirement that the real estate investment be necessary for the transaction of the bank's business. We believe that this ignores the limitations of the National Bank Act and the OCC's regulations, and reflects questionable administrative procedure. At a minimum, OCC precedent suggests that you should have sought public comment before issuing the Hotel Letter. In this regard, we note that your suggestion that the term "bank premises" should be interpreted expansively is at odds with the OCC's definition of the term when it adopted its rule regarding investment in bank premises.[7] At the time it adopted the rule, the OCC stated the following definition would apply:

> The final rule also defines the term "bank premises" by adopting certain provision of the Call Report line item on Bank Premises and Fixed Assets. Under the final rule, "bank premises" is defined as: (1) premises that are owned and occupied (or to be occupied, if under construction) by the bank, its branches, or its consolidated subsidiaries; (2) capitalized leases and leasehold improvement, vaults, and fixed machinery and equipment; (3) remodeling costs to existing premises; (4) real estate acquired and intended, in good faith, for use in future expansion; or (5) parking facilities that are used by customers and employees of the bank, its branches, and its consolidated subsidiaries. The inclusion of this definition will clarify the types of investments and loans subject to this section.[8]

It is curious that in the Hotel and Condominium Letters, the OCC ignored the definition of "bank premises" which the OCC had instructed national banks to use in connection with investments in real estate premises under § 5.37.

[7] 61 *Fed. Reg.* 60342 (November 27, 1996).
[8] 61 *Fed. Reg.* at 60355.

We also believe that the Condominium Letter is at odds with prior OCC actions which indicate that the development of residential condominiums is not within the authority of a national bank. In 1997, the OCC requested public comment on a request by NationsBank, N.A. to engage in limited real estate development activities in connection with bank premises through an operating subsidiary.[9] The bank proposed to establish an operating subsidiary to engage in the development of real estate in locations the bank occupied as bank premises. In conjunction with constructing an office building, the bank also proposed to sponsor the development of a building containing approximately 45 residential condominium units. The bank contended that the residential building would be ancillary to the bank's office building and both buildings would form an integrated mix-use development. The OCC's notice states that OCC regulations—

> permit a national bank to conduct an activity through its operating subsidiary that is different from that permissible for the parent national bank . . . For activities not previously approved by the OCC, the OCC provides public notice and opportunity for comment on the application by publishing notice of the application in the Federal Register.[10]

The OCC did not approve NationsBank's request to develop residential condominiums. The OCC's letter approving other aspects of the proposal suggests that the proposal had changed, and that rather than develop the residential condominiums, the bank would to sell a portion of the property to an unaffiliated third party who would develop the residential units.[11] As best as we can determine, until issuance of the Condominium Letter, the OCC had never previously approved a national bank's request to develop residential properties. The residential condominium development activity approved by the OCC in the Condominium Letter is substantively indistinguishable from NationsBank's 1997 proposal which the OCC did not approve. By its own admission in its 1997 *Federal Register* notice, the OCC regarded residential real estate development as an activity that "is different from that permissible for the parent national bank." If residential real estate development was not permissible for national banks in 1997, it should not be a permissible activity in 2005. We believe it is difficult to reconcile the OCC's 1997 position in which it rejected NationsBank's request with its 2005 position in which it approved the development of residential condominiums. Moreover, if the OCC thought it important enough to seek public comment in 1997 on the new activity, in accordance with established OCC policy, the OCC should have requested public comment prior to issuance of the Condominium Letter in 2005.[12]

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[9] 62 *Fed. Reg.* 16213 (April 4, 1997).
[10] 62 *Fed. Reg.* at 16214.
[11] OCC Conditional Approval No. 298 at fn. 2.
[12] 62 *Fed. Reg.* at 16214; 12 C.F.R. § 5.37(d)(4) ("However, if the OCC concludes that an application presents significant and novel policy, supervisory, or legal issues, the OCC may determine that any or all parts of §§ 5.8 [public notice], 5.10 [public comment], 5.11 [public hearing] apply.")

III. THE WINDMILL LETTER

Your letter suggests that the Windmill Letter represents nothing more than a loan disguised as an equity investment. We believe that it represents a dramatic step in the direction of eroding the separation of banking and commerce. Public commenters appear to agree with our assessment[13]. In this regard, we point out the comments of the OCC regarding this separation. In testimony before the House Committee on Banking and Financial Services, Comptroller Ludwig indicated the following:

> . . . I am concerned that we do not approach this issue in such a rigid manner that we prevent the natural evolution of the banking industry. We must recognize that the line separating banking from commerce has shifted over the past two centuries, and our views of what is a banking activity and what is a commercial activity will continue to change over time.[14]

This position is consistent with prior OCC testimony to the effect that "we should keep in mind that there is no bright and unyielding line between banking and commerce."[15] We believe that the Windmill Letter represents yet another marker in the OCC's continuing efforts to permit national banks to expand into commercial activities.[16]

IV. CONCLUSION

Notwithstanding the assertions set forth in your letter, we continue to be of the opinion that the OCC's actions represent a marked departure from what is permitted by the National Bank Act, the OCC's regulations and previous OCC issuances regarding the types of real estate activities in which national banks may engage. In effect, the OCC has removed any effective barriers to the continued expansion of national bank real estate powers. The OCC's actions have the potential to lead to a significant erosion of the separation between banking and commerce. Such

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[13] "Tough Enforcement Belie Effort to Expand Bank Powers," *Financial Services Policy Bulletin*, Stanford Washington Research Group (January 25, 2006).

[14] Testimony of Eugene Ludwig, Comptroller of the Currency, before the Committee on Banking and Financial Services, House of Representatives, May 22, 1997. OCC NR 97-48.

[15] Testimony of Eugene Ludwig, Comptroller of the Currency, before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Banking and Financial Services, House of Representatives, February 13, 1997. OCC NR 97-15.

[16] As evidence of yet another OCC action permitting a national bank to expand into commercial activities, we note the OCC's approval of the application of a national bank to engage in global trade management services on the basis that the provision of such services will enable the national bank to become engaged with clients earlier and to better understand the total needs of a customer. In granting its approval, the OCC indicated that expansion of such capabilities "will allow the[b]ank to more effectively meet customers' needs and expectations for integrated trade solutions. The OCC stated that the bank's proposed acquisition was a response to efforts by firms engaged in transportation and shipment to provide financing for trade as part of a complete package of services for customers seeking a single provider for their global trade requirements. The bank had observed that it was competing for trade finance business with non-bank shippers and other trade services companies that provide a comprehensive package of finance and trade services. The acquisition of the company enabled the bank to couple the company's trade management services with those of the bank's trade finance business to offer customers a package of trade-related finance and services that would be more competitive with other companies than would be the case with the bank offering solely finance services. OCC Corporate Decision No. 2005-02 (March 24, 2005).

expansion will dramatically increase the risk exposure of national banks and threaten the safety and soundness of the nation's banking system. Accordingly, we continue to urge the OCC to reconsider these recent rulings and, in any case, cease from taking any future actions that have the result of expanding bank powers to engage in real estate development.

We appreciate the opportunity to respond to your letter and your attention to this matter that is of such great public importance.

Sincerely,

Thomas M. Stevens, CRB, CRS, GRI
2006 President, National Association of REALTORS®