



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

January 12, 1998

Interpretive Letter #818
February 1998
12 U.S.C. 36J4

Dear []:

This is in response to your letter to the OCC's Midwestern District Office in Kansas City, requesting confirmation that two methods outlined in your letter for disbursing loan proceeds at a national bank's loan production office ("LPO") would be legally permissible and would not cause the LPO to be a branch of the owning bank. Your letter has been forwarded here, and I apologize for the delay in responding. As explained below, I agree with your conclusion.

FACTS

According to your letter, the [] ("the Bank") plans to open an LPO in [*City, State*], that primarily will originate mortgage loans. The long established practice of mortgage companies and other banks that will be the Bank's competitors in that area is to deliver checks representing loan proceeds to the real estate agents, seller, and sometimes a balance to the mortgagor, at the time and location of the closing. Since the LPO will have a limited staff, it will not be possible for employees to travel to other locations, such as the offices of escrow agents, for closings and loan disbursal. Therefore, for competitive reasons, the Bank desires to have loan closings, including disbursal of loan proceeds, take place at the LPO.

You have suggested two possible ways to structure the LPO's operations that you believe would accommodate the Bank's needs, while at the same time avoiding impermissible branching activities:

1. The Bank would establish a correspondent account at an unaffiliated bank. Prior to the time of the closing, the correspondent bank would prepare cashier's checks drawn on itself and representing correspondent bank funds in amounts requested by the Bank. The correspondent

bank would deliver these checks to the LPO, where they would then be delivered by the Bank LPO employee to the borrower and other parties entitled to payment from loan proceeds, e.g., realtors. Afterwards, the correspondent bank would debit the Bank's correspondent account for the amount of the checks and would be compensated for issuing the checks.

2. An unaffiliated correspondent bank would establish on its books a regular checking account in the correspondent bank's name. Prior to the time of the closing, the correspondent bank would place a sufficient amount of its own funds into this account to cover a planned loan disbursement by the Bank. By agreement between the Bank and the correspondent bank, the Bank LPO employee preparing the documents and materials for the closing would also prepare and execute checks drawn on this account and representing the loan proceeds. In essence, the LPO employee would be preparing cashier's checks drawn on the correspondent bank. At the closing, the LPO employee would deliver these checks to the borrower and other appropriate parties. Thereafter, the correspondent bank would settle the account by charging the Bank's correspondent account, receiving a fee for its services.

You believe that under either scenario, there would not be any disbursement directly from the Bank's funds at the closing, and therefore the LPO should not be considered a branch for purposes of the McFadden Act, 12 U.S.C. § 36. You have requested confirmation that we agree with that conclusion.

LEGAL ANALYSIS

As you are aware, the courts have identified three requirements for a bank facility to be a branch under the McFadden Act. It must offer at least one of the "core" banking activities listed in 12 U.S.C. § 36(j), namely, receiving deposits, paying checks, or lending money. *Clarke v. Securities Industry Association*, 479 U.S. 388 (1987). In addition, a facility must be "established," i.e., owned or rented, by the bank. *Independent Bankers Association of America v. Smith*, 534 F.2d 921 (D.C. Cir.), cert. denied, 429 U.S. 862 (1976) ("*Smith*"); *Independent Bankers Association of New York v. Marine Midland Bank*, 757 F.2d 453 (2d Cir. 1985), cert. denied, 476 U.S. 1186 (1986). And, the convenience to the public of the facility's location must give the bank a competitive advantage in obtaining customers. *First National Bank in Plant City v. Dickinson*, 396 U.S. 122 (1969). For a more detailed discussion of these principles, see generally Interpretive Letter No. 634, [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,520 (July 23, 1993).

The only issue raised by your letter is whether core banking activities would be performed, that is, whether loans would be "made" at the LPO if either of the plans you outline are implemented. The leading cases construing the core McFadden activities specifically conclude that a loan is "made" for purposes of the McFadden Act at the time and place a borrower receives lending bank funds. *Smith*, 534 F.2d at 948, 946 n.95; *Illinois ex rel. Lignoul v. Continental Illinois National Bank*, 409 F. Supp. 1167, 1178 (N.D. Ill. 1975), aff'd, 536 F.2d 176 (7th Cir.), cert. denied, 429 U.S. 871 (1976).

Accordingly, the OCC has concluded that if LPO operations are structured in such a way that a borrower does not receive bank funds, then funds representing loan proceeds may be disbursed at an LPO without violating branching restrictions. This conclusion has been embodied in an OCC interpretive ruling:

(a) *General.* For purposes of what constitutes a branch within the meaning of 12 U.S.C. 36(j) and 12 CFR 5.30 [the OCC's rule on branch licensing], "money" is deemed to be "lent" only at the place, if any, where the borrower in-person receives loan proceeds directly from bank funds:

(1) From the lending bank or its operating subsidiary; or

(2) At a facility that is established by the lending bank or its operating subsidiary.¹

Interpretive Ruling 7.1003, 12 C.F.R. § 7.1003. A loan disbursement that fits these criteria will constitute a branching activity, that is, the location will be deemed to be a place where money is "lent" for purposes of 12 U.S.C. § 36, and will require licensing as a branch. On the other hand, if the criteria are not satisfied, the location will not be a branch.

Neither of the scenarios proposed in your letter would satisfy these requirements. Although disbursement would be performed by Bank personnel at a Bank-established facility, borrowers would not receive loan proceeds directly from Bank funds, as required by the Interpretive Ruling and case law. Therefore, I agree with your conclusion that, under either alternative, the LPO would not be a branch of the Bank under 12 U.S.C. § 36.

The OCC has previously addressed a fact situation that was similar to your first alternative in its use of cashier's checks issued by a bank other than the lending bank. In that case, an affiliate of the lending bank originated loans on behalf of the lending bank, issued cashier's checks drawn on its own funds to represent loan proceeds, and delivered these checks to borrowers on its own premises. It was then reimbursed by the lending bank. Interpretive Letter No. 721, [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-036 (March 6, 1996).

Although I am not aware of any OCC precedents addressing your second alternative, I find it to be legally permissible. The analysis is the same whether the borrower receives a correspondent bank cashier's check, or a check drawn on the correspondent bank by an LPO employee. The crucial factor in either case is that the borrower would not receive Bank funds.

¹ Paragraph (b) of the ruling deals with the permissible, off-premises disbursement of bank funds by independent third parties such as escrow agents. Your letter does not involve that situation.

An additional option for the disbursement of funds at the LPO that you may wish to consider is the use of independent third parties, such as escrow agents. The OCC has taken the position that disbursement may be performed at an LPO where the lending bank disburses loan funds to a closing or escrow agent several days prior to a loan closing, and at the closing the escrow agent delivers to the borrower a check drawn on the escrow agent's own account. Letter of Christopher C. Manthey, Senior Attorney, Bank Activities and Structure Division (December 22, 1994, unpublished). A copy of that letter is attached for your information.

I hope that this has been responsive to your inquiry. If you have further questions, please feel free to contact Senior Attorney Christopher C. Manthey of my staff at (202) 874-5300.

Sincerely,

/s/

Eric Thompson
Director
Bank Activities and Structure Division

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