



Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

December 16, 1999

Interpretive Letter #880
February 2000
12 USC 24(7)

Re: Investment Advice Related to Real Estate

Dear []:

This letter responds to your request for an opinion regarding the permissibility of certain investment advisory and related intermediary services (“Services”) provided in connection with investment in real estate by a bank’s clients. The Services include activities in connection with the exchange of existing investment real estate in a client’s portfolio (the “Original Property”) for “like kind” investment real estate (the “Exchange Property”) in a tax-free exchange under Internal Revenue Code Section 1031 (“1031 Exchange Transaction”). In connection with the real estate investment advisory services the banks would take part in negotiating the 1031 Exchange Transactions. Based on the representations made in your letter and in subsequent conversations with this Office, and for the reasons discussed below, we believe the bank’s negotiating services, in the manner described, are permissible.

I. Background

A. *Real Estate Investment Advisory and Related Intermediary Services*

As described in your letter, a national bank would provide Services to individuals and institutional investors whose investment portfolios include investment real estate held for the purpose of realizing capital appreciation or income. These real estate investments would typically include apartments and other multi-family housing, office buildings, medical offices, industrial facilities, warehouses, and other commercial buildings. They could also include raw land on which the client-investor may intend to construct a “built-to-suit” facility for an end-user or which the client-investor would develop, at least partly on a speculative basis, and hold for lease rather than immediate disposition.

A bank providing services would consult with a client to determine the composition of the client's existing portfolio, his objectives and his tax exposure. The basic analytical tools employed in evaluating this information are comparable to those employed in general investment management, and include the consideration of diversification, cash flows, potential for appreciation, the estate planning objectives of the client, and liquidity needs. In its analysis of the client's existing real estate portfolio, a bank would undertake a review of the concept, design, layout, suitability for purpose, and prospects of any real estate, including an identification of possible Original Properties and any characteristics of Exchange Properties in consideration of a potential 1031 Exchange Transaction.

Based on its review of its client's objectives, needs and portfolio, a bank providing Services would prepare a written analysis of the client's portfolio and would formulate a proposal to hold or dispose of specified Original Properties and, in the case of a recommended disposition, consider possible exchanges and proposed characteristics of possible Exchange Properties.

B. 1031 Exchange Transactions

Section 1031 of the Internal Revenue Code (IRC) provides for tax deferred treatment for exchanged property of like-kind.¹ IRC Section 1031 also generally requires that the acquisition be completed within 6 months of the disposition of the original property.

Your letter states that a bank's involvement in the sale of Original Property could entail: (1) advising its client on sale strategies; (2) placing the property by contacting a limited number of qualified investors; (3) identifying and engaging a real estate broker; (4) advising the investor concerning valuation issues and the terms of sale, with particular emphasis on the consistency of such terms with the investor's overall investment strategy; (5) participating in the structuring of the transaction (including negotiations with the buyer)²; and (6) administering the closing. The bank's involvement in the purchase of an Exchange Property would entail similar services.

A bank would also provide general administrative services in connection with 1031 Exchange Transactions. These services include: (1) disbursement services; (2) helping a client identify and comply with contractual conditions; (3) assisting a client in coordinating actions associated with the real estate transactions (including the review of title information and the sufficiency of title insurance coverage); (4) identification of and the engagement of persons to provide any required real estate management

¹ "Like-kind" is defined as real property for real property, this means exchanging not only an apartment building for an apartment building, but also an apartment building for raw land, as long as the new property will be held for productive use or investment.

² Although negotiating 1031 Exchange Transactions represents only a very small portion of the proposed Services, such negotiation services are an element of the competitive range of real estate investment advisory services that your letter states that a bank must offer to meet its clients' portfolio objectives. 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. See discussion at pages 6 - 9 *infra*.

services; (5) preparation of tax returns; and (6) in consultation with appropriate third-party tax experts, documenting and assisting the client in reviewing compliance with the technical requirements of IRC Section 1031. Once the 1031 Exchange Transaction was finalized, a bank would ordinarily continue to provide general real estate investment portfolio advice and services with respect to the Exchange Property and other investment property held by the client.

C. *Limitations and Conditions*

Your letter also represents that a bank involved in a 1031 Exchange (1) will not arrange transactions resulting in the acquisition of real estate to be “held for productive use in a trade or business”; (2) will not directly market or advertise real estate to the general public, or be involved “on a day-to-day basis” in showing the property to prospective acquirers; (3) will not base its fees for the Services on the profits ultimately realized by clients on 1031 Exchange Transactions; and (4) will not acquire any of the subject real estate. A bank could, however, lend in connection with a 1031 Exchange Transaction. If the bank desires to lend in connection with a 1031 Exchange Transaction, the bank will base its loan decision on an independent credit evaluation, and the loan will be on terms and under circumstances substantially the same as those prevailing at the time for comparable transactions with or involving non-1031 Exchange Transaction clients.

II. Discussion

A. *The National Bank Act*

The National Bank Act provides, in relevant part, that national banks have the power:

[t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes.³

The powers clause of 12 U.S.C. § 24(Seventh) is a broad grant of power to engage in the business of banking, including, but not limited to, the five enumerated powers and the business of banking as a whole.⁴

Many activities that are not included in the enumerated powers are also part of the business of banking. Judicial cases reflect three general principles used to determine whether an activity is within the scope of

³ 12 U.S.C. § 24(Seventh).

⁴ *NationsBank v. Variable Life Annuity Co.*, 513 U.S. 251 (1995) (“*VALIC*”). The Comptroller of the Currency is the administrator of the National Bank Act and is the primary supervisor of national banks and accorded deference in determining the scope of “the business of banking.” See 12 U.S.C. §§ 1, 24, 26-27, and 481.

the “business of banking” under 12 U.S.C. § 24(Seventh): (1) is the activity functionally equivalent to, or a logical outgrowth of, a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks.⁵

National banks are also authorized to engage in an activity if that activity is incidental to the performance of the five powers enumerated in 12 U.S.C. § 24(Seventh) or incidental to the performance of an activity that is part of the business of banking.⁶ Incidental activities are activities that are permissible for national banks, not because they are part of the “business of banking,” but rather because they are “convenient” or “useful” to an activity that is part of the “business of banking.”⁷

B. Real Estate Investment Advisory and Related Intermediary Services are Part of the Business of Banking

The OCC has long recognized that the provision of investment advisory services relating to real estate is part of the business of banking and thus permissible for national banks.⁸ In particular, the OCC has specifically determined that a national bank may serve as an advisor to a real estate investment trust and

⁵ See, e.g., *Merchants’ Bank v. State Bank*, 77 U.S. 604, 648 (1871) (certification of checks has grown out of the business needs of the country and involves no greater risk than a bank issuing a certificate of deposit); *M&M Leasing Corp. v. Seattle First Nat’l Bank*, 563 F.2d 1377, 1382-83 (9th Cir. 1977), *cert. denied*, 436 U.S. 987 (1978) (personal property lease financing is “functionally interchangeable” with the express power to loan money on personal property); *American Ins. Assoc. v. Clarke*, 865 F.2d 278, 282 (D.C. Cir. 1988) (standby credits to insure municipal bonds is “functionally equivalent” to the issuance of standby letters of credit).

⁶ *VALIC*, *supra*; Interpretive Letter No. 742 (August 19, 1996), *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,106 (bank may provide full Internet access to customers and non-customers in order to create a package of related services needed to satisfy consumer demand and enable the bank to successfully market its home banking services); Interpretive Letter No. 737 (August 19, 1996), *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,101 (where a national bank was providing a closed stored value system, the provision of multi-function smart cards and card readers is incidental to the business of banking because it enables the bank to create a package of related services required to satisfy customer needs and to market successfully its stored value system).

⁷ *VALIC*, *supra*; *Norwest Bank Minn., N.A. v. Sween Corp.*, 916 F. Supp. 1494 (D.Minn. 1996), *aff’d* 118 F.3d 1255 (8th Cir. 1997).

⁸ Interpretive Letter No. 508 (April 6, 1990), *reprinted in* [Transfer Binder 1990-1991] Fed. Banking L. Rep. (CCH) ¶ 83,206 (operating subsidiary may engage in real estate investment advisory services, including identifying and evaluating proposed real estate investments; making specific investment recommendations to a client with respect to investment in, or disposal of, individual real estate investments; providing analysis to client as to performance of portfolio; acting as finder to bring together parties for real estate transaction); Interpretive Letter No. 389 (July 7, 1987), *reprinted in* [Transfer Binder 1988-1989] Fed. Banking L. Rep. (CCH) ¶ 85,613 (allowing operating subsidiary to engage in similar real estate investment advisory activities). See also Conditional Approval No. 241 (May 1, 1997) (approving operating subsidiary’s investment in partnership advising clients relative to their real estate, including purchase and sale of real estate and acting as finder to bring together parties wishing to finance the purchase, construction, development and operation of real estate).

provide investment advice and management of a portfolio of real estate equity investments.⁹ The scope of the real estate investment advisory component of the Services is well within the range of those permitted in Interpretive Letter No. 508. The evaluation process, the proposal and implementation of an investment strategy, the ancillary services and fee terms are the same as those approved in Interpretive Letter No. 508.¹⁰

Real estate investment advisory services respond to the needs of customers and benefit the bank. These services meet the convenience and needs of customers by enabling them to take advantage of a broad range of products and services in a single interaction. Customers benefit from the ability to utilize fully a bank's expertise in real estate investment advice to enhance their assets and meet their financial objectives. The ability of a national bank to offer customers a complete package of real estate investment advisory services enables the bank to better serve its customers by offering a full range of products to meet their needs, compete more effectively with other companies providing similar services, expand its customer base, and generate additional fee income.

C. The Negotiation of 1031 Exchange Transaction in the Present Case is Incidental to the Business of Banking

Under the proposal outlined in your letter, a national bank also would participate in negotiating 1031 Exchange Transactions in connection with the provision of comprehensive real estate investment advisory services. Those negotiations would constitute a *de minimus* portion of the bank's total revenue from its real estate investment advisory services, but the ability to offer this service as part of a full range of real estate investment advisory services is integral to the bank's ability to successfully compete with other types of firms that offer a full range of financial products and services in connection with their real estate investment advisory services. Were a bank unable to offer its services in the negotiations of 1031 Exchange Transactions, it would be unable, in some cases, to help obtain the property that it had recommended as most appropriate for a particular customer. Moreover, the bank would be unable to provide the full range of services offered by competitors in the real estate investment management business. Accordingly, for the reasons discussed below, we conclude that a national bank may offer its services as negotiator in a 1031 Exchange Transaction, in the manner described herein, as an activity incidental to the bank's authority to provide real estate investment advisory services.

⁹ Interpretive Letter No. 508, *supra*; Interpretive Letter No. 389, *supra*.

¹⁰ See also Conditional Approval No. 276 (May 8, 1998) (approving, in connection with the origination of extensions of credit by third parties, appraisal management; title review activities; closing management; property inspections; property preservation services; and real estate tax services). Furthermore, as part of the permissible real estate investment advisory services, the bank may act as finder to bring together the parties for the 1031 Exchange Transaction. The OCC has determined that a national bank, as part of comprehensive real estate investment advisory services, may assist a client by acting as a finder to bring together parties for a recommended real estate transaction. Interpretive Letter No. 508, *supra*. See also Conditional Approval No. 241, *supra*.

I. *The Negotiating Services are Necessary to Successfully Provide Competitive Financial Planning Services*

The Services proposed in your letter are supported by ample precedent which holds that national banks may provide a variety of ancillary products and services incidental to the business of banking when necessary to successfully package or promote permissible banking related products or services. Products and services are incidental to a banking activity, as is the case here, when they make the use of a banking authorized product or service more convenient and thereby increase customer demand for banking products. For example, in *Clement Nat'l Bank v. Vermont*,¹¹ the Supreme Court held that a national bank could, incidental to its deposit services, perform the additional services of computing, reporting, and paying the tax levied on the interest earned by bank customers on their deposits, thereby promoting the convenient consumer use of its business and enhancing the demand for a banking service. Similarly, in *Miller v. King*¹² the Supreme Court held that a national bank could institute a lawsuit on behalf of a customer to collect funds as an activity incidental to the bank's power to accept deposits; the bank's service to facilitate collection of the funds enabled the customer to use the bank's deposit services.¹³

Numerous OCC precedents have also confirmed that banks may provide a variety of ancillary incidental products and services to promote consumer use or demand for banking products. In OCC Interpretive Letter No. 754, the OCC permitted a national bank to sell general purpose computer hardware to other financial institutions as part of its larger computer network services in response to consumer demand for a single-source provider of network services.¹⁴ The OCC has also authorized a national bank to provide full Internet access to customers and non-customers in order to create a package of related services needed to satisfy consumer demand and enable the bank to successfully market its home banking services.¹⁵ Similarly, the OCC has permitted a national bank to provide a smart phone to offer a variety of banking and non-banking services "to increase the customer base and the usage of the program."¹⁶

¹¹ 231 U.S. 120 (1913).

¹² 223 U.S. 505 (1912).

¹³ See also *Corbett v. Devon Bank*, 299 N.E.2d 521, 12 Ill. App. 3d 559 (1973) (as a means of promoting its banking business, a national bank may sell state motor vehicle licenses).

¹⁴ Interpretive Letter No. 754 (November 6, 1996), reprinted in [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,118 (national bank operating subsidiary may sell general purpose computer hardware to other financial institutions as part of larger product or service when necessary, convenient, and useful to bank permissible activities).

¹⁵ Interpretive Letter No. 742, *supra* note 6.

¹⁶ Interpretive Letter No. 611 (November 23, 1992), reprinted in [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,449. See also Interpretive Letter No. 737; Interpretive Letter No. 737 (August 19, 1996), reprinted in [1996-1997] Fed. Banking L. Rep. (CCH) ¶ 81,101 (national banks may offer non-banking products as part of larger product or service to create a package of related services required to satisfy customer need and promote other permissible banking services); Conditional Approval Letter No. 221 (December 4, 1996) (Internet access incidental to the business of banking because Internet access is necessary for the successful marketing of home financial services and constitutes only a minor part of the total package of services offered).

Likewise, courts have relied on incidental powers to permit bank affiliates to provide nonbanking services where necessary for the successful promotion of other permissible services. This concept was applied to bank holding companies in *National Courier Ass'n v. Board of Governors*.¹⁷ The *National Courier* court, in analogizing to the powers of national banks under 12 U.S.C. § 24(Seventh), stated that “[i]n enumerating the activities that could be carried on, [Congress] certainly could not have meant to forbid engagement in other ‘incidental’ activities as were reasonably necessary to carrying out those that were enumerated.”¹⁸ The promotional powers concept was further developed in *Alabama Ass’n of Insurance Agents v. Board of Governors*,¹⁹ where the court reviewed orders of the Board of Governors of the Federal Reserve System (“Board”) granting holding companies permission to act as agent with respect to certain types of insurance. The orders were issued under provisions of the Board’s then Regulation Y that permitted holding companies to sell insurance, including insurance sold as a matter of convenience to the purchaser, so long as the premium income did not constitute a significant portion of the aggregate insurance premium income of the holding company. The court, troubled that the regulation did not require the insurance to be related at all to banking, nevertheless concluded that “[t]o the extent that [the Board asserts] that [the insurance] is an incidental activity reasonably necessary to the carrying on of clearly permissible [activities] we would find that it is [an activity] that, if supported, would be legally sufficient.”²⁰

As described above, the negotiation of 1031 Exchange Transactions presents a comparable situation. Your letter argues that a bank should be able to negotiate the transaction in order to benefit its customers by providing comprehensive Services.

Clients may obtain real estate investment advisory services from a bank, including recommendations for one or more 1031 Exchange Transactions. A client obtaining these services may wish to pursue a recommended 1031 Exchange Transaction with the bank participating in the negotiations. This would

¹⁷ 516 F.2d 1229, 1240 (D.C. Cir. 1975) (“*National Courier*”).

¹⁸ *Id.*

¹⁹ 553 F.2d 224 (5th Cir. 1976), *vacated in other part*, 558 F.2d 729 (1977), *cert. denied*, 435 U.S. 904 (1978).

²⁰ *Id.* at 242 (citing 12 U.S.C. § 24(Seventh)). Recently the Board approved a holding company’s application to acquire an employee benefits consulting company that provides insurance-related services. Order of the Federal Reserve Board Approving Notice by Mellon Bank Corporation to Acquire an Employee Benefits Consulting Company (June 16, 1997) (“*Mellon*”). The insurance agency activities, had they been viewed in isolation, would have been prohibited under the Bank Holding Company Act. Nevertheless, the Board ruled that acting as a licensed insurance agent for an employee benefits consulting business was permissible because it was necessary and “incidental” to the permissible activity of providing employee benefit consulting services. In determining whether an activity is an incidental activity, the Board noted it “generally has considered whether the activity is reasonably necessary to the conduct of a permissible activity and whether the activity constitutes a relatively minor part of the overall business of the company conducting the activities.” *Id.* The Board must also determine that “proposed activities are a proper incident to banking, that is, that the proposal ‘can reasonably be expected to produce benefits to the public.’” *Id.* The Board found that this test was met in the *Mellon* case, because the employee benefits consulting company would otherwise operate at a competitive disadvantage; customers would derive increased convenience from being able to purchase a wider range of services from one entity; the combination of these services increased operational efficiency for the company; and the insurance activities represented only a small fraction of the consulting work performed.

allow a customer to obtain nearly seamless real estate investment advisory services and minimize the necessity of engaging separate service providers. Your letter states that the ability to provide a full range of real estate investment advisory services, including negotiating 1031 Exchange Transactions, would be integral to a bank's ability to compete successfully with other types of firms that offer a full range of financial products and services in connection with their real estate investment advisory services.

2. *The Negotiating Services Enable the Bank to Optimize the Use and Value of Its Facilities, Competencies and Personnel*

The negotiating services described in your letter are also supported by numerous precedents holding that, within reasonable limits, certain activities can be incidental to banking when those activities enable a bank to optimize the use and value of its facilities and other resources.

The ability to include negotiating services as part of the Services offered in connection with 1031 Exchange Transactions allows a bank to operate in an economically rational manner by optimizing the use and value of its facilities, competencies and personnel and by avoiding waste. In developing real estate investment advisory plans, the bank collects information; identifies client investment goals and objectives; assesses a client's need to adjust his real estate portfolio; and prepares a comprehensive real estate investment advisory plan that may include one or more 1031 Exchange Transactions. Through the planning process and advising a client in a 1031 Exchange Transaction, a bank also does much of the analysis and work involved negotiating a 1031 Exchange Transaction. Permitting a bank to participate in the 1031 Exchange Transaction negotiations optimizes the use of the bank's time, expertise and personnel in developing and implementing real estate investment advice.

OCC precedents establish that national banks may offer incidental non-banking products and services to customers where the non-banking product or service offered is part of a larger banking product or service. In Interpretive Letter No. 742,²¹ the OCC permitted a national bank to provide customers with full Internet access in order to deliver banking services over the Internet, even though customers might use that access for non-banking purposes because full access did not dominate the bank's services. In Interpretive Letter No. 653,²² the OCC permitted a national bank that maintained a database of insurance agent activities for purposes of calculating and paying commissions as a service to its customers, to also maintain incidental information on the agents' licensing status as a minor part of the overall operation. In Interpretive Letter No. 611,²³ the OCC permitted a national bank to sell a variety of banking services to customers and a smaller amount of incidental non-banking services

²¹ Interpretive Letter No. 742, *supra* note 6.

²² Interpretive Letter No. 653 (December 22, 1994), *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601.

²³ Interpretive Letter No. 611 (November 23, 1992), *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,449.

through a specially developed smart phone. In Interpretive Letter No. 345,²⁴ the OCC permitted a national bank to provide a package of bank permissible data processing services to customers with incidental full function hardware where the hardware was not the dominant part of the total package offered.²⁵ In the case of 1031 Exchange Transaction negotiating services, the negotiations are necessary to implement a portion of the Bank's real estate investment advisory services and constitute an extremely small part of the overall Services.

III. Conclusion

Accordingly, based on the representations made in your letter and in subsequent conversations with this Office, we concur that the bank's real estate investment advisory and related services, including participation in 1031 Exchange Transaction negotiations, as described herein, are permissible.

If you have any questions concerning this letter, please contact Steven V. Key, Attorney, Bank Activities and Structure Division, at (202) 874-5300.

Sincerely,

/s/

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

²⁴ Interpretive Letter No. 345 (July 9, 1985), *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,515.

²⁵ *See also* Unpublished Letter from Michael J. O'Keefe, District Counsel, Midwestern District (July 13, 1987) (distribution of software and incidental full function hardware to banks permissible so long as full function hardware does not "dominate" permissible data processing services involved); Interpretive Letter No. 516, *supra* (sale of incidental hardware permissible when incidental hardware does not exceed 30% of total cost of package).