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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

**Corporate Decision #2001-27**  
**October 2001**

September 13, 2001

Bruce Rigelman  
First Vice President and Counsel  
Bank One, N.A.  
OH1-0158  
100 East Broad Street  
Columbus, Ohio 43271-0158

Re: Application by Bank One, N.A., Chicago, Illinois, to establish a wholly-owned operating subsidiary to provide commercial real estate construction loan services  
Application Control Number: 2001-ML-08-0008

Dear Mr. Rigelman:

This responds to the application filed by Bank One, N.A., Chicago, Illinois (the "Bank"), to establish an operating subsidiary ("Operating Subsidiary") to provide various credit underwriting, administrative, management, and consulting services as correspondent services to unaffiliated lenders engaged in commercial real estate construction financing ("Lenders"). Based upon the representations and commitments made by the Bank in writing and in subsequent telephone conversations, the application is approved.

**DESCRIPTION OF THE PROPOSAL**

The Operating Subsidiary will be organized as a Delaware corporation and will be headquartered in Phoenix, Arizona. The Operating Subsidiary will provide various services to the Lenders. The proposed services, which are discussed in more detail below, may be broadly grouped into the following categories: (1) construction project feasibility review; (2) loan document preparation; (3) loan and collateral management services; (4) administration of participated and syndicated loans; (5) administration of loans to residential real estate developers; (6) problem construction loan/workout services; (7) construction loan administration process consulting; and (8) construction loan risk management process consulting (collectively, the "Proposed Services").

The Operating Subsidiary will not make credit underwriting decisions for clients and will not originate or purchase any loans. Instead, the Operating Subsidiary's focus will be on the project review and administration aspects of commercial real estate loans. At the credit underwriting stage, the Operating Subsidiary will focus on the likely costs and feasibility of the projects to be

financed, the availability of utilities, environmental concerns, and the like. At the loan administration stage, the Operating Subsidiary's focus will be on verifying the certifications underlying draw requests, inspecting the building site, verifying the cost to complete the project, and the like. At the work-out stage, the Operating Subsidiary will trace loan disbursements to the project, identify steps to preserve the project while the lender decides how to proceed, determine the cost to complete, determine the feasibility of completing the project, and the like. The Operating Subsidiary will not provide legal services, in any form, to its clients.

The Operating Subsidiary will be managed and staffed by Bank One Corporation's commercial real estate loan administration group ("CRELA Group"). The CRELA Group is currently housed in Bank One, Arizona, N.A., and several other Bank One Corporation banks. As the Operating Subsidiary's business grows, the Bank anticipates that the Operating Subsidiary will begin to hire its own separate staff.

### **The Proposed Services**

The Bank represents that the Operating Subsidiary will conduct each of the following Proposed Services in accordance with applicable OCC regulations, rulings, and policies:

- (1) Project Cost Review, Project Cost to Loan Budget Management Services, Construction Scheduling Review, and Construction Schedule Compliance

Construction loans are vulnerable to a variety of risks. One significant risk is attributable to the need to complete a project within specified cost and time limits. To have effective control over its commercial construction loans, a lender must have an established process that monitors each project. *See* Appendix A to Subpart D of 12 C.F.R. Part 34 – Interagency Guidelines For Real Estate Lending (hereinafter, "Interagency Real Estate Lending Guidelines"); Comptroller's Handbook, Commercial Real Estate and Construction Lending, at pp. 15, 21, 24-29 (Nov. 1995) (hereinafter, "Comptroller's Commercial Real Estate Lending Handbook"). The Operating Subsidiary will review construction budgets and cost limits and monitor the project for budget compliance for the Lenders. The Operating Subsidiary will also review construction scheduling and time limits and monitor the project for compliance with scheduling for the Lenders.

- (2) Contract Review

The Operating Subsidiary will review the Lenders' loan documents to ensure that essential project management details – *e.g.*, loan budgeting, project costs, project scheduling – are complete, feasible, and consistent with the project feasibility review. *See* Interagency Real Estate Lending Guidelines; Comptroller's Commercial Real Estate Lending Handbook, at p. 22. The Bank has represented that the Operating Subsidiary will not provide legal services to the Lenders in this or any other connection.

(3) Project Feasibility Review

A lender's documentation files for construction loans should include a project feasibility study showing the borrower's project plans and budget, development plans, marketing plans, and equity contributions. *See* Interagency Real Estate Lending Guidelines; Comptroller's Commercial Real Estate Lending Handbook, at p. 22. The Operating Subsidiary will provide project feasibility review for the Lenders.

(4) Appraisal Management

Appraisals to determine the value of collateral are generally prepared when depository institutions make a construction loan. *See, e.g.*, OCC appraisal regulations at 12 C.F.R. Part 34, Subpart C; Federal Reserve Board appraisal regulations at 12 C.F.R. Part 225, Subpart G; and Office of Thrift Supervision appraisal regulations at 12 C.F.R. Part 564. *See also* Interagency Real Estate Lending Guidelines. Even absent a legal requirement to do so, prudent creditors will routinely take appropriate steps to determine the value of the property securing the loan when making a credit decision. The Operating Subsidiary will provide typical appraisal services for the Lenders.

(5) Environmental Risk Review

A lender's documentation files for construction loans should provide information on the essential details of the loan transaction, including a review of any environmental risks deemed necessary given the location and type of project. *See* Comptroller's Commercial Real Estate Lending Handbook, at p. 23. The Operating Subsidiary will provide typical environmental risk review and seismic risk review for the Lenders.

(6) Loan Document Preparation

The Operating Subsidiary will assist the Lenders in preparing documents for commercial real estate loan transactions, most likely by providing blank forms for clients to complete. *See* Conditional Approval No. 322 (July 30, 1999). As mentioned, the Bank has represented that the Operating Subsidiary will not provide legal services to the Lenders in this or any other connection.

(7) Construction Inspection and Collateral Monitoring

In connection with the collateral for construction loans made by the Lenders, the Operating Subsidiary will arrange for inspections to determine the condition of collateral securing the loans. This will include inspections of commercial or construction loan collateral during the construction phase to ensure that funds requested are appropriate for the given stage of development. *See* Interagency Real Estate Lending Guidelines; Comptroller's Commercial Real Estate Lending Handbook, at pp. 20-21, 24-29.

(8) Draw Review and Certification

To ascertain whether draws are being taken in accordance with a predetermined disbursement schedule, a lender must be accurately informed of the project's progress to date. *See* Interagency Real Estate Lending Guidelines; Comptroller's Commercial Real Estate Lending Handbook, at p. 25. The Operating Subsidiary will provide draw review and certification services for the Lenders.

(9) Mechanics' Lien Monitoring and Administration

Before any draw amount is disbursed, a lender must have knowledge of whether liens have been filed against the title of the project since the previous draw. *See* Comptroller's Commercial Real Estate Lending Handbook, at pp. 24, 32. The Operating Subsidiary will monitor the Lender's construction projects for the filing of mechanics' liens.

(10) Administration of Participated and Syndicated Loans

The Operating Subsidiary will perform for participated and syndicated loans the functions typically performed by the lead or agent bank, including the calculation of participant/syndicate member shares. *See* Comptroller's Handbook, Loan Portfolio Management, Appendix E: Loan Participations, at pp. 86-90 (1998) (hereinafter, "Comptroller's Loan Portfolio Management Handbook").

(11) Administration of Construction Loans to Residential Real Estate Developers

To avoid overextending the developer's capacity, residential real estate construction loan agreements should include some form of "borrowing base" structure.<sup>1</sup> *See* Comptroller's Commercial Real Estate Lending Handbook, at pp. 17-18. The Operating Subsidiary will administer and service construction loans to residential real estate developers, where the loans employ such "borrowing base" structures, for the Lenders.

(12) Troubled Loan/Workout Management and Services

Since the full collateral value supporting a construction loan does not exist when the loan is granted, if default occurs a bank must be in a position to determine where loaned funds have been spent and either to complete the project or to salvage its construction advances. *See* Comptroller's Commercial Real Estate Lending Handbook, at pp. 31-37; Comptroller's Loan Portfolio Management Handbook, at pp. 34-36. The Operating Subsidiary will offer various

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<sup>1</sup> For example, a loan to a residential tract builder may include a predetermined limit on the number of unsold units to be financed at any one time. In larger, residential developments that are financed and built in phases, a lender may require that some fixed percentage of units in the next phase be under a firm sale contract before the lender will begin releasing funds for its development. *See* Comptroller's Commercial Real Estate Handbook, at pp. 17-18.

services for problem construction loans, including funding forensics,<sup>2</sup> advice and planning to complete construction projects so costs are minimized, and, if necessary, expert testimony related to the Operating Subsidiary's funding forensics findings.

(13) Construction Loan Administration Process Consulting

The Operating Subsidiary will review the processes and procedures that the Lenders employ in their construction loan administration activities and make recommendations for improvements.

(14) Construction Loan Risk Management Process Consulting

The Operating Subsidiary will offer consulting services, including training sessions, to the Lenders on various construction loan risk management processes and techniques.

**ANALYSIS**

National banks may engage in activities that are part of or incidental to the business of banking by means of an operating subsidiary. 12 C.F.R. § 5.34(e). The OCC has long permitted national banks to perform for other financial institutions an array of activities called "correspondent services" as part of the business of banking.<sup>3</sup> Such correspondent services may include any corporate or banking service that a national bank may perform for itself.<sup>4</sup> Therefore, if the Proposed Services are permissible banking or corporate services that a national bank may perform for itself, then the Operating Subsidiary may provide the Proposed Services to other financial institutions as correspondent services.

The OCC has permitted national banks to perform real estate appraisals both for themselves and for other lenders as a correspondent service.<sup>5</sup> The OCC has permitted national banks to prepare

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<sup>2</sup> Funding forensics provides an accounting analysis of where and how the loaned funds were spent. Funding forensics is one part of a "post mortem" review that national banks should perform to better understand how problem loans and losses develop. Comptroller's Loan Portfolio Management Handbook, at pp. 35-36 (April 1998).

<sup>3</sup> See, e.g., 12 C.F.R. § 5.34(e)(5)(v)(S); Interpretative Letter No. 875, *reprinted in* [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-369 (Oct. 31, 1999); Interpretative Letter No. 811, *reprinted in* [1997-1998 Transfer Binder] Fed. Banking L. Rep. ¶ 81-259 (Dec. 18, 1997); Corporate Decision 97-79 (July 11, 1997); Interpretative Letter No. 513, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. ¶ 83,215 (June 18, 1990). See also *United States v. Citizens and Southern Nat'l Bank*, 422 U.S. 86, 114-15 (1975).

<sup>4</sup> See Interpretative Letter No. 467, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,691 (Jan. 24, 1989) (national bank may offer wide range of correspondent services); Letter from Wallace S. Nathan, Regional Counsel (Dec. 3, 1982) (unpublished) (microfiche services); Letter from John E. Shockey, Chief Counsel (July 31, 1978) (unpublished) (advertising services).

<sup>5</sup> Conditional Approval No. 276 (May 8, 1998); Interpretive Letter No. 467, *reprinted in* [1988-1989] Transfer Binder Fed. Banking L. Rep. (CCH) ¶ 85,691 (Jan. 24, 1989).

loan-related documents for other lenders.<sup>6</sup> The OCC has also permitted, as a correspondent service, national banks to service and administer loans for other financial institutions.<sup>7</sup> Therefore, the Operating Subsidiary may provide Proposed Services (4), (6), and (11) as correspondent services for the Lenders. 12 C.F.R. § 5.34(e)(5)(v)(S).

Many of the remaining Proposed Services are activities national banks undertake in their commercial real estate and construction lending and, therefore, are permissible as part of the “making loans or other extension of credit” and “purchasing, selling, servicing ... loans or other extensions of credit ...” 12 C.F.R. § 5.34(e)(5)(v)(C) & (D). For example, as part of the construction lending process, national banks should review and monitor construction project costs and scheduling; complete a project feasibility study; review loan documents to ensure that costs, budgeting, and scheduling are feasible and consistent with the feasibility study; conduct environmental and seismic risk reviews; monitor and inspect collateral and construction progress; review draws and draw certifications; and, finally, monitor liens filed against the title of the project. *See, e.g.*, Comptroller’s Commercial Real Estate Lending Handbook.<sup>8</sup> Because national banks perform these services for themselves, they may perform Proposed Services (1), (2), (5), and (7) through (9) as correspondent services for the Lenders.

Also as part of the “making loans or other extensions of credit” and “purchasing, selling, servicing ... loans or other extensions of credit,” national banks may serve as lead or agent bank for their loan participations and syndications,<sup>9</sup> and manage troubled credits and the workout of such credits.<sup>10</sup> As part of the troubled credit management and workout services, the Operating Subsidiary proposes to provide expert testimony concerning its funding forensics findings.

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<sup>6</sup> Conditional Approval No. 322 (July 30, 1999) (loan document preparation is integral part of lending function and a logical outgrowth of that function); Conditional Approval No 276, *supra* (same).

<sup>7</sup> Interpretive Letter No. 389, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,613 (July 7, 1987) (national bank may service loan participations for other financial institutions); Letter from Kenneth Gartlir, Attorney (Oct. 2, 1985) (unpublished) (national bank may service loans for other financial institutions).

<sup>8</sup> *See also* Board of Governors of the Federal Reserve System, Commercial Bank Examination Manual: §§ 2100.1 “Real Estate Construction Loans” and 2090.1 “Real Estate Loans”; Federal Deposit Insurance Corporation Letter FIL-110-98 (Oct. 8, 1998) (guidelines for managing risks associated with acquisition, development and construction lending).

<sup>9</sup> *See* Interpretive Letter No. 463, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,687 (Dec. 27, 1988) (banks have a long history of selling participations and syndications in their own loans to other financial institutions); Interpretive Letter No. 389, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,613 (July 7, 1987) (national bank may service loan participations for other financial institutions); Comptroller’s Loan Portfolio Management Handbook, Appendix E: Loan Participations, pp. 86-90 (1998).

<sup>10</sup> *See* Comptroller’s Loan Portfolio Management Handbook, at pp. 34-36 (April 1998) (managing troubled credits); *id.* at p. 35-36 (bank should conduct loan “post mortem” to better understand how problem loan and associated losses developed); Comptroller’s Commercial Real Estate Handbook, at pp. 31-32; *id.*, Appendix F: Troubled Loan Workouts and Loans to Borrowers in Troubled Industries, at pp. 123-26.

Providing expert testimony about an area of one's expertise is a corporate service that a national bank may perform for itself. Because national banks may perform each of these services for themselves, they may perform Proposed Services (10) and (12) as correspondent services for the Lenders.

Finally, the OCC has long permitted national banks, where they have developed a level of expertise, to pass on the benefits of that expertise through management and consulting services provided to correspondent institutions.<sup>11</sup> The Operating Subsidiary proposes to provide construction loan administration and risk management advice, training, and consulting to the Lenders. These are permissible correspondent services and, therefore, the Operating Subsidiary may perform Proposed Services (13) and (14) for the Lenders. 12 C.F.R. § 5.34(e)(5)(v)(S).

### **CONCLUSION**

Based on the facts and analysis herein, and the representations and commitments made by the Bank in connection with this application, the OCC concludes that the Operating Subsidiary may engage in the Proposed Services and we approve the Bank's application.<sup>12</sup> If you have any questions, please contact Abel Reyna, Licensing Analyst, Licensing Operations, at (202) 874-5060, or Steven V. Key, Senior Attorney, in the Bank Activities and Structure Division, at (202)874-5300.

Sincerely,

**-signed-**

Julie L. Williams  
First Senior Deputy Comptroller and Chief Counsel

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<sup>11</sup> Interpretive Letter No. 137, *reprinted in* [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,218 (Dec. 17, 1979); Letter from John E. Shockey, Deputy Chief Counsel (February 20, 1976) (unpublished) (national bank may provide bank-related instructional training to employees of other financial institutions as correspondent service).

<sup>12</sup> This approval, and the activities and communications by OCC employees in connection with the filing, do not constitute a bilateral contract, express or implied, or any other obligation binding upon the OCC, the U.S., any agency or entity of the U.S., or an officer or employee of the U.S., and do not affect the ability of the OCC to exercise its supervisory, regulatory and examination authorities under applicable law and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the U.S.