Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

# Interpretive Letter #1009
# October 2004
# 12 CFR 215

August 12, 2004

Subject: Residential mortgage loans under Federal Reserve Board Regulation O

Dear **[ ]**:

This is in response to your letter to National Bank Examiner **[ ]**. Your letter notes that in a recent review by compliance staff at **[ ]** (Bank or **[ ]**), staff cited a potential violation of Regulation O, 12 C.F.R. part 215. Your letter requests the OCC to review the loan at issue and opine as to whether there was a violation. Based on our review and as described more fully below, we agree with the Bank's compliance staff that the loan violated Regulation O.

Facts

The Bank made a residential mortgage loan to an executive officer and held it for a short time prior to sale to the Federal Home Loan Mortgage Corporation (Freddie Mac) pursuant to an arrangement described immediately below. At the time it made the loan, the Bank had on its books another residential mortgage loan to the same officer secured by a different residence. Each of the loans exceeded $100,000. The Bank has a "preauthorized" sale/purchase arrangement with Freddie Mac under which Freddie Mac has agreed to purchase loans that are consonant with criteria established by Freddie Mac. The Bank makes loans and holds them for sale temporarily until there are sufficient loans to sell to Freddie Mac as one package. The Bank is under no contractual obligation to sell a specific loan, but merely has the privilege to offer conforming loans to Freddie Mac as part of a loan package.

Legal Analysis

Absent an exception, a bank may only lend to an executive officer in an amount that does not exceed the quantitative limit in 12 C.F.R. § 215.5(c)(4). Section 215.5(c)(4) provides that this limit is the higher of 2.5 percent of a bank's capital and surplus or $25,000, but in no event more

than $100,000. Based on the Bank's capital and surplus, the effective limit for **[ ]** is $100,000.

An exception that is potentially available under the facts described above is the exception in 12 C.F.R. § 215.5(c)(2) which provides that a bank may extend credit to an executive officer in any amount to finance or refinance the purchase, construction, maintenance, or improvement of a residence of the executive officer, subject to certain conditions. As you note in your letter, however, it is well established that this exception can only apply to a single loan secured by a first lien on one residence.[1] Thus, when the Bank made the second loan it violated the limit in section 215.5(c)(4) absent another exception, just as the Bank's compliance staff noted.

Your letter notes that the limit in section 215.5(c)(4) is also subject to an exception for loans secured by unconditional takeout commitments or guarantees of any department, agency, bureau, board, commission or establishment of the United States or any corporation wholly owned directly or indirectly by the United States.[2] Freddie Mac is not such an entity.[3] While Freddie Mac is a government-sponsored corporation, the federal government does not wholly own it directly or indirectly.[4] Thus loans secured by an unconditional takeout commitment of Freddie Mac do not qualify for the government takeout exception.[5]

As your letter also notes, section 215.3(e) provides that a participation without recourse is considered to be an extension of credit by the participating bank, not by the originating bank. You suggest that the purchase commitment by Freddie Mac may be viewed as a participation at the time of the origination of the second loan. I disagree. It is not possible to view the commitment as a participation. The Bank simply has a contract for the sale of conforming loans which sale is to be consummated in the future. There is no participation in the ordinary meaning of that term in section 215.3(e). The expectation of selling a package of loans in the future is unlike a loan participation because a participation involves a sale of an interest in a loan, not merely an expectation of a sale. Further, unlike a participation that involves a specific loan, the arrangement with Freddie Mac pertains to a package of conforming loans and the Bank is under no obligation to sell a specific loan.

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[1] *See* 12 U.S.C. § 375a(2). *See also* H.R. Rep. No. 262, 90th Cong., 1st Sess., reprinted in 1967 U.S. Code Cong. & Ad. News 1373, 1374 ("[an] officer could not borrow … for a year-round residence and … for a vacation residence."). *See also* letter of J. Virgil Mattingly, Jr., General Counsel, Board of Governors of the Federal Reserve System, 1992 WL 693697 (F.R.B.) (Oct. 15, 1992).

[2] 12 C.F.R. §§ 215.5(c)(3), 215.4(d)(3)(i)(B).

[3] *Cf.* letter of Christopher C. Manthey, Senior Attorney (Jul. 13, 1989) (unpublished).

[4] Further indications that Freddie Mac is not the type of corporation required by the exception are that its obligations are not guaranteed by the full faith and credit of the United States (*see* 12 U.S.C. § 1455(h)) and the fact that it is not included in the list of government corporations in 31 U.S.C. § 9101.

[5] In light of this fact, it is not necessary to consider whether the arrangement with Freddie Mac described above would constitute an unconditional takeout commitment or guarantee.

As there are no other exceptions to the limit in section 215.5(c)(4) available under the facts described above, I conclude that when the bank made the second loan it violated Regulation O.

I trust this has been responsive to your inquiry.

Sincerely yours,

/s/ *Jonathan Fink*

Jonathan Fink
Senior Attorney
Bank Activities & Structure