



State of Washington

**DEPARTMENT OF FINANCIAL INSTITUTIONS  
DIVISION OF BANKS**

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May 13, 2004

**ISGC – 2004 – 004 - DOB**

[REDACTED]

Subject: Authority to Form Subsidiary to Hold and Complete Development of Foreclosed Property

Dear [REDACTED]:

Thank you for notifying the Division of Banks of the Washington State Department of Financial Institutions (hereinafter, "Division of Banks") of the intent of [REDACTED] Bank (hereinafter, "the Bank") to form a wholly owned subsidiary to hold and complete the development of foreclosed properties. The Bank has requested of the Director of Division of Banks an interpretive letter granting the Bank permission to form and operate such a subsidiary.

Based on the analysis, terms and conditions of this interpretive letter, the Division of Banks has determined that the Bank should be granted permission to form and operate a wholly owned subsidiary to hold and complete the development of foreclosed properties. However, in an effort to clarify the requirements of our governing statutes, we take this opportunity to explain the nature and extent of the Bank's power and authority in this regard.

1.0 ACKNOWLEDGMENT OF RECEIPT OF FDIC LETTER

We acknowledge our receipt of the letter from the Federal Deposit Insurance Corporation (hereinafter, "FDIC") to you, dated [REDACTED] (hereinafter, "FDIC Letter"), wherein the FDIC has concluded that the Bank is not required to apply to the FDIC to form a wholly owned subsidiary to hold and dispose of other real estate (hereinafter, "ORE") acquired pursuant to a debt previously contracted (hereinafter, "DPC"), because such activity, in the opinion of the FDIC, is not restricted by Section 24 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831a.

2.0 RELEVANT FACTS

The Bank has foreclosed on a certain \$4.1 million loan (DPC) the Bank had made to [REDACTED] Corporation to develop and construct 24 houses in the [REDACTED] District

of Seattle, Washington, 12 of which are already completed and sold. The remaining collateral of 12 houses is in various stages of completion.

While the specific facts above have prompted the Bank to form a subsidiary, the Bank intends to maintain such subsidiary to dispose of future ORE acquired pursuant to a DPC.

### 3.0 RELEVANT LAW

The Bank is a Washington-state chartered commercial bank deriving its authority to do business from Title 30, Revised Code of Washington (RCW Title 30). It is not a member of the Federal Reserve System and has not been granted special powers by the U.S. Congress greater than any other non-member Washington state commercial bank.<sup>1</sup>

#### 3.1 Substantive Provisions of Washington State Commercial Bank Law (RCW Title 30)

3.1.1 Power to Purchase, Hold and Convey Real Estate – Generally. RCW § 30.04.210 states, in pertinent part:

A bank . . . may purchase, hold, and convey real estate for the following purposes:

(1) Such as shall be necessary for the convenient transaction of its business, including with its banking offices other space in the same building to rent as a source of income: PROVIDED, That any bank . . . shall not invest for such purposes more than the greater of: (a) Fifty percent of its capital, surplus, and undivided profits; or (b) one hundred twenty-five percent of its capital stock without the approval of the director.

. . .

(3) *Such as it shall purchase at sale under judgments, decrees, liens, or mortgage foreclosures, from debts owed to it.*

[Emphasis added.]

The legislative intent of subsection (3) of RCW § 30.04.210 clearly permits the Bank to purchase and sell real estate acquired through foreclosure.

3.1.2 Additional Power to Acquire or Own Real Estate. In addition, a Washington state commercial bank may engage in other real estate activity as set forth in and subject to the requirements and limitations of RCW § 30.04.212, which declares, in pertinent part, as follows:

(1) In addition to the powers granted under RCW 30.04.210 and subject to the limitations and restrictions contained in this section and in RCW 30.60.010 and 30.60.020 [Community Credit Needs Act], **a bank:**

(a) ***May acquire any interest in unimproved or improved real property;***

(b) ***May construct, alter, and manage improvements of any description on real estate in which it holds a substantial equity***

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<sup>1</sup> Confer RCW § 30.04.215(1).

*interest.*

**(2) The powers granted under subsection (1) of this section do not include, and a bank may not:**

(a) Manage any real property in which the bank does not own a substantial equity interest;

(b) Engage in activities of selling, leasing, or otherwise dealing in real property as an agent or broker; or

(c) **Acquire any equity interest in any one to four-family dwelling that is used as a principal residence by the owner of the dwelling;** however, this shall not prohibit a bank from making loans secured by such dwelling where all or part of the bank's anticipated compensation results from the appreciation and sale of such dwelling.

[Emphasis added.]

In furtherance of RCW § 30.04.212, the DFI has by rule imposed a limitation on the amount of investment that can be made in a single parcel of real property. As set forth in WAC 208-512-180:

The total investment by a bank in a single parcel of real property, and improvements thereon, shall not exceed **twenty-five percent** of the aggregate amount of such bank's real estate investments allowed by RCW 30.04.212.

[Emphasis added.]

However, in the present case, it would appear as if the real estate in question consists of 12 separately identified tax parcels, each of which is far less than 25% of the aggregate amount of Bank's real estate owned.

3.1.3 Power to Form or Incorporate a Subsidiary. RCW § 30.04.127 generally governs the statutory requirements of a Washington-state commercial bank, including the Bank, in the formation and incorporation of a subsidiary. As set forth, in relevant part, in RCW § 30.04.127:

(1) **A bank . . . may form [or] incorporate . . . corporations or other entities, whether or not such other corporation or entity is related to the bank or trust company's business.** The aggregate amount of funds invested, or used in the formation of corporations or other entities under this section shall not exceed ten percent of the assets or fifty percent of the net worth, whichever is less, of the bank or trust company. For purposes of this subsection, "net worth" means the aggregate of capital, surplus, undivided profits, and all capital notes and debentures which are subordinate to the interest of depositors.

(2) **A bank or trust company may engage in an activity permitted under this section only with the prior authorization of the director.** In approving or denying a proposed activity, **the director shall consider the financial and management strength of the institution, the convenience and needs of the public, and whether the proposed activity should be conducted through a subsidiary or affiliate of the bank.** The director may not

authorize under this section and no bank or trust company may act as an insurance or travel agent unless otherwise authorized by state statute.

[Emphasis added.]

Further, subsection (4) of RCW § 30.04.215 states, in pertinent part, as follows:

(4) Any activity which may be performed by a bank . . . , except the taking of deposits, may be performed by (a) a corporation or (b) another entity *approved by the director*, which in either case is owned in whole or in part by the bank . . . .

[Emphasis added.]

3.1.4 Power to Invest in Corporation. RCW § 30.04.125 also grants authority to the Bank, in pertinent part, as follows:

*Unless otherwise prohibited by law*, any state bank or trust company may invest in the capital stock of corporations organized to conduct the following businesses:

(8) A corporation in which all of the voting stock is owned by the bank and that engages exclusively in nondeposit-taking activities that are authorized to be engaged in by the bank or trust company . . . .

[Emphasis added.]

The Division of Banks notes, however, that the clause, “unless otherwise prohibited by law,” requires that the entitlements of RCW § 30.04.125 be subject to the limitations of other federal and state law as noted in this letter.

3.1.5 Interpretation of Substantive Provisions of RCW Title 30. Based on the above, the Division of Banks has determined [and certain federal and state-charter parity statutes] that, when taking into consideration all relevant provisions of RCW Title 30 [including RCW §§ 30.04.125, 30.04.127, 30.04.210, 30.04.212 and subsection (4) of 30.04.215], the Bank may form a wholly owned subsidiary corporation to purchase, hold, and convey real estate (ORE) that it has foreclosed upon incident to the default of one of its mortgage loans (DPC), subject to the following terms, conditions, limitations and/or exceptions:

1. This determination is made without reference to Section 24 of the Federal Deposit Insurance Act (12 U.S.C. § 1831a).
2. This determination is made without reference to whether the Bank may invoke the “federal parity” provisions of RCW § 30.04.215 [see Page 5 below].
3. This determination is made without reference to whether the Bank may invoke the “state-charter parity” provisions of RCW § 30.04.215 [see Page 6 below].
4. The Director of the Division of Banks must, pursuant to subsection (2) of RCW § 30.04.127, find:

- a. The Bank has suitable financial and management strength to undertake the requirements of operating the subsidiary;
  - b. The convenience and needs of the public are met by formation and operation of the subsidiary; and
  - c. The proposed activity is appropriate to be conducted through a subsidiary or affiliate of the bank.
5. Subsection (1) of RCW § 30.04.127 does, indeed, require that the aggregate amount of funds invested, or used in the formation of a bank subsidiary may not exceed ten percent (10%) of the assets or fifty percent (50%) of the net worth, whichever is less, of the Bank. However, the Director of the Division of Banks has determined that this statutory limitation is concerned only with the *formation cost* of a subsidiary and is, therefore, not applicable to (1) the book or market value of real estate taken in foreclosure that may be acquired through a subsidiary, or (2) the ongoing concentration of Bank assets or net worth held through a subsidiary.

### 3.2 The Implications of the “Federal Parity” Statute.

Notwithstanding the subparagraph 3.1.5 above, subsection (3) of RCW § 30.04.215, states in pertinent part, as follows:

- (3) Notwithstanding any restrictions, limitations, and requirements of law, in addition to all powers, express or implied, that a bank . . . has under the laws of this state, a bank . . . shall have the powers and authorities conferred as of August 31, 1994, or a subsequent date not later than July 27, 2003, upon a *federally chartered bank* doing business in this state. A bank . . . may exercise the powers and authorities conferred on a federally chartered bank after July 27, 2003, only if the director finds that the exercise of such powers and authorities:
- (a) Serves the convenience and advantage of depositors, borrowers, or the general public; and
  - (b) Maintains the fairness of competition and parity between state-chartered banks or trust companies and federally chartered banks.

As used in this section, "powers and authorities" include without limitation powers and authorities in corporate governance and operational matters.

The restrictions, limitations, and requirements applicable to specific powers or authorities of federally chartered banks shall apply to banks or trust companies exercising those powers or authorities permitted under this subsection but only insofar as the restrictions, limitations, and requirements relate to exercising the powers or authorities granted banks or trust companies solely under this subsection.

[Emphasis added.]

Subsection (3) of RCW § 30.04.215 may be invoked by the Bank in order to assume, if necessary, the powers of a national bank as discussed in the FDIC Letter received by the Bank.<sup>2</sup> However, the invoking of national bank powers, pursuant to subsection (3) of RCW § 30.04.215 and in the context of this case, does not exempt the Bank from being required to obtain the approval of the Division of Banks before being permitted to form a subsidiary corporation of the Bank to acquire and dispose of ORE obtained incident to the default of DPC. Such advance approval is clearly required pursuant to RCW §§ 30.04.127, 30.04.210 and subsection (4) of 30.04.215.

### 3.3 The Implications of “State-Charter Parity”.

Notwithstanding any other analysis made above in this letter, the Bank may rely upon the “state-charter parity” provisions of RCW § 30.04.217 to invoke the power and authority of a state-charter mutual savings bank pursuant to RCW Title 32. RCW § 30.04.217 sets forth, in pertinent part, as follows:

“ . . . a bank or trust shall have the powers and authorities conferred upon a mutual savings bank under Title 32 RCW, only if:

(1) The bank or trust company notifies the director at least thirty days prior to the exercise of such power or authority by the bank or trust company, unless the director waives or modifies this requirement for notice as to the exercise of a power, authority, or category of powers or authorities by the bank or trust company;

(2) The director finds that the exercise of such powers and authorities by the bank or by the trust company serves the convenience and advantage of depositors, borrowers, or the general public; and

(3) The director finds that the exercise of such powers and authorities by the bank or by the trust company maintains the fairness of competition and parity between banks or trust companies and mutual savings banks.”

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<sup>2</sup> We note that the FDIC Letter discusses with particularity the reasons why an application to the FDIC to operate a subsidiary to acquire and hold ORE incident to DPC is *not* required. Section 24 of the Federal Act (12 U.S.C. § 1831a) essentially prohibits state nonmember banks (i.e., banks that are not members of the Federal Reserve) from acquiring or retaining, directly or indirectly, any equity investments, including real estate investments, which are impermissible investments for national banks. However, pursuant to the FDIC’s rules and regulations, at 12 C.F.R. § 362.1(b)(3), the restriction contained in Section 24 of the Federal Act does not include the following:

Equity investments acquired in connection with DPC if the insured state bank does not hold property for speculation and takes only such actions as would be permissible for a national bank’s DPC. The bank must dispose of the property within the shorter of the period set by federal law for national banks or the period allowed under state law. For real estate, national banks may not hold DPC for more than 10 years.

Therefore, according to the FDIC Letter, the FDIC will require no application from the Bank and approves, [REDACTED] Bank’s acquisition and holding of the [REDACTED] ORE, as long as the Bank complies with the requirements of 12 C.F.R. § 362.1(b)(3). Moreover, this is not inconsistent with Washington State law as noted in this Interpretive Letter.

In addition, the FDIC Letter noted that, pursuant to regulations of the Office of the Comptroller of the Currency (hereinafter, “OCC”), at 12 C.F.R. § 34.86, a national bank may acquire ORE for a development or improvement project, and it may also make advances to complete the project (as long as the advances are not made for the purposes of speculation in real estate and are consistent with safe and sound banking practices).

Nothing in the FDIC Letter, however, can be construed to preclude, through the invoking of Washington State’s “federal parity” statute, any requirement of applying to the Division of Banks for permission to form, incorporate and operate a subsidiary to conduct the business approved of in the FDIC Letter.

In the context of the Bank's current request, RCW § 30.04.217 may be invoked to assume the powers and authorities conferred upon mutual savings banks pursuant to RCW § 32.20.285, which permits Washington mutual savings banks to engage in real estate development. RCW § 32.20.285 declares:

**“A mutual savings bank may invest its funds in such real estate, improved or unimproved, and its fixtures and equipment, as the savings bank shall purchase either alone or with others or through ownership of interests in entities holding such real estate. *The savings bank may improve property which it owns, and rent, lease, sell, and otherwise deal in such property, the same as any other owner thereof. The total amount a mutual savings bank may invest pursuant to this section shall not exceed twenty percent of its funds.* No officer or trustee of the bank shall own or hold any interest in any property in which the bank owns an interest, and in the event the bank owns an interest in property hereunder with or as a part of another entity, no officer or trustee of the bank shall own more than two and one-half percent of the equity or stock of any entity involved, and all of the officers and trustees of the bank shall not own more than five percent of the equity or stock of any entity involved.”**

[Emphasis added.]

Based on the above-stated provision, then, the Bank, if it invoked “state-charter parity” under RCW § 30.04.217, could assume the real estate development powers of a mutual savings bank. The Division of Banks views these Title 32 powers as significantly more flexible in regard to how a wholly owned subsidiary may operate to hold and develop foreclosed real estate.

The Bank should be mindful that the Director of Division of Banks may consider the requirements of meeting “community credit needs” [i.e., the Bank's rating under the federal Community Reinvestment Act (hereinafter, “CRA”) and RCW Chapter 30.60], as set forth in subsection (3) of RCW §§ 30.04.212, in determining the aggregate amount of funds that may be invested by the Bank in real estate, either directly or through a subsidiary. It is the view of the Division of Banks that the limitations of subsection (3) on real estate investment that may be imposed on the Bank according to its CRA-rating refer only to real estate investment in general and not to the acquisition of ORE on account of DPC. However, it is also the view of the Division of Banks that, if the Bank later applies for permission to use the subsidiary in question for general real estate development purposes, the real estate investment ceiling of ten percent (10%) of the Bank's capital, surplus and undivided profits, imposed by subsection (3) of RCW §§ 30.04.212, cannot, simply by invoking “state-charter parity,” be supplanted by the real estate development ceiling of twenty percent (20%) of Bank funds as set forth in RCW § 32.20.285. While the Division of Banks may in the future entertain an application for “state-charter parity” pursuant to RCW §§ 30.04.217 and 32.20.285, the Division of Banks must, as a matter of public policy, give preference, in the event of conflict, to a lesser ceiling imposed by RCW § 30.04.212.

#### 4.0 AGENCY DETERMINATIONS & GRANT OF PERMISSION

Based on the relevant facts and law as stated above, the Division of Banks makes the following determinations with respect to the Bank's request:

1. The Director of the Division of Banks has determined, pursuant to subsection (2) of RCW § 30.04.127, that:
  - (a) The Bank has suitable financial and management strength to undertake the requirements of operating the subsidiary in question;
  - (b) The convenience and needs of the public will be met by formation and operation of the subsidiary; and
  - (c) The proposed activity will be appropriate to be conducted through a subsidiary of the Bank.
  
2. While the Bank's present intent is to use the subsidiary only to acquire, hold and further develop for resale certain real estate taken in foreclosure, the Bank may nonetheless make application in the future to use the subsidiary for general real estate development purposes, by invoking (a) the "state-charter parity" provisions of RCW § 30.04.217 and (b) thereby assuming for the wholly owned subsidiary in question real estate development powers accorded pursuant to RCW § 32.20.285. If the Bank makes an application in the future to augment the power of the subsidiary, the determination of the Division of Banks, at that time, will be subject to the restrictions, limitations and requirements of RCW §§ 30.04.217 and 32.20.285, including the following:
  - (a) The notice requirements of subsection (1) of RCW § 30.04.217 must be met.
  - (b) Pursuant to a review of both subsection (3) of RCW § 30.04.212 and RCW § 32.20.285, the maximum amount that the Bank may invest in acquired real estate, including general development activity that the Bank may later request approval for by and through the subsidiary, shall be the ceiling imposed by RCW § 32.20.285 or the ceiling to which the Bank is entitled under subsection (3) of RCW § 30.04.212 based on its CRA-rating, whichever is less.
  - (c) At the time of making the application for expanded powers of the subsidiary as a real estate development company, the Director of Division of Banks must find, pursuant to RCW § 30.04.217 and subsections (2) and (3) of RCW § 32.20.285 that the exercise of such powers and authorities by the Bank:
    - i. Serves the convenience and advantage of depositors; and
    - ii. Maintains the fairness of competition and parity between banks or trust companies and mutual savings banks.
  
3. Future use of the subsidiary for real estate development in excess of the holding and liquidation of ORE acquired through DPC may, in addition to approval of the Division of Banks as set forth above, require approval from the FDIC pursuant to Section 24 of the Federal Deposit Insurance Act (12 U.S.C. § 1831a)

The Bank is, therefore, granted permission to form a wholly owned subsidiary to take title to foreclosed real estate it made in connection with a certain \$4.1 million loan the Bank had

made to [REDACTED] Corporation to develop and construct 24 houses in the [REDACTED] District of Seattle, Washington. In doing so, the Bank may hold and further develop the foreclosed real estate for sale in the name of such subsidiary.

At a future date, subject to approval of the Division of Banks upon the terms set forth above and as may be required by the FDIC, the Bank may expand the operation of the subsidiary to include general real estate development other than simply involving liquidation of ORE, ***provided that*** (1) the Bank's operation of the subsidiary does not materially and adversely affect its safe and sound condition, and (2) that the total invested by the Bank in or through the subsidiary does not exceed twenty percent (20%) of the Bank's funds.

#### 5.0 CONCLUDING REMARKS

The statutory standards for making this determination are uniformly applicable for any Washington state commercial bank, similarly situated, seeking to conduct the activity applied for by the Bank as stated above. However, institutions other than the Bank are advised that each applicant's relevant facts and circumstances, including financial and management strength, may be different; and such relevant facts, as applied to the governing law, may result in the Division of Banks reaching a conclusion different than the one accorded Washington First International Bank in this case.

Should you have any questions, please do not hesitate to call upon me at either (360) 902-8747 or (206) 956-3229.

Sincerely,

WASHINGTON STATE DEPARTMENT  
OF FINANCIAL INSTITUTIONS

By:

David G. Kroeger, Director – Division of Banks

Cc: Margaret Leslie, Field Supervisor, FDIC