RB 30 rescinded 1/13/95. It was incorporated into Thrift Activities 211.

Office of Thrift Supervision

Regulatory Bulletin

Handbook: Thrift Activities **Section: 211**
Subject: Loan Portfolio Diversification **RB 30**

January 25, 1993

RESCINDED

Guidance on the Use of Salvage Powers to Exceed Loans to One Borrower Limitations

Summary: A savings association has authority to use salvage powers to exceed the loans to one borrower (LTOB) limitations[1] only in furtherance of a reasonable and bona fide salvage plan. The Office of Thrift Supervision (OTS) generally considers a salvage plan acceptable only if the association can demonstrate that the plan reduces the risks associated with a particular asset, is necessary for the protection of collateral value, and is in the best interest of the association. Because salvage plans that involve investments in excess of the LTOB limitation present unique safety and soundness concerns, savings associations should contact the appropriate OTS Regional Director before implementing any such plan.

For Further Information Contact: For Further Information Contact: Your Regional Office or Supervision Policy (Credit Risk), OTS, Washington, D.C.

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Background

It has long been the position of the OTS and its predecessor that a federal savings association has inherent or implied authority to take whatever steps may be necessary to salvage an investment, provided: (i) the steps taken are an integral part of a reasonable and bona fide salvage plan, and (ii) the steps taken do not contravene a specific legal prohibition.[2] State-chartered savings associations have similar authority under state law. Traditionally, salvage powers have provided the legal justification for savings associations to hold, operate (if necessary), and invest additional funds (if necessary) in property acquired as a result of, or in lieu of, foreclosure prior to re-sale of that property.

General Policy

A savings association may use its salvage powers to exceed the LTOB limitation provided it is able to demonstrate that its excess investments are being made pursuant to a reasonable and *bona fide* salvage plan. Excess investments that are not made pursuant to such a plan are illegal and could trigger enforcement action by the OTS. The plan should be expressly approved by the Board of Directors.

The LTOB limitation is a critical safety and soundness standard that is intended to prevent savings associations from placing themselves at risk by concentrating too great a portion of their assets in any single borrower. Given the importance of this standard for the maintenance of safe and sound operations and the unique risks presented when a savings association exceeds this standard in the context of a salvage operation, the OTS will carefully review any use of salvage powers to exceed the LTOB limit.

The OTS encourages savings associations to notify regional OTS supervisory officials before engaging in any significant salvage operation. For the reasons explained above, the need to consult with regional supervisory officials is especially great when salvage powers will be used to exceed the LTOB limitation, since safety and soundness considerations will affect whether a proposed use of salvage powers is appropriate.

Accordingly, a savings association that intends to make a salvage powers investment in excess of its LTOB limitation should first contact the appropriate OTS Regional Director to ensure that the Regional Director does not object to the association's judgment that the proposed salvage plan is appropriate prior to exceeding the LTOB limitation.[3] This advance notice should reduce the potential for misunderstanding between the savings association and OTS as to the appropriateness of a significant salvage operation.

Regional Directors, in their review of the risks posed by proposed salvage plans, will take into consideration an institution's past history of salvage operations, the financial condition of the institution, and its ability to undertake the risks attendant to salvage operations. In general, Regional Directors will defer to an institution's judgment on the advisability of a specific salvage operation if the institution is well-managed and well-capitalized.

The level of scrutiny given to a salvage plan will also vary depending on the foreclosure status of the asset being salvaged, as explained below:

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1. 12 U.S.C. Section 1464(u) and 12 C.F.R. Section 563.93.

2. The OTS does not consider the LTOB limitation to be a specific legal prohibition within the meaning of the salvage powers doctrine.

3. An association need not contact its Regional Director before making reasonable delinquent tax or insurance payments necessary to protect the association's security interest in the property. In such instances, an association should still document that such action is necessary and appropriate.

1. Assets acquired as a result of, or in lieu of, foreclosure

Once an asset has been acquired as a result of, or in lieu of, foreclosure, the LTOB limitation no longer applies directly to subsequent investments in that asset. In such situations, however, the OTS uses the LTOB limitation as a prudential standard to identify significant salvage operations that may require special scrutiny to ensure that they are being prudently conducted. This includes salvage operations on foreclosed assets held in the insured institution and those held in subsidiaries.[4]

The OTS recognizes that the payment of certain operating expenses (such as taxes and insurance or expenses to prevent deterioration of the investment) may be prudent steps necessary to minimize the potential for loss pending the disposition of repossessed assets. Some capital expenditures, such as those necessary to put collateral property in final form for occupancy or sale, may also be prudent. However, the burden of demonstrating that capital expenditures are reasonable is greater than for operating expenditures, since capital expenditures are likely to be much more substantial.

When reviewing a proposed salvage plan, Regional Directors will, in addition to the factors identified above, consider whether the plan: (i) is necessary to enable the association to salvage its existing investment, (ii) is necessary to protect the value of the foreclosed property (e.g., the additional investments will result in a more marketable property), (iii) is in the best interest of the association, and (iv) will reduce the risks associated with the foreclosed property.

2. Loans in the process of foreclosure

A loan will be deemed to be in the process of foreclosure if a savings association has begun the process necessary to foreclose or to take a deed in lieu of foreclosure and is actively pursuing that process, but has not yet acquired title to the property securing the loan.

Although Regional Directors will use the same standards outlined in Part 1 above ("Assets acquired as a result of, or in lieu of, foreclosure") to review salvage plans that call for investments in excess of LTOB limits in loans in the process of foreclosure, they will also take account of the additional risks associated with investing funds in a property that has not yet been acquired by the association. Under these circumstances, a savings association should also demonstrate that the timing of its proposed investment (i.e., before foreclosure) is reasonable.

3. Troubled loans not in the process of foreclosure

Although a savings association may also use its salvage powers to invest funds in excess of its LTOB limits in a troubled loan that is not in the process of foreclosure, the burden of demonstrating that this type of salvage operation is prudent is high. Regional Directors will assess whether a savings association has made a compelling showing that the standards outlined in Part 1 ("Assets acquired as a result of, or in lieu of, foreclosure") have been met and that the association's decision to delay or forego foreclosure is consistent with safe and sound operations.

John F. Robinson

—John F. Robinson
Acting Deputy Director for Washington Operations

4. For purposes of measuring whether the LTOB limit has been exceeded, the OTS will aggregate all of a savings association's investments in the property in question regardless of whether those investments occurred before or after foreclosure.