

Safety and Soundness

Capital
Adequacy
(C)

Asset
Quality
(A)

Management
(M)

Earnings
(E)

Liquidity
(L)

Sensitivity to
Market Risk
(S)

Other
Activities
(O)

RESCINDED

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Introduction

The Office of the Comptroller of the Currency's (OCC) *Comptroller's Handbook* booklet, "Other Real Estate Owned," is prepared for use by OCC examiners in connection with their examination and supervision of national banks, federal savings associations (FSA), and federal branches and agencies of foreign banking organizations (collectively, banks). Each bank is different and may present specific issues. Accordingly, examiners should apply the information in this booklet consistent with each bank's individual circumstances. When it is necessary to distinguish between them, national banks, FSAs, and covered savings associations (CSA) are referred to separately.¹ (Updated in versions 1.1 and 1.2)

This booklet focuses on the acquisition, management, disposition, and accounting of other real estate owned (OREO) held by banks. (Updated in version 1.1)

OREO is real estate, including leases, that is (updated in version 1.2)

- acquired through any means in full or partial satisfaction of a debt previously contracted.
- a former banking facility, including a property that was acquired for future expansion but for which banking use is no longer contemplated.

For regulatory reporting purposes, OREO also includes

- equity holdings, such as limited liability companies, that indirectly represent real estate acquired through foreclosure or by deed in lieu of foreclosure.
- real estate collateral securing a loan when the bank has obtained physical possession of the collateral, regardless of whether formal proceedings have been instituted against the borrower.
- foreclosed real estate sold under contract and accounted for under the deposit accounting method in accordance with the Financial Accounting Standards Board's Accounting Standards Codification (ASC) Subtopic 610-20, "Other Income—Gains and Losses From the Derecognition of Nonfinancial Assets," when the transaction does not meet the requirements of ASC Topic 606, "Revenue From Contracts With Customers." Refer to the "Accounting for Sales of OREO" section of this booklet for more information on the applicable accounting standards and effective dates for different types of entities. (Updated in versions 1.1 and 1.2)

While this booklet focuses on foreclosed real property, the acquisition accounting and reporting guidance described in this booklet may apply to other types of foreclosed (repossessed) property, such as consumer and commercial goods, financial instruments, and

¹ Generally, references to "national banks" throughout this booklet also apply to federal branches and agencies of foreign banking organizations unless otherwise specified. Refer to the "Federal Branches and Agencies Supervision" booklet of the *Comptroller's Handbook* for more information regarding applicability of laws, regulations, and guidance to federal branches and agencies. Certain FSAs may make an election to operate as a CSA. For more information, refer to OCC Bulletin 2019-31, "Covered Savings Associations Implementation: Covered Savings Associations," and 12 CFR 101, "Covered Savings Associations." (Footnote added in version 1.2)

intangible assets.² For reporting purposes, as with real property, other foreclosed assets include loans where a bank has received physical possession of a borrower's assets, regardless of whether formal proceedings take place. (Updated in version 1.1)

Authority to Hold

(Section updated in versions 1.1 and 1.2)

12 USC 29 permits a national bank or CSA to hold certain types of real estate, including OREO. The authority for an FSA to obtain real property in connection with satisfaction of a loan previously made, including at foreclosure, is an inherent power associated with making a loan secured by a mortgage on real property under 12 USC 1464(c)(1)(B) and (2)(B).

12 CFR 34, "Real Estate Lending and Appraisals," subpart E, "Other Real Estate Owned," implements requirements relating to the OREO holding period, disposition, appraisals, and additional expenditures and notifications. OREO may be held directly or indirectly through equity ownership in an entity formed to hold the real estate. Refer to appendix A of this booklet for more information.

Under 12 CFR 7.1000(d), a bank should normally use real estate acquired for future bank expansion within five years. After holding such real estate for one year, the bank must state, by resolution of the board of directors or an appropriately authorized bank official or subcommittee of the board, definite plans for the real estate's use. Such resolution or other official action must be available for inspection by OCC examiners. If at any time during the five-year period such property is no longer being considered for banking use, the property must be transferred to OREO.

Risks Associated With OREO

From a supervisory perspective, risk is the potential that events will have an adverse effect on a bank's current or projected financial condition³ and resilience.⁴ The OCC has defined eight categories of risk for bank supervision purposes: credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation. These categories are not mutually exclusive. Any product or service may expose a bank to multiple risks. Risks also may be interdependent and may be positively or negatively correlated. Examiners should be aware of and assess this interdependence. Examiners also should be alert to concentrations that can significantly elevate risk. Concentrations can accumulate within and across products, business lines, geographic areas, countries, and legal entities. Refer to the "Bank Supervision

² Information regarding other repossessed property can be found in the "Installment Lending" booklet of the *Comptroller's Handbook* and the Federal Financial Institutions Examination Council (FFIEC) call report instructions. (Footnote updated in versions 1.1 and 1.2)

³ Financial condition includes impacts from diminished capital and liquidity. Capital in this context includes potential impacts from losses, reduced earnings, and market value of equity. (Footnote added in version 1.2)

⁴ Resilience recognizes the bank's ability to withstand periods of stress. (Footnote added in version 1.2)

Process” booklet of the *Comptroller’s Handbook* for an expanded discussion of banking risks and their definitions. (Updated in version 1.2)

While price risk is the primary risk presented by OREO, liquidity, operational, compliance, and reputation risks may also be present. These risks are often interdependent, and each should be considered when assessing the quantity of risk OREO presents to a bank.

Real estate price declines during the holding period can reduce the proceeds that may be realized upon a property’s disposal. Economic trends that may have played a role in the bank’s acquisition of the property as OREO could continue, and values may be further diminished by the sale of properties by other banks or distressed borrowers. It may be difficult to obtain accurate valuations in markets experiencing volatile sales prices or in markets dominated by distressed sales. A bank may find it challenging to realize the market value of a property because of potential purchasers’ perceptions that the bank may be anxious to dispose of it.

Real estate is by its nature illiquid. High levels of OREO and ineffective disposal strategies may negatively affect a bank’s liquidity. (Updated in version 1.1)

Operating policies and procedures for OREO can pose operational risk that may result in reduced property revenues and excessive expenses, uninsured casualty losses, inadequate or ineffective marketing and sales efforts, collateral deterioration, unrecognized losses, and lower recoveries.

A bank assumes substantial compliance risk when it acquires OREO. The bank must comply with relevant laws and regulations, beginning with the foreclosure process and continuing through ultimate disposition of the property, including laws governing property preservation, the treatment of tenants, and fair housing requirements for non-discriminatory treatment in these areas. The bank has legal responsibilities with regard to owning, operating, maintaining, marketing, and selling OREO and may be held liable for damages to other parties. Foreclosure activities involving residential properties, in particular, can pose significant compliance risk. The bank should have policies, processes, and control systems governing compliance with relevant laws and regulations. (Updated in version 1.1)

The acquisition of OREO can negatively impact a bank’s reputation in several ways. A bank’s reputation may suffer when it manages OREO in an imprudent manner, owns or neglects an unpopular or deteriorated property, or employs foreclosure management or sales practices that are inconsistent with sound risk management, local or state laws, or federal regulations. These practices can create negative public opinion, which in turn may impair a bank’s competitiveness by affecting its ability to establish new relationships or maintain existing relationships. (Updated in version 1.1)

Risk Management

Each bank should identify, measure, monitor, and control risk by implementing an effective risk management system appropriate for its size and the complexity of its operations. When

examiners assess the effectiveness of a bank’s risk management system, they consider the bank’s policies, processes, personnel, and control systems. Refer to the “Corporate and Risk Governance” booklet of the *Comptroller’s Handbook* for an expanded discussion of risk management. (Updated in versions 1.1 and 1.2)

Policies and Procedures

(Section updated in versions 1.1 and 1.2)

A bank should have appropriate policies and procedures to govern the acquisition, holding, maintenance, and disposition of OREO. The bank’s policies, procedures, and practices should be consistent with financial reporting requirements and applicable laws and regulations.

Acquiring title to properties—either for the bank or as servicer or trustee for a third-party mortgagee—results in new or expanded risks. The “Managing Foreclosed Properties” section of this booklet describes considerations for the bank’s OREO policies and procedures as owners of foreclosed properties. Appendix B, “Guidance on Potential Issues With Foreclosed Residential Properties as Servicer or Trustee,” includes policy and procedural considerations when servicing for others. While the focus of the guidance for foreclosed properties is primarily on residential properties, many of the principles also apply to commercial properties.

Holding Period

(Section updated in versions 1.1 and 1.2)

There are restrictions on how long a bank can hold OREO. The holding period restrictions are generally the same for national banks and FSAs but are presented separately as the standards are based on different statutory authorities.

The holding period begins on⁵

- the date that ownership of the property is originally transferred to the bank, including as a result of a merger with or acquisition of another organization holding OREO,
- the date that the bank completes relocation from its former banking premises to new banking premises, or ceases to use the former banking premises without relocating,
- the date that the bank decides not to use real estate acquired for future bank expansion, or
- January 1, 2020, for OREO obtained by an FSA before that date.⁶

If the bank converted to a national bank or an FSA after January 1, 2020, and was already a national bank or FSA immediately before the conversion, the holding period does not reset

⁵ Refer to 12 CFR 34.82(b), “Commencement of Holding Period.” (Footnote added in version 1.2)

⁶ If an FSA makes an election to operate as a CSA, the holding period would commence no earlier than January 1, 2020. (Footnote added in version 1.2)

on the merger or acquisition date. The length of time that the OREO was held while the bank was subject to the holding period restrictions counts in total toward the holding period after merger or acquisition. For example, if an FSA converted to a national bank in January 2018, the OREO holding period would have been reset to start in January 2018, as the FSA was not subject to a holding period before that date. If an FSA acquired OREO in January 2018 and converted to a national bank in January 2021, the holding period for that OREO would not be reset to start in January 2021; in this example, the final disposition date would remain January 2023 (five years from acquisition). The bank could, however, use a holding period with a start date of January 2020, as that was the date the FSA and its OREO became subject to the OCC's rule.

National banks: A national bank must dispose of OREO at the earliest time that prudent judgment dictates, but the holding period must be no longer than five years, unless the OCC grants the bank an extension.⁷ A national bank desiring an extension of the five-year holding period should file a request with and receive written approval from the bank's OCC supervisory office before the expiration of the holding period. The OCC may grant multiple extensions, as long as those extensions, in the aggregate, do not exceed an additional five years. To receive an extension, the bank must be able to demonstrate to the OCC that it has made a good-faith effort to dispose of the property within the initial five-year period or that disposal of the property within the initial five-year period would be detrimental to the bank.

FSAs: An FSA may hold OREO for not more than five years after the commencement of the holding period unless the OCC grants an extension.⁸ An FSA may request that the OCC extend the holding period for not more than an additional five years. As with national banks, in deciding whether to grant an extension, the OCC typically considers the FSA's efforts to dispose of the property and any safety and soundness concerns related to an immediate disposition of the property.

Foreclosure Redemption Periods

(Section moved in version 1.2)

As part of the foreclosure process, certain states have a mandatory period following a foreclosure sale during which the borrower can redeem its interest in the property by satisfying the debt. During this redemption period, the borrower generally has the right to occupy the property, thereby maintaining physical possession of the collateral. The length of the redemption period varies by state and often by property type, ranging from three months to one year. Although the bank has foreclosed on the property and, depending on the state, may have equitable or legal title, or both, the bank may not have possession before the expiration of the redemption period. The bank may sell its interest in the collateral during the redemption period, but this interest remains subject to the borrower's right of redemption.

⁷ Refer to 12 CFR 34.82(a)(1). (Footnote added in version 1.2)

⁸ Refer to 12 CFR 34.82(a)(2). (Footnote added in version 1.2)

Foreclosed real estate should be accounted for as OREO pursuant to generally accepted accounting principles (GAAP) and call report instructions without regard to any state redemption statutes. The five-year holding period does not, however, begin until the end of the redemption period, assuming the borrower does not redeem the property through payment in full.⁹ (Updated in version 1.2)

Effect of a Failed Disposition (Tolling Period)

(Section added in version 1.2)

Sometimes, when a bank enters into a transaction to dispose of OREO, the real estate is conveyed back to the bank for a reason other than a subsequent repurchase by the bank. This can happen, for example, when the OREO disposition fails to be completed or the disposition is validly rescinded. For example, in certain U.S. government mortgage loan programs, a bank may be required to transfer a foreclosed property to a U.S. government entity, and that entity may later validly reject receipt of the property and return the title to the bank.

In such instances, the five-year holding period is not reset for the property. Instead, any previous holding period is tolled¹⁰ for the period that the bank was not in possession or control of the property.¹¹ For example, if a buyer enters into an agreement to purchase a parcel of OREO from the bank but then legally rescinds the sale, the bank does not start a new five-year holding period for that property. Any previous holding period (including any approved extension) is then tolled between the time the bank sold and reacquired the property.

Reacquisition of Former OREO

(Section added in version 1.2)

If a bank reacquires property that was previously OREO and was disposed of consistent with 12 CFR 34.83, then the five-year holding period resets.¹² For example, if the bank originated a mortgage loan in connection with the sale of an OREO property that met the requirements for a valid disposition under 12 CFR 34 but then later forecloses on the property, a new five-year holding period would commence.

Accounting

The Federal Financial Institutions Examination Council (FFIEC) call report instructions provide accounting guidance for OREO and other foreclosed assets. The instructions require

⁹ Refer to 12 CFR 34.82(c). (Footnote added in version 1.2)

¹⁰ Tolling is a legal term used for the pausing or delaying of a period of time, such as the period set forth by a statute of limitations. (Footnote added in version 1.2)

¹¹ Refer to 12 CFR 34.82(d), “Effect of a Failed Disposition.” (Footnote added in version 1.2)

¹² Refer to 12 CFR 34.82(e), “Re-Acquisition of Former OREO.” (Footnote added in version 1.2)

that foreclosed assets be accounted for in accordance with GAAP. More information regarding OREO accounting can be found, along with various scenarios with accounting entries, in the OCC's *Bank Accounting Advisory Series*. (Updated in versions 1.1 and 1.2)

Accounting at Acquisition or Designation as OREO

(Section updated in versions 1.1 and 1.2)

ASC Subtopic 310-40, "Receivables—Troubled Debt Restructurings by Creditors," and ASC Topic 360 provide general guidance for the initial recording of foreclosed assets.

Upon foreclosure or physical possession, whichever is earlier, OREO should be recorded at the fair value of the property, less the estimated costs to sell; this amount becomes the new cost basis of the property. The amount by which the recorded amount of the loan exceeds the new cost basis is a loss and must be charged to the allowance for loan and lease losses (ALLL) or the allowance for credit losses (ACL) for banks that have adopted Accounting Standards Update (ASU) 2016-13, "Financial Instruments—Credit Losses." The recorded amount of the loan is the loan balance adjusted for any unamortized premium or discount and unamortized loan fees or costs, less any amount previously charged off, plus recorded accrued interest.

Other assets besides real property received in full satisfaction of a loan—such as motor vehicles, furniture and fixtures, equipment, financial instruments, and intangible assets—should be initially measured at the asset's fair value, less estimated costs to sell, if applicable, at the time of foreclosure or physical possession, whichever is earlier. As with OREO, the amount, if any, by which the recorded amount of the loan exceeds the fair value, less costs to sell, if applicable, must be charged to the ALLL or ACL. Refer to GAAP and the call report instructions for other accounting and reporting requirements for other foreclosed assets.

Assets received in partial satisfaction of a loan should be accounted for as previously described, and the recorded amount of the loan should be reduced by the fair value, less costs to sell, if applicable, of the asset at the time of foreclosure.

A gain at the time of establishing OREO is rare. When a gain is recognized, the valuation supporting the fair value and estimated costs to sell should be closely reviewed. If concern exists about the accuracy of the valuation, examiners should perform further analysis.

If OREO is sold shortly after it is acquired, the amount of the loss originally charged to the ALLL or ACL may be adjusted for the value actually received in the sale (net of the costs to sell). "Shortly after" is generally defined as being before the filing of the next call report.

Former bank premises should be recorded at the lower of the premises' net book value or fair value at the date of transfer to OREO. Any excess of net book value over fair value must be charged to expense of the current period.

An independent appraisal or evaluation, as appropriate, normally establishes the fair value of OREO and is discussed in the “Appraisals and Evaluations” section of this booklet. ASC Subtopic 820-10, “Fair Value Measurement,” provides guidance on measuring the fair value. The valuation should be consistent with the price that a market participant will pay to purchase the property at the measurement date in its as-is condition. Circumstances such as changed economic conditions may indicate that the appraised value is not an accurate measurement of the property’s current fair value and is no longer valid. See the “Appraisals and Evaluations” section for further discussion of the validity of appraisals and evaluations.

Costs incurred by a bank to perfect its lien before foreclosure may be eligible for inclusion in the recorded amount of the loan satisfied, subject to the bank recording the property at fair value, less estimated costs to sell. Examples of eligible costs are payments of delinquent property taxes to clear tax liens, payments to contractors and subcontractors to clear mechanic’s liens, or paying off first lien positions on properties for which the bank holds the second lien. The bank should expense legal fees, filing fees, legal notice advertising costs, and other direct costs of acquiring title to the property when incurred.

When the bank acquires a parcel of property through foreclosure as a junior lienholder without paying off the senior lien,¹³ the property should be booked at fair value, less costs to sell and the amount of any senior debt reported as a liability at the time of foreclosure. Any excess between the recorded amount of the loan plus the senior debt and the fair value of the property less costs to sell should be charged against the ALLL or ACL at the time of foreclosure.¹⁴

Accounting for OREO During the Holding Period

Subsequent to acquisition and transfer, OREO must be carried at the lower of cost or fair value, less estimated costs to sell. Management should maintain documentation supporting each property’s carrying value consistent with prudent banking practice and as required to ensure that quarterly regulatory reports are accurate and consistent with GAAP. Subsequent declines in fair value below the initial cost basis are recorded through the use of a valuation allowance with a charge to net gains (losses) on sales of OREO under noninterest income.¹⁵ Subsequent recoveries of fair value before disposition of the property may be recognized up

¹³ If a junior lienholder forecloses and the senior mortgage remains, the junior lienholder is responsible for keeping the contractual payments on the senior mortgage note current.

¹⁴ See the OCC’s *Bank Accounting Advisory Series*, topic 5A.

¹⁵ A bank may also reduce an OREO property’s value via direct write-off rather than establishing a valuation allowance. When a bank reduces a property’s value by direct write-off, a new cost basis for the property is established. Subsequent to the direct write-off, the bank may establish a valuation allowance for any additional fair value decline rather than record an additional direct write-off. For more information, refer to the OCC’s *Bank Accounting Advisory Series*, topic 5A. (Footnote added in version 1.2)

to the initial cost basis of the property established upon transfer to OREO and may be recouped up to the amount of previously recognized valuation allowances established after acquisition.¹⁶ (Updated in version 1.2)

Changes in fair value must be determined on a property-by-property basis. An allowance allocated to one property may not be used to offset losses incurred on another property. Unallocated OREO valuation allowances are not acceptable. Subsequent increases in the fair value of a property may be used to reduce the valuation allowance, but not below zero. OREO valuation allowances are not included in regulatory capital because such valuation allowances are not included in the ALLL or ACL. (Updated in versions 1.1 and 1.2)

Generally, the revenues and expenses from OREO should be included in the income statement for the call report period in which they occur. The call report instructions require that gross rentals from OREO be included in other noninterest income. The expenses of operating or maintaining the property should be included in other noninterest expense. Normal OREO expenses include insurance, taxes, utilities, and routine maintenance and repairs. A bank may not recognize depreciation expense for assets held for sale, including OREO.

ASC Subtopic 970-340, “Real Estate—General—Other Assets and Deferred Costs,” provides guidance on the accounting for costs incurred in the completion of development and construction, while ASC Subtopic 835-20, “Interest—Imputation of Interest,” provides guidance on capitalization of interest costs, if applicable. See the “OREO Expenditures” section of this booklet for more information. (Updated in version 1.1)

Accounting for Sales of OREO

(Section updated in versions 1.1 and 1.2)

In May 2014, the FASB issued ASU 2014-09, which created ASC Topic 606. ASC Topic 610 applies to a bank’s sale of repossessed nonfinancial assets, such as OREO. Pursuant to ASU 2014-09, sales of OREO should be accounted for in accordance with ASC Subtopic 610-20. Refer to appendix C of this booklet for a detailed discussion of ASC Subtopic 610-20. Appendix C includes a summary of ASC Subtopic 360-20 for reference (sales of OREO by banks that were non-public business entities in fiscal years beginning on or before December 15, 2018, were accounted for in accordance with ASC Subtopic 360-20).

¹⁶ See the FFIEC call report instructions, RC-M “Memoranda,” item 3, “Other Real Estate Owned,” for a discussion of valuation allowances for OREO.

Appraisals and Evaluations

(Section updated in version 1.1 and 1.2)

12 CFR 34.85 establishes the appraisal requirements for OREO held by banks, with reference to the appraisal requirements in 12 CFR 34, subpart C, “Appraisals.” Additional guidance can be found in various OCC bulletins listed in the “References” section of this booklet.

12 CFR 34.85 requires banks to obtain an appraisal or evaluation, as appropriate, to substantiate the market value of each parcel upon transfer to OREO.¹⁷ In addition, a bank may request alternate values, such as liquidation or disposition values. If the bank has a valid and compliant appraisal or evaluation that was previously obtained in connection with the underlying real estate loan, however, the bank does not need to obtain a new appraisal or evaluation to comply with these regulations. Section XIV, “Validity of Appraisals and Evaluations,” of the “Interagency Appraisal and Evaluation Guidelines”¹⁸ states that banks should establish criteria for assessing whether an existing appraisal or evaluation remains valid and discusses factors that should be considered in such an assessment. Factors to consider should include

- passage of time.
- volatility of the local market.
- changes in terms and availability of financing.
- natural disasters.
- limited or over supply of competing properties.
- improvements to the subject property or competing properties.
- lack of maintenance of the subject or competing properties.
- changes in underlying economic and market assumptions, such as capitalization rates and lease terms.
- changes in zoning, building materials, or technology.
- environmental contamination.

The application of an arbitrary period of time, such as 12 months, should not be used as stand-alone criteria for determining the validity of an appraisal or an evaluation. The passage of time is just one component of that assessment, and other factors that affect value should be considered in making such a determination.¹⁹

¹⁷ A bank may substantiate a property’s market value by obtaining an appropriate evaluation when the recorded investment in the loan satisfied is equal to or less than \$400,000 (residential real estate) or \$500,000 (commercial real estate). Requirements for an appropriate evaluation are described in 12 CFR 34.85 with additional guidance in OCC Bulletin 2010-42, “Sound Practices for Appraisals and Evaluations: Interagency Appraisal and Evaluation Guidelines,” and OCC Bulletin 2018-39, “Appraisals and Evaluations of Real Estate: Frequently Asked Questions.” (Footnote updated in versions 1.1 and 1.2)

¹⁸ Refer to OCC Bulletin 2010-42, “Sound Practices for Appraisals and Evaluations: Interagency Appraisal and Evaluation Guidelines.”

¹⁹ Ibid.

The bank should maintain documentation that provides the facts and analysis used to support the conclusion that an existing appraisal or evaluation remains valid and appropriate to establish the property's current market value.

When the bank transfers the property to OREO but does not yet have access to the interior of the property, an exterior-only appraisal may be performed to fulfill the requirements under 12 CFR 34.85. Such appraisals would use extraordinary assumptions regarding the interior condition of the property or other areas that could not be reasonably and safely accessed. Once access is obtained, the bank should inspect the property to determine if the assumptions and appraisal remain valid. If conditions warrant, an updated appraisal should be performed.

The bank is not required to obtain another appraisal or evaluation when selling OREO if the sale is consummated based on a valid appraisal or evaluation as described in 12 CFR 34.85(c).

A bank's collateral valuation policies should be consistent with 12 CFR 34.85(a)(2). The policy should require the monitoring of OREO values in a manner consistent with prudent banking practice; this should include appropriate periodic reviews of the property throughout its holding period. These reviews should substantiate the property's carrying value. Appraisals and evaluations should be reviewed, and the reviews should be documented in writing and approved by authorities defined in the bank's appraisal policy. Examiners should review the adequacy of the bank's OREO appraisal policy and determine if bank staff responsible for managing OREO complies with the bank's policy and applicable laws and regulations. The OCC may require the bank to obtain a new appraisal or evaluation when the agency believes it is necessary to address safety and soundness concerns.

Management and Disposition

OREO Expenditures

(Section updated in version 1.2)

Under certain circumstances, banks may make additional expenditures on OREO, including the following:

- **Operating expenses**, including taxes, insurance, utilities, and maintenance, that are reasonable and consistent with safe and sound banking practices.²⁰
- **Business expenditures**, if the expenses are²¹
 - reasonably calculated to reduce any shortfall between the property's market value and the recorded investment amount.
 - not made for investment purposes.
 - consistent with safe and sound banking practices.

²⁰ Refer to 12 CFR 34.86(a), "Operating Expenditures." (Footnote added in version 1.2)

²¹ Refer to 12 CFR 34.86(b), "Business Expenditures." (Footnote added in version 1.2)

- **Additional expenditures to complete a development or improvement project**, if the advances are²²
 - reasonably calculated to reduce any shortfall between the property’s market value and the recorded investment amount,
 - not made for the purpose of speculation in real estate, and
 - consistent with safe and sound banking practices.

For expenditures to complete a development or improvement project, the bank must notify the OCC when the proposed additional expenditures and the bank’s current recorded investment amount (including any unpaid prior liens) exceeds 10 percent of the bank’s total equity capital based on its most recent call report. The bank must notify the OCC at least 30 days before implementing the development or improvement plan.

The required notification must demonstrate that the additional expenditure is consistent with the conditions and limitations set forth at 12 CFR 34.86(c). Unless otherwise informed by the OCC, the bank may implement the plan on the 31st day (or sooner if notified by the OCC) after the OCC receives the notification, subject to any conditions imposed by the OCC.²³

Other OREO Expenditure Considerations

Banks may capitalize costs incurred to complete construction; however, the recorded balance of the OREO should not exceed the “as-completed” fair value, less estimated costs to sell. The recorded OREO balance should never exceed fair value, less estimated costs to sell. (Updated in versions 1.1 and 1.2)

In reviewing OREO expenditures, the OCC considers several factors. The completion of unfinished construction may be justified if significant funds have already been expended and completion is likely to result in enhanced recovery of funds. Completion of projects that are far from complete would typically not be approved and would require a careful analysis of the facts supporting the expenditures. (Updated in version 1.2)

Ground-up construction of buildings, including out-parcels and separate structures in a development, usually would not be approved absent extenuating circumstances. Circumstances may include preleased commercial buildings or presold residences and the construction of common buildings, such as clubhouses, where compelling evidence exists that a significant number of real estate closings are dependent on their completion.

Speculative lot development would not normally be approved. Completion of partially developed lots may be approved, however, especially if builder commitments are in place to purchase the lots. If prospects for selling lots in the foreseeable future are poor, additional expenditures usually should not be incurred. Expenditures required by government entities

²² Refer to 12 CFR 34.86(c), “Additional Expenditures.” (Footnote added in version 1.2)

²³ Refer to 12 CFR 34.86(d), “Notification Procedures for Additional Expenditures.” (Footnote added in version 1.2)

(i.e., when the owner has no choice) for erosion control and completion of other mandated site improvements are generally allowable.

Managing Foreclosed Properties

This section discusses important topics related to managing and dispositioning OREO. Examiners should assess a bank's processes for managing foreclosed properties, including fulfilling ownership obligations and actions and addressing other ownership issues. (Updated in version 1.2)

Ownership Obligations and Actions

(Section updated in version 1.2)

- In acquiring title to foreclosed properties, a bank assumes the primary responsibilities of an owner, including providing maintenance and security, paying taxes and insurance, and serving as landlord for rental properties.
 - The bank should communicate with localities, including homeowners' associations, about specific requirements with respect to foreclosed residential properties. For example, localities may have requirements for upkeep—such as lawn mowing, property maintenance, and security—and the requirements may become applicable at different stages of the foreclosure process.
 - If it fails to take these actions, the bank could be subject to potential nuisance actions or the exercise of local receivership powers to seize properties.
- For Federal Housing Administration (FHA)-insured mortgages, the bank must comply with applicable property and preservation requirements issued by the U.S. Department of Housing and Urban Development (HUD) to preserve the insurance claim and obtain reimbursements for allowable expenses.
- For FHA-insured mortgages, rehabilitation and improvement expenditures are permissible if reasonably calculated to reduce any shortfall between the parcel's market value and the bank's recorded investment amount. If such expenditures are permissible and the bank makes them, the bank should comply with local building codes and licensing requirements. After foreclosure, the bank must record its ownership interest in local land records.
- The bank must comply with OREO appraisal and accounting requirements.
- The bank should maintain appropriate insurance on the property.
- Some localities require registration of foreclosed properties, properties in foreclosure, or vacant properties.
- The Protecting Tenants at Foreclosure Act of 2009 provides tenants with protections from eviction resulting from foreclosure on the properties they are renting. The "Protecting Tenants at Foreclosure Act" booklet of the *Comptroller's Handbook* provides additional information.
 - When a bank takes title to a house after foreclosure, it must honor any existing rental agreement with a bona fide tenant and must provide 90 days' notice to the tenant before eviction, whether or not the tenant has a rental agreement (after taking title through foreclosure).

- State laws may impose additional requirements that are not preempted by the Protecting Tenants at Foreclosure Act.
- Additional potential requirements with respect to rental properties include
 - reviewing the lease to determine if the property can be shown to prospective purchasers.
 - returning any security deposit upon termination of the rental agreement.
- The Servicemembers Civil Relief Act provides servicemembers relief from certain obligations when military service affects the servicemember’s ability to meet or attend to civil matters. The “Servicemembers Civil Relief Act” booklet of the *Comptroller’s Handbook* provides additional information.
 - Real property acquired by a servicemember before the servicemember’s military service began cannot be sold, foreclosed, or seized during the period of military service and for a one-year period subsequent to the military service. These restrictions can be superseded with the approval of a court or a written agreement in which the servicemember agrees to waive certain rights. (Updated in version 1.1)
 - A landlord may not evict a servicemember or his or her dependents from certain residences²⁴ occupied primarily as a residence during a period of military service except by court order.

Additional Ownership Issues

(Section updated in version 1.2)

- A bank should have sufficient staff to manage foreclosed property portfolios. A bank should have policies, procedures, and risk management systems in place to properly oversee and manage third-party relationships. The use of third parties does not diminish the bank’s responsibility to manage foreclosed properties in a safe and sound manner and in compliance with applicable laws and regulations. Third-party relationships should be subject to the same risk management process that would be expected if a bank were conducting the activities directly.²⁵ Such a risk management process should include
 - written contracts outlining the duties, obligations, and responsibilities of the parties involved.
 - appropriate due diligence before entering a third-party contract.
 - continuous oversight of the third parties and third-party activities.
- The following are important considerations for a bank as a property owner when disposing of foreclosed residential properties:
 - Disposition costs and delays, including advertising, broker, or maintenance fees and repair costs for defects found at inspection.

²⁴ For leased residences, the law, as originally passed by Congress, applied to dwellings with monthly rents not exceeding a certain amount. This amount is adjusted yearly and is published in the *Federal Register* by the U.S. Department of Defense. The amount as of January 1, 2020, was \$3,991.90 (85 Fed. Reg.4296). (Footnote updated in versions 1.1 and 1.2)

²⁵ Refer to OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance,” and OCC Bulletin 2020-10, “Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29.” (Footnote added in version 1.1 and updated in version 1.2)

- The provision of financing for OREO properties. While generally not subject to lending limits, financing the sale of a significant number of properties to the same borrower could result in unsafe or unsound concentrations.
- Negative reaction and potential reputation risk from disposition practices that favor, as purchasers of foreclosed properties, non-occupying investors over owner-occupants.
- Opportunities to participate in and coordinate with state and local land bank programs, neighborhood stabilization programs, redevelopment programs, and other anti-bligh programs, or opportunities to enhance owner occupancy.
- When disposing of foreclosed residential properties from FHA-insured mortgages, either through sales or conveyance to HUD, the bank must comply with HUD requirements to receive insurance payments or other allowable reimbursements.
- Holding period issues may arise if the bank is not able to dispose of foreclosed properties.

Appendix B of this booklet contains guidance for managing foreclosed properties when the bank is acting as the servicer of foreclosed property and when the bank is the trustee of a securitization trust that holds title to foreclosed property.

Releasing a Residential Real Estate Lien Rather Than Foreclosing

(Section updated in versions 1.1 and 1.2)

At times, lenders may release a lien securing a defaulted residential real estate loan rather than foreclose on the property. This decision is often based on financial considerations, such as when the expected costs to foreclose, rehabilitate, and sell a property exceed its current market value. When this decision is made after a bank or servicer has initiated foreclosure, the borrower may have already abandoned the property or discontinued the care and maintenance of the property, increasing the chance of a blighted property in the community. It is prudent for banks and servicers to confirm that the valuation of the property provides the most accurate information practicable, while complying with investor requirements before initiating foreclosure and subsequently deciding to release the lien. The potential for elevated reputation and litigation risk arising from the role as a prior mortgagee or servicer of a now-abandoned property are key considerations before releasing a lien.

If the decision is made to forgo foreclosure and release the lien, the bank or servicer should notify, or attempt to notify, the borrower of the decision. Borrowers should be notified that (1) the mortgage holder is not pursuing foreclosure and has released the mortgage lien, (2) the borrower may continue to occupy the property, and (3) the borrower is obligated to maintain the property consistent with all local codes and ordinances and to pay property taxes and the debt owed. The bank or servicer should also make appropriate notifications to the local jurisdiction when it makes the decision to release a lien in lieu of foreclosure.

Exchanging OREO for Other Assets

A weak economic environment can lead to significant deterioration in asset quality resulting in an increase in lower-quality assets, including OREO. When this occurs, third parties may

market OREO exchange programs to a bank as a means of reducing problem assets. These programs purport to reduce nonperforming assets by exchanging OREO for an interest in another asset that may be represented to be of higher quality. This “higher quality asset” is often an equity interest in the entity acquiring the OREO or a trade for a large number of loans, such as home equity lines of credit. These programs can raise significant safety and soundness, legal, and accounting concerns. Examiners should consult with OCC subject matter experts and OCC legal counsel, as appropriate, when encountering such programs. Further, the OCC strongly encourages banks to consult with their OCC supervisory office before entering into any such agreements.²⁶ Additional information on this topic is included in appendix A of this booklet. (Updated in version 1.2)

Rental of Residential OREO

(Section updated in versions 1.1 and 1.2)

The OCC supports a bank’s efforts to obtain the highest recovery possible on residential OREO while also considering the impact of OREO disposition on the communities the bank serves. The bank must dispose of OREO within the holding period permitted by regulation.²⁷ If the bank can recover the recorded loan amount as well as recorded accrued interest, additional advances, and other costs, it should promptly dispose of the property.

In certain markets, the bank’s analysis may support renting residential OREO for a reasonable period of time, generally one year or less, as part of a prudent disposition strategy. If the bank employs such a strategy, examiners should assess whether the bank has demonstrated and documented diligent and ongoing sales efforts.²⁸ Examiners should consider the reasonableness of the bank’s sales efforts.

A rental program should be executed under an appropriate risk management framework that is commensurate with the size and scope of the program and is designed to control the heightened reputation, credit, operational, and compliance risks that can arise when the bank becomes a landlord. This framework includes complying with federal, state, and local laws that govern rental agreements and tenant rights. Specific controls should generally include

- comprehensive written policy objectives and operating procedures governing OREO recognition, carrying values, management and maintenance, and disposition.
- reporting systems that track OREO flows, volumes, and disposition status (including any rental programs).

²⁶ Refer to OCC Bulletin 2017-43, “New, Modified, or Expanded Bank Products or Services: Risk Management Principles,” for more information. (Footnote added in version 1.2)

²⁷ Refer to the “Holding Period” section of this booklet and 12 CFR 34.82 for more information. (Footnote added in version 1.2)

²⁸ 12 CFR 34.83(c), “Disposition Efforts and Documentation,” requires banks to make diligent and ongoing efforts to dispose of each parcel of OREO and to maintain documentation adequate to reflect those efforts. (Footnote added in version 1.2)

- accounting and reporting for rental OREO in accordance with existing regulatory reporting requirements.
- active oversight of any third parties that assist with the management and disposition of OREO properties. Refer to OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance,” and OCC Bulletin 2020-10, “Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29.”
- control systems (e.g., audit, quality control, quality assurance) with sufficient scope, review schedules, and expertise to assess compliance with all pertinent federal, state, and local laws.²⁹

Disposition of OREO

(Section updated in versions 1.1 and 1.2)

12 CFR 34.83, “Disposition of OREO,” describes how a bank may comply with its legal obligation to dispose of real estate. The bank may dispose of OREO

- by entering into a sale in accordance with GAAP.³⁰
- by entering into a transaction that involves a loan guaranteed or insured by the U.S. government or by an agency of the U.S. government, or a loan eligible for purchase by a federally sponsored instrumentality that purchases loans.
- by selling the property pursuant to a land contract or a contract for deed.
- with respect to real estate acquired in exchange for debts previously contracted, by retaining the property for its own use as bank premises or by transferring it to a subsidiary or affiliate for use in the business of the subsidiary or affiliate.
- with respect to a lease, by obtaining an assignment or a coterminous sublease.³¹ If the bank enters into a sublease that is not coterminous, the period during which the master lease must be divested will be suspended for the duration of the sublease and will begin running again upon termination of the sublease. A bank holding a lease as OREO may

²⁹ These laws include landlord-tenant laws; landlord licensing or registration requirements; minimum leasing requirements; eviction protections under the Protecting Tenants at Foreclosure Act (Pub. L. 111-22, “Helping Families Save Their Homes Act of 2009,” Title VII, sections 701-704, “Protecting Tenants at Foreclosure Act,” as amended by the Dodd–Frank Wall Street Reform and Consumer Protection Act, section 1484, and the Economic Growth, Regulatory Relief, and Consumer Protection Act, section 304); protections under the Servicemembers Civil Relief Act (50 USC 3901 et seq.); reasonable accommodation and accessibility requirements for handicapped or disabled tenants under the Fair Housing Act (42 USC 3601 et seq.) and the Americans With Disabilities Act; antidiscrimination laws, including the Fair Housing Act; and other standards associated with providing clean, sanitary, and safe properties. (Footnote updated in version 1.2)

³⁰ Refer to the “Accounting for Sales of OREO” section of this booklet for more information. (Footnote added in version 1.2)

³¹ A coterminous sublease has the same term as the master lease. (Footnote added in version 1.2)

- enter into an extension of the lease that exceeds the holding period if the extension meets the following criteria:³²
 - The extension is necessary to sublease the master lease.
 - The national bank or FSA, before entering into the extension, has a firm commitment from a prospective subtenant to sublease the property.
 - The term of the extension is reasonable and does not materially exceed the term of the sublease.
- by transferring the OREO to a service corporation to hold as OREO or as an investment in real estate (FSAs only).³³
- by any other method approved by the OCC.³⁴

The bank must make diligent and ongoing efforts to dispose of³⁵ each parcel of OREO and maintain documentation adequate to reflect those efforts.

An FSA's³⁶ service corporation may hold OREO property as an investment longer than 10 years;³⁷ however, under current statutory and regulatory capital requirements, the FSA must deconsolidate and deduct any investments in a subsidiary engaged in activities not permissible for a national bank, including holding property as an investment in real estate.³⁸

With respect to a transaction that does not qualify as a disposition under the regulation, a disposition is considered to be achieved when the bank receives or accumulates from the purchaser an amount in a down payment, principal and interest payments, and private mortgage insurance totaling at least 10 percent of the sales price, as measured by GAAP.³⁹

³² If the OCC determines that a bank has entered into a lease, an extension of a lease, or a sublease for the purpose of real estate speculation, the OCC will take appropriate measures to address the violation, which may include requiring the bank to take immediate steps to divest the lease or sublease. Refer to 12 CFR 34.83(a)(3)(ii). (Footnote added in version 1.2)

³³ An FSA may invest in a service corporation, which in turn may engage in the same activities as its parent FSA under the same terms and conditions. A service corporation also may engage in additional activities not permitted at an FSA, including certain real estate-related services, such as holding property as an investment in real estate (e.g., OREO). In addition, 12 CFR 5.59(i), "Exercise of Salvage Powers Through Service Corporations," permits an FSA to contribute to a service corporation in the exercise of the association's salvage powers. Refer to 12 USC 1464(c)(4)(B), "Service Corporations," and 12 CFR 5.59, "Service Corporations of Federal Savings Associations." For these provisions, a CSA is treated as a national bank. (Footnote added in version 1.2)

³⁴ For example, the OCC previously has approved banks to dispose of OREO in certain circumstances by donating or escheating OREO or by negotiating early terminations of OREO leases. Refer to 84 Fed. Reg. 56369. (Footnote added in version 1.2)

³⁵ Refer to 12 CFR 34.83(c). (Footnote added in version 1.1 and updated in version 1.2)

³⁶ A CSA is treated as a national bank for the provisions in this paragraph. (Footnote added in version 1.2)

³⁷ Refer to 12 CFR 5.59(f)(5), "Real Estate Related Services." (Footnote added in version 1.2)

³⁸ Refer to 12 USC 1464(t)(5), "Capital Standards," and 12 CFR 3.22(a)(8). (Footnote added in version 1.2)

³⁹ Refer to 12 CFR 34.83(a)(4). (Footnote added in version 1.2)

While the OCC does not prescribe specific methods to be used, such as listing a property with a broker, examiners will evaluate the effectiveness of a bank's marketing program in assessing the diligence of the bank's efforts to dispose of OREO.

Concentrations

(Section updated in version 1.2)

Concentration risk in OREO should be considered together with similar commercial or residential real estate-related concentrations that may be present in the loan portfolio. The OCC's "Concentrations of Credit" booklet of the *Comptroller's Handbook* defines a concentration as exceeding 25 percent of tier 1 capital plus either the ALLL or ACL as appropriate, as the denominator. OCC Bulletin 2006-46, "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices: Interagency Guidance on CRE Concentration Risk Management," provides guidance on the management of concentrations in commercial real estate.

A bank's holding of OREO may represent concentrations of specific types of real estate or in specific geographic locations. The bank's systems should permit analysis of the OREO portfolio for concentrations. Sound concentration risk management for OREO typically includes identifying and separately analyzing the types of OREO properties, the aging of holdings (e.g., how many were acquired in the last year, the last three years, or the last five years), and management's efforts to sell the properties. It is important to identify geographic concentrations of OREO, if applicable, even though the types of real estate may be different, because economic conditions in a particular geographic location may pose similar risks to different types of real estate. (Updated in version 1.1)

Environmental Risk Management

(Section updated in version 1.2)

An effective environmental risk management policy that assesses a property's environmental risk before extending a loan is an important element of sound risk management. Sound risk management typically also includes environmental risk management policies and procedures for OREO for several reasons. Property use may have changed, an adequate assessment may not have been performed at origination, contamination may not have been evident, a property may have become contaminated subsequent to loan closing, or a bank may be exposed to expanded liability as an owner of a contaminated property.

Sound environmental risk management for OREO generally includes the following:

- Assessing the potential adverse effect of environmental contamination.
 - Appropriate controls to limit the bank's exposure to environmental liability from OREO.
- (Updated in version 1.1)

Environmental contamination may negatively affect the value of real property collateral as well as create potential liability for the bank under various federal or state environmental laws. Appraisals or evaluations must recognize and evaluate known property contamination and include this assessment in estimates of market value.

The “Commercial Real Estate Lending” booklet of the *Comptroller’s Handbook* provides more information on the risks presented by contaminated properties and associated risk management.

Regulatory Risk Rating

(Section updated in version 1.2)

OREO should be risk-rated in accordance with the interagency asset classification definitions.⁴⁰ FSAs must classify assets in a manner consistent with, or reconcilable to, the asset classification system used by the OCC.⁴¹

It is not OCC policy to automatically adversely risk-rate OREO. OREO is generally treated as a substandard asset because of the collateral-dependent nature of the asset, the disposition risks, and the potential fluctuations in market value. A bank’s purchase of property through foreclosure usually indicates a lack of demand for the property, and a bank often recognizes a loss when disposing of OREO despite the apparent adequacy of appraised values. OREO is often a nonearning asset, and the bank typically incurs costs of ownership, such as property taxes, insurance, utilities, repairs, and maintenance. The bank may also incur substantial liability generated by environmental issues. (Updated in version 1.1)

Examiners should evaluate OREO to determine if the bank has assigned the appropriate regulatory risk ratings. An examiner should review all relevant factors to determine the amount of risk presented by each parcel of OREO and assess the probability that the bank will realize the OREO’s carrying value.

Factors an examiner should consider as part of the evaluation include

- the property’s carrying value relative to its fair value, the bank’s asking price, and offers received. For example, a carrying value in excess of fair value would indicate a loss, an asking price significantly above the carrying value may discourage offers or indicate a bank’s unwillingness to sell at the carrying value, and offers that are significantly below the asking price may indicate that the carrying value or asking price is too high. Any of these could reduce the probability of realizing the carrying value.
- the quality and timeliness of the property’s appraisal or evaluation.

⁴⁰ Refer to the “Rating Credit Risk” booklet of the *Comptroller’s Handbook* for the regulatory definitions for classified and special mention assets. (Footnote added in version 1.2)

⁴¹ Refer to 12 CFR 160.160, “Asset Classification.” (Footnote added in version 1.2)

- the length of time the property has been on the market and local market conditions for the type of property involved, such as the history and recent sales trends for comparable properties.
- management's ability and track record in disposing of foreclosed assets.
- the income generated by the property and other economic factors affecting the probability of loss exposure; generally, assets need to generate a reasonable net return commensurate with similar-risk assets to warrant a pass classification.
- other pertinent factors, including title, statutory redemption privileges, zoning, and other liens.

Rental properties should be evaluated on a case-by-case basis, considering income generated and all expenses of ownership when making the classification determination. The appraisal or evaluation of the property may provide useful information for evaluating the adequacy of the property expenses and rate of return expectations used in support of the risk rating. Generally, OREO should generate a reasonable net return commensurate with similar-risk assets to warrant a pass risk rating.

RESCINDED

Examination Procedures

This booklet contains expanded procedures for examining specialized activities or specific products or services that warrant attention beyond the core assessment contained in the “Community Bank Supervision,” “Federal Branches and Agencies Supervision,” and “Large Bank Supervision” booklets of the *Comptroller’s Handbook*. Examiners determine which expanded procedures to use, if any, during examination planning or after drawing preliminary conclusions during the core assessment.

Scope

These procedures are designed to help examiners tailor the examination to each bank and determine the scope of the OREO examination. This determination should consider work performed by internal and external auditors, independent risk management, and other examiners on related areas. Examiners need to perform only those objectives and steps that are relevant to the scope of the examination as determined by the following objectives. Seldom is every objective or step of the expanded procedures necessary. (Updated in version 1.2)

The examiner conducting the OREO examination should work closely with the examiner-in-charge, or designated loan portfolio manager, credit functional examiner-in-charge, or credit team lead, to confirm areas of concern and to maximize examination efficiencies. OREO issues that pose a challenge to management or present unusual or significant risk to the bank should be included in comments on risk management and asset quality. (Updated in version 1.2)

Objective: To determine the scope of the OREO examination and identify examination objectives and activities necessary to meet the needs of the supervisory strategy for the bank.

(Procedure 2 updated in version 1.1; procedures 1, 2, 3, 5, and 6 updated in version 1.2)

1. Review the following sources of information to identify previously identified deficiencies related to OREO that require follow-up:
 - Supervisory strategy.
 - Scope memorandum.
 - Previous supervisory activity work papers.
 - Previous supervisory letters and reports of examination, and management’s responses.
 - Previous OCC work papers.
 - Internal and external audit reports and work papers, and management’s responses.
 - Customer complaints and litigation. Examiners should review customer complaint data from the OCC’s Customer Assistance Group, the bank, and the Bureau of Consumer Financial Protection (when applicable). When possible, examiners should

review and leverage complaint analysis already performed during the supervisory cycle to avoid duplication of effort.

2. Review the Uniform Bank Performance Report and applicable OCC reports or analytical tools. Review OREO levels and growth rates, trends in the classification of real estate loans, and other factors that can assist in assessing the risk presented by OREO.
3. Review policies, procedures, and reports that bank management uses to supervise OREO, focusing on any significant changes or trends since the last examination, including internal risk assessments and relevant board or committee minutes.
4. In discussions with bank management, determine whether there have been any significant changes (in policies, processes, personnel, control systems, products, volumes, markets, geographies, etc.) since the prior OREO examination.
5. Based on an analysis of information obtained in the previous steps, as well as input from the examiner-in-charge, loan portfolio manager, functional examiner-in-charge, or team lead, if applicable, determine the scope and objectives of the OREO examination.
6. Select from the following examination procedures the steps necessary to meet examination objectives and the supervisory strategy.

RESCINDED

Quantity of Risk

Conclusion: The quantity of each associated risk is (low, moderate, or high).

Objective: To determine the quantity of price risk associated with OREO activities.

(Procedures 2 and 5 updated in version 1.1. Procedures 2, 3, and 5 updated in version 1.2.)

1. Consider the following in forming your conclusion:
 - The amount of OREO and trends in the bank’s volume of acquisition and disposition.
 - The amount and trend of OREO as a percentage of capital.
 - Real estate market conditions and trends.
 - The effectiveness of the bank’s disposition efforts.
2. Determine whether bank management has accurately identified all OREO assets by discussing the following with the examiner-in-charge or loan portfolio manager, functional examiner-in-charge, or team lead and the examiners assigned to review the ALLL (or ACL) and bank premises and equipment:
 - Does the bank hold any real estate acquired in full or partial satisfaction of debt?
 - Are there vacated bank premises or property originally purchased for future expansion that is no longer intended for such usage?
 - Does the bank report as OREO properties of which it has physical possession, even if it does not have title?
 - Does the bank report as OREO properties for which it has received title, regardless of whether the properties are in statutory redemption periods?
 - Does the bank report as OREO equity interests that it may have in special purpose entities (SPE) that hold OREO?
 - Are there OREO sales that did not qualify for sales treatment according to GAAP?
3. Select a sample of OREO for review. Refer to the “Sampling Methodologies” booklet of the *Comptroller’s Handbook*. From bank credit files, liability records, and internal reports, transcribe the following information to line sheets for each property:
 - A description of the property.
 - The date that title—or possession, if this occurred before title—was obtained and when the asset was recorded as OREO.
 - The method of acquisition.
 - The current book value and balance at establishment of OREO.
 - The amount and date of the most recent appraisal or evaluation.
 - The bank’s asking price and the dates and amounts of any offers.

- The amount of insurance (including liability coverage), whether it is adequate, and whether the bank is named as the insured (or as loss payee if title has not yet been acquired).
 - Dates and findings of inspection reports.
 - Dates and findings of environmental reports.
 - Whether the property is subject to a statutory redemption period.
 - Whether the property is occupied.
 - Whether the property is subject to a lease.
 - Income and expense records, if applicable.
 - A list of expenditures made to improve the property.
 - When the sum of the bank’s recorded investment amount plus the expenditures (including any unpaid prior liens) exceeds 10 percent of the bank’s total equity capital, indicate whether the bank obtained prior OCC approval. Note whether each expenditure is
 - reasonably calculated to reduce the shortfall between the property’s market value and book value.
 - not made for speculative purposes.
 - consistent with safe and sound practices.
4. Determine whether bank management reviews properties for possible environmental contamination and deterioration in physical condition that might affect the value of the property. Investigate actions bank management has taken, or is in the process of taking, to address these conditions when bank management has discovered them. (Updated in versions 1.1 and 1.2)
5. Through discussions with bank management, assign appropriate risk ratings. When necessary, forward a list of OREO classifications, including write-ups, as appropriate, to the examiner-in-charge, loan portfolio manager, functional examiner-in-charge, or team lead. (Updated in version 1.2)

Objective: To determine the quantity of liquidity risk associated with OREO activities.

1. Determine this risk by considering the following:
 - A comparison of the amount and volume trends of OREO with the bank’s liquidity levels and anticipated liquidity needs.
 - The composition of the OREO portfolio and the volume of OREO disposition.
 - A comparison of the volume of cash sales and financed sales.
 - Market conditions and trends.

Objective: To determine the quantity of operational risk associated with OREO activities.

1. Determine the effect of the following on operational risk as it relates to the acquisition, holding, and disposition of OREO:

- The amount, volume, type, and trend of OREO; consider both acquisition and disposition.
- The amount and trend of operational losses resulting from inadequate or failed internal processes or systems, the misconduct or errors of people, and adverse external events.
- The volume and severity of operational, administrative, personnel, and accounting control errors.
- The effectiveness of the bank's appraisal and evaluation program.
- The quality and independence of the audit and asset review functions.
- The adequacy of staffing, both in number and level of expertise.
- The adequacy of OREO information systems and reports.
- The volume and types of activities that are performed by third parties.
- The adequacy of systems to properly select, oversee, and manage third-party relationships.
- The bank's strategies with respect to acquiring, holding, and marketing OREO.
- External factors, including market conditions and any legislative, regulatory, or accounting changes.

Objective: To determine the quantity of compliance risk associated with OREO activities.

(Procedures 3 and 6 updated in version 1.1. Procedures 3, 5, and 7 updated in version 1.2.)

1. Review each parcel in the sample to determine whether the bank accounts for and reports OREO in accordance with GAAP and call report instructions.
2. Review each parcel in the sample to determine compliance with applicable laws and regulations as discussed in the "Introduction" section and cited in the "References" section of this booklet.
3. Review each parcel of OREO that has been held more than five years. Determine whether the OCC granted an extension to the holding period in accordance with 12 CFR 34.82.
4. Review each parcel of OREO in the sample to determine if appropriate measures have been taken to identify and manage risks presented by environmental contamination.
5. Assess bank management's knowledge of and compliance with state or local laws that govern the bank's ownership of property and obligations regarding contaminated properties.
6. Assess the bank's policies, processes, and internal controls related to compliance with the Fair Housing Act, Equal Credit Opportunity Act (if the bank makes or facilitates credit), Protecting Tenants at Foreclosure Act, and the Servicemembers Civil Relief Act. Bank policies and procedures that govern marketing and sales strategies (including selling to investors), property maintenance, and other aspects of OREO management should provide for equal treatment of geographies where the properties are located, without regard to racial or ethnic composition, and must comply with the Fair Housing Act.

7. Identify any OREO insider transactions. Consult with the examiners performing the review of insider activities or related organizations, if applicable. Refer to the “Insider Activities” booklet of the *Comptroller’s Handbook* for more information regarding transactions with insiders, including statutory and regulatory restrictions.

Objective: To determine the level of reputation risk associated with OREO activities.

1. Reach a conclusion by considering the following:

- The number, value, and types of OREO.
- The volume of foreclosures and the bank’s foreclosure practices.
- The volume and nature of litigation related to OREO activities.
- The volume and nature of OREO with environmental issues. (Added in version 1.2)
- The impact of the bank’s property management practices on neighborhoods and communities where the bank holds OREO.
- The effect of disposition practices that favor investors (paying cash) over owner-occupants (purchasing with financing).
- Participation in and coordination with (or lack thereof) state and local land bank programs, neighborhood stabilization programs, redevelopment programs, and other anti-bligh programs or opportunities to enhance owner occupancy.

Quality of Risk Management

Conclusion: The quality of risk management is (strong, satisfactory, insufficient, or weak). (Updated version 1.1)

The conclusion on risk management considers all risks associated with OREO activities.

Policies

Policies are statements of actions adopted by a bank to pursue certain objectives. Policies guide decisions, often set standards (on risk limits, for example), and should be consistent with the bank's underlying mission, risk appetite, and core values. Policies should be reviewed periodically for effectiveness and approved by the board of directors or designated board committee. (Updated in version 1.2)

Objective: To determine whether the board has approved and bank management has implemented effective policies that are consistent with safe and sound banking practices and appropriate to the size, nature, and scope of the bank's OREO portfolio. (Updated in version 1.1)

(Procedure 1 updated in version 1.1. Procedures 1 and 2 updated in version 1.2.)

1. Evaluate OREO policies to determine whether they provide appropriate guidance for managing the bank's OREO and are consistent with the bank's mission, values, and principles.
 - Determine whether the bank's policies provide guidance consistent with
 - a bank's statutory authority to hold OREO.
 - regulations governing permitted holding periods.
 - regulations governing property management and disposition.
 - current accounting standards.
 - appraisal and evaluation requirements.
 - sound practices for appraisals and evaluations.
 - sound practices pertaining to the rental of residential OREO.
 - the Protecting Tenants at Foreclosure Act.
 - the Servicemembers Civil Relief Act.
 - risks posed by environmental contamination.
 - Determine if the bank's policies address risks associated with foreclosed properties as described in the "Managing Foreclosed Properties" section of this booklet and appendix B, "Guidance on Potential Issues With Foreclosed Residential Properties as Servicer or Trustee."
2. Determine whether the board of directors periodically reviews and approves the bank's OREO policies.

Processes

Processes are the procedures, programs, and practices that impose order on a bank's pursuit of its objectives. Processes define how daily activities are carried out. Processes define how activities are carried out and help manage risk. Effective processes are consistent with the underlying policies and are governed by appropriate checks and balances (such as internal controls). (Updated in version 1.2)

Objective: To determine whether the bank has adequate processes in place to execute its OREO policies. (Updated in version 1.2)

1. Evaluate whether processes are effective, consistent with established policies, and effectively communicated to appropriate staff. (Updated in version 1.2)

Do processes address

- compliance with requirements of local authorities and prudent standards regarding property maintenance and security?
 - recording ownership interest in local land records?
 - OREO appraisal and accounting requirements?
 - payment of property insurance premiums and real estate taxes?
 - third-party relationships that include
 - written contracts outlining duties and obligations?
 - appropriate due diligence of third parties?
 - ongoing oversight?
 - development and oversight of plans for the disposition of properties?
 - consideration of the Protecting Tenants at Foreclosure Act and the Servicemembers Civil Relief Act?
 - the establishment and governance of and accounting for SPEs that hold OREO, if applicable?
2. Determine whether the bank's processes include periodic reviews of OREO. Such reviews should address the following:
 - A valid appraisal or evaluation that supports the property's carrying value. This review should be completed at least annually.
 - Marketing plans and documented sales efforts, including all external inquiries and offers.
 - The prudent and proper authorization of additional expenditures on the property.
 - Changes in tax status, zoning restrictions, other liens, etc.
 - Compliance with accounting requirements.
 - Reporting of acquisitions and disposal of OREO assets to the board or its designated committee.

3. Before foreclosure, do procedures require to the extent possible

- the evaluation of property for the presence of contaminants, including
 - lead-based paint in residential housing constructed before 1978?
 - underground or aboveground storage tanks?
 - asbestos?
 - groundwater contamination?
 - other known contaminants used in or produced by activities consistent with the historic use of the property?
 - other known contaminants common to the area?
- an evaluation of the risks of foreclosing on contaminated property?
- formulation and implementation of appropriate plans to manage contaminants and mitigate the liability the contamination may impose?

4. Assess the adequacy of the bank's processes for the acquisition, holding, or disposition of the following types of OREO:

Former Banking Premises

- Was the property transferred to OREO when it ceased to be used as banking premises?
- If operations were relocated, was the property transferred to OREO upon relocation from the former banking premises to the new banking premises?

Real Estate Held for Future Expansion

- Within one year of acquisition, did the board or a delegated committee approve a resolution for use of the property?
- Will the bank use the property within five years?

Real Estate Held Under a Lease (Updated in version 1.2)

To determine if the bank has disposed of its interest, consider whether

- the bank has assigned the lease to another party.
- if the bank has not assigned the lease, it has sublet the premises to another party and whether the remaining term of the sublease matches the remaining term of the original lease entered into by the bank (i.e., is it coterminous).

5. Review the bank's disposition processes. Consider whether

- the bank's efforts to dispose of OREO are diligent and ongoing.
- the bank maintains adequate documentation of its marketing and sales efforts.
- the bank maintains acceptable documentation to support asking prices.
- the bank maintains acceptable documentation to justify the acceptance of lower bids.

- bank management has requested or received OCC permission to hold OREO for more than five years. (Updated in versions 1.1 and 1.2)
6. For OREO sales that did not qualify for sales treatment according to GAAP, determine whether the bank continues to report the properties as OREO.

Personnel

Personnel are the bank staff and managers who execute or oversee processes. Personnel should be qualified and competent, have clearly defined responsibilities, and be held accountable for their actions. They should understand the bank's mission, risk appetite, core values, policies, and processes. Banks should design compensation programs to attract and retain personnel, align with strategy, and appropriately balance risk-taking and reward. (Updated in version 1.2)

Objective: To determine bank management's ability to supervise OREO in a safe and sound manner. (Updated in version 1.1)

1. Given the scope and complexity of the bank's OREO, assess the bank management structure and staffing. Consider
 - the adequacy of staffing and volume of staff turnover.
 - the use of outsourcing arrangements for functions such as property management and marketing.
 - whether reporting lines encourage open communication and limit the chances of conflicts of interest.
 - the capability to address identified deficiencies.
 - responsiveness to regulatory, accounting, industry, and technological changes.
2. Given the scope and complexity of the bank's OREO activities, assess the experience, education and training, and demonstrated expertise and competency of management and staff. Consider
 - the suitability of an incumbent's experience and training for his or her position, particularly with respect to OREO property and accounting issues.
 - the availability, adequacy, and requirements for training to keep bank management and staff current with regulatory and other changes affecting the bank and its acquisition, management, and disposition of OREO. (Updated in version 1.1)
 - the experience and training or education of individuals responsible for the bank's appraisal and evaluation program.
3. Evaluate the effectiveness of the bank's management of third-party relationships and whether they are subject to the same risk management process that would be expected if the bank were conducting the activities directly. Does the risk management process include

- written contracts outlining the duties, obligations, and responsibilities of the parties involved?
 - appropriate due diligence before entering into a third-party contract? (Updated in version 1.2)
 - ongoing oversight of the third parties and third-party activities?
4. Assess performance management and compensation programs. Consider whether these programs measure and reward performance that aligns with the bank's strategic objectives and risk tolerance. If the bank offers incentive compensation programs, determine whether they (1) provide employees with incentives that appropriately balance risk and reward; (2) are compatible with effective controls and risk management; and (3) are supported by strong corporate governance, including active and effective oversight by the bank's board of directors. Refer to OCC Bulletin 2010-24, "Interagency Guidance on Sound Incentive Compensation Policies." (Updated in version 1.1)

Control Systems

Control systems are the functions (such as internal and external audits, quality assurance, and credit risk review) and information systems that bank managers use to measure performance, make decisions about risk, and assess the effectiveness of processes and personnel. Control functions should have clear reporting lines, sufficient resources, and appropriate access and authority. Management information systems should provide timely, accurate, and relevant feedback. (Updated in version 1.2)

Objective: To determine whether the bank has systems in place to provide accurate and timely assessments of the risks associated with its OREO activities.

1. Evaluate the effectiveness of monitoring systems intended to identify, measure, and track exceptions to policies and established limits. Do the systems permit the effective monitoring of exceptions to
 - regulatory and internally established limits on holding periods?
 - policies pertaining to OREO expenditures?
 - policies governing the appraisal or evaluation of OREO?
 - policies establishing standards for the management of OREO?
 - policies governing the disposition of OREO?
2. Determine whether management information systems provide timely, accurate, and useful information to evaluate risk levels and trends in the bank's OREO portfolio. Can the bank's systems report
 - the amount, volume, and type of OREO?
 - aging of OREO?

- sales data, including prices, volume, marketing times, and disposition proceeds relative to book value?
 - OREO expenditures?
3. Determine whether the reports used to convey and monitor information are effectively used by management and staff. Consider
- the data presented by the reports.
 - the accuracy of the data.
 - the timeliness and frequency of the reports.
 - who receives the reports.
 - who is responsible for monitoring the data presented by the reports.
 - how the data are used by the board, management, or staff.
4. In consultation with the examiner assigned responsibility for assessing the bank's overall audit program, assess the scope, frequency, effectiveness, and independence of the internal and external audits or other independent reviews of OREO. The audits or reviews should test for compliance with OREO statutes, regulations, and the bank's policies and procedures. Audits or reviews should also assess the bank's risk management of OREO. (Updated in version 1.1)

Consider

- the frequency and scope of audits and reviews.
 - the qualifications of audit and review personnel.
 - the comprehensiveness and accuracy of findings and recommendations.
 - if violations or exceptions were noted, determine whether management took appropriate and timely corrective action(s).
5. Determine whether the bank's appraisal and evaluation review process provides adequate controls for an OREO appraisal and evaluation program that complies with statutes, regulations, and the bank's policies and procedures, and is consistent with sound risk management principles. (Updated in version 1.1)

Conclusions

Conclusion: The aggregate level of each associated risk is (low, moderate, or high).
The direction of each associated risk is (increasing, stable, or decreasing).

Objective: To determine, document, and communicate overall findings and conclusions regarding the examination of OREO activities.

(Procedures 1 and 3–6 updated in version 1.2)

1. Discuss preliminary examination findings and conclusions with the examiner-in-charge, including the
 - quantity of associated risks.
 - quality of risk management.
 - direction of risks associated with OREO.
 - overall risk in OREO activities.
 - violations of laws and regulations and other deficiencies.

In reaching conclusions about OREO risk management, consider

- the adequacy of policies, processes, personnel, and control systems.
 - how actual practices conform to established policies and processes.
 - adverse trends.
 - significant internal control weaknesses.
 - corrective actions needed to correct deficiencies.
 - the quality of departmental management.
 - the adequacy of management information systems and reporting.
 - the adequacy of internal and external audits.
 - other matters of significance.
2. If substantive safety and soundness concerns remain unresolved that may have a material adverse effect on the bank, further expand the scope of the examination by completing verification procedures.
 3. In consultation with the examiner-in-charge, discuss examination findings with bank management, including violations, deficient practices, and conclusions about risks and risk management practices. If necessary, obtain commitments for corrective action.
 4. Compose conclusion comments, highlighting any issues that should be included in the report of examination or supervisory letter. Address the following, as applicable:

- Adequacy of policies and procedures for the acquisition, holding, and disposition of OREO.
- Amount, volume, type, and trend of OREO.
- Volume, type, and trend of OREO dispositions.
- Volume of OREO expenditures, if significant.
- Property sample results, including valuation, accounting, management, marketing efforts, and compliance with OREO policy, including expenditures and their justification.
- Quality of board oversight and supervision.
- Quality of staffing.
- Accuracy and timeliness of management and board reports.
- Effectiveness of OREO administration and internal controls.
- Effectiveness of the bank’s appraisal and evaluation program and the reliability of valuations.
- Extent to which OREO activities and risk management practices affect risks, including liquidity, price, operational, compliance, and reputation risks.
- Concentrations and associated risk management.
- Violations of laws and regulations.
- Matters requiring attention.

5. Complete the following table summarizing the risks associated with the bank’s OREO activities.

Summary of Risks Associated With OREO Activities (Updated in version 1.1)				
	Quantity of risk	Quality of risk management	Aggregate level of risk	Direction of risk
Risk category	(Low, moderate, high)	(Weak, insufficient, satisfactory, strong)	(Low, moderate, high)	(Increasing, stable, decreasing)
Liquidity				
Price				
Operational				
Compliance				
Reputation				

6. Update the OCC’s supervisory information systems and any applicable report of examination schedules or tables.
7. Document recommendations for the supervisory strategy (e.g., what the OCC should do in the future to effectively supervise trade finance and services in the bank, including time periods, staffing, and workdays required). (Updated in version 1.1)

8. Update, organize, and reference work papers in accordance with OCC policy.
9. Properly dispose of or secure any paper or electronic media that contain sensitive bank or customer information. (Updated in version 1.1).

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Internal Control Questionnaire

An internal control questionnaire (ICQ) helps an examiner assess a bank's internal controls for an area. ICQs typically address standard controls that provide day-to-day protection of bank assets and financial records. The examiner decides the extent to which it is necessary to complete or update ICQs during examination planning or after reviewing the findings and conclusions of the core assessment.

1. Are the preparation, addition, and posting of subsidiary OREO records tested by persons who do not have direct physical or accounting control of those assets?
2. Are the subsidiary OREO records reconciled at least monthly to the appropriate general ledger accounts by persons who do not have direct physical or accounting control of those assets?
3. Are supporting documents maintained for all entries to OREO accounts?
4. Is revenue received from OREO accounted for as other noninterest income in the period it is received?
5. Are expenses for the maintenance of OREO, including taxes, accounted for as other noninterest expense in the period they are incurred? (Updated in version 1.2)
6. Are acquisitions and disposals of OREO reported to the board of directors or its designated committee?
7. Does the bank maintain insurance coverage on OREO, including liability coverage when necessary?
8. Does the bank pay real estate taxes either as they are due or before they become a lien on the property?
9. Does the bank have an inspection program that permits it to maintain an assessment of the current condition of OREO?
10. Does the bank give proper notification to the borrower before foreclosure or repossession?
11. Does the bank record collateral property as OREO upon foreclosure regardless of any ensuing statutory redemption periods?
12. Does the bank hold valid title, or valid claim to title if the bank has taken possession, to OREO?
13. Does the bank review all OREO it acquires by deed in lieu of foreclosure for prior liens?

14. Does the bank have valid appraisals or evaluations upon transfer to OREO?
15. Does the bank have valid appraisals or evaluations to support the sale of OREO?
16. Does the bank or its bonded agent directly control rental income received from OREO?
17. Do any unbonded agents collect rents or manage properties?
18. Does the bank document third-party activities performed on behalf of the bank?
19. Are all parcels of OREO reviewed periodically, consistent with the frequency established by the bank's policy, for
 - a valid appraisal or evaluation?
 - documented inquiries and offers?
 - documented sales efforts?
 - evidence of the prudence of and proper authorization of additional advances?
 - marketing plans for disposal of the property?
 - changes in tax status, zoning restrictions, other liens, etc.?
20. Are the bank's OREO policies and procedures in writing?

Conclusion

21. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls, or other circumstances that impair any controls or mitigate any weaknesses indicated above? (Explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures.)
22. Based on the answers to the foregoing questions, internal control for OREO activities is considered (strong, satisfactory, insufficient, weak). (Updated in version 1.2)

Verification Procedures

Verification procedures are used to verify the existence of assets and liabilities or to test the reliability of financial records. Examiners generally do not perform verification procedures as part of an examination. Rather, verification procedures are performed when substantive safety and soundness concerns are identified that are not mitigated by the bank's risk management systems and internal controls.

1. Using appropriate sampling techniques, select specific properties and determine whether
 - the asset was recorded as OREO when the bank obtained title or possession, whichever occurred first.
 - legal fees and direct costs of acquiring title, including payment of existing liens, taxes, and recording fees, are expensed when incurred and not capitalized.
 - insurance, including liability coverage, is adequate, and the bank is named as insured (or as loss payee if the bank does not have title).
2. Using appropriate sampling techniques, select specific properties, and for expenses incurred in maintaining the properties or capitalized costs of improvement and development
 - trace transactions to any succeeding summary records and to postings in the general ledger.
 - determine whether the bank performed an inspection before disbursing funds for capital improvements or development and construction costs.
3. Trace proceeds received from the rental of OREO; determine whether the bank receives the proceeds directly and whether the amount received agrees with the stated terms of the rental contract.
4. Review sales proceeds that the bank receives from partial sales of OREO, such as lot sales or condominiums sales; determine whether the bank records the receipt of the proceeds and records any gains or losses on the sale of OREO in accordance with GAAP.

Appendixes

Appendix A: Exchanging OREO for Interests in Other Assets

Exchanging of Participation Interests in OREO (National Banks and CSAs)

(Heading updated in version 1.2)

In a limited number of circumstances, a national bank may acquire a noncontrolling equity interest in an SPE, such as a limited liability company (LLC), in exchange for the national bank's interest in OREO. The OCC has approved this type of exchange in which an LLC is established as a means for the participants in the original loan to hold the real estate collateral acquired through or in lieu of foreclosure. The participants in the original loan are the members of the LLC, and each participant holds an interest in the LLC equivalent to its participation interest in the loan and OREO. The LLC is established specifically to manage and dispose of the OREO. The member banks retain control over the OREO asset and maintain the same level of risk as before the exchange. The exchange, however, enables the participants to manage and dispose of the OREO more efficiently than if each bank had to manage its own partial interest in the property. (Updated in version 1.2)

A national bank wishing to complete such an exchange of its loan interest for an equivalent SPE interest has two options. The bank may follow the well-established licensing procedures in 12 CFR 5.36 for making a noncontrolling investment by submitting a notice (an option limited to well-capitalized, well-managed banks) or an application, as appropriate. Alternatively, the bank may seek approval from its supervisory office under the standards established in OCC Interpretive Letter No. 1123, "Re: Exchange of interest in real property acquired DPC for interest in an entity which would dispose of the real property." Supervisory office approval under the standards established in Interpretive Letter No. 1123 is available only for those instances, as described previously, in which the participants in a loan form an SPE to hold, manage, and dispose of the OREO collateral acquired for debts previously contracted. Interpretive Letter No. 1123 does not provide legal support for national banks to exchange OREO for equity interest in an entity aggregating various unrelated OREO parcels from multiple banks.

OCC Interpretive Letter No. 1123

The interpretive letter⁴² describes a procedure under which a national bank could seek non-objection from its supervisory office to exchange a participation interest in OREO for an interest in an LLC that would manage, market, and sell the OREO. Provided the bank makes certain representations concerning the exchange, the supervisory office can give the bank a written notification of non-objection to the exchange. The bank must receive the supervisory office's non-objection before making the exchange.

⁴² OCC Interpretive Letter No. 1123, "Re: Exchange of interest in real property acquired DPC for interest in an entity which would dispose of the real property" (September 18, 2009).

Before the supervisory office may provide a non-objection notification, the bank is required to make certain representations that include the following:

1. The bank's board of directors has determined that the exchange is in the best interests of the bank and would improve the ability of the bank to recover, or otherwise limit, its loan loss, and the basis for such determination has been documented.
2. The bank has adequate risk management and measurement systems and controls in place to enable it to exchange for, hold, and dispose of the LLC interest in a safe and sound manner.
3. The bank will not exchange the LLC interest for an interest in any other real or personal property.
4. The bank will ensure that the LLC complies with the provisions of the OCC's OREO regulation, 12 CFR 34, subpart E, including the appraisal requirements for OREO.
5. The bank will dispose of its interest in the LLC no later than five years from the date it initially acquired title to the OREO (unless granted an extension by the OCC as allowed by 12 USC 29).

Supervisory Office Review and Non-Objection Notification

When a bank submits a request to its supervisory office to make an exchange of an interest in OREO for an interest in an SPE that would hold the OREO, the supervisory office will take the following steps.

- *Review the request, including the representations made by the bank and the basis for the representations.*

The supervisory office should review the incoming request. The review should include an evaluation of the representations made by the bank and an analysis of the reasonableness of the support for the transaction. If the supervisory office is not comfortable with the support given, it should request additional information from the bank to more fully assess the bank's representations.

For example, if the bank states that it has adequate risk management and measurement systems and controls to engage in the exchange in a safe and sound manner, the supervisory office should ask the bank to provide an explanation of the systems and controls. If the bank states that it will ensure that the SPE complies with the provisions of the OCC's OREO regulation, the supervisory office should ask the bank to describe the authority it has over the SPE and determine compliance with the OREO regulation. The supervisory office should request, in each instance, that the bank provide a copy of the SPE agreement or the relevant excerpts from the SPE agreement, to assess the basis for the bank's representations. The supervisory office should contact OCC legal counsel with any questions related to the SPE agreement or sufficiency of the representations. (Updated in versions 1.1 and 1.2)

- *Determine whether the bank’s representations are sufficient or whether additional representations are necessary.*

To address safety and soundness concerns, the supervisory office may request that the bank make additional representations. The five representations listed above are the minimum required for supervisory non-objection. The supervisory office may require the bank to make any additional representations that the supervisory office believes would be appropriate given the nature and character of the proposed exchange.

For example, the supervisory office may wish to supervise and examine the activities of the SPE. In such an instance, the supervisory office should require the bank to represent that the SPE would be subject to OCC supervision and examination and acknowledge that the SPE itself has agreed to be supervised and examined by the OCC. Such agreement is usually reflected in the SPE agreement. (Updated in version 1.1)

- *Decide whether to issue a supervisory non-objection notification.*

If the supervisory office is satisfied that the bank has made the necessary representations and that there is sufficient support for the representations, the supervisory office may issue a written non-objection to the bank’s proposed exchange. Such non-objection should refer to (or could even recite) the representations made by the bank. For example, the notification letter may state that, based on the representations made by the bank, the supervisory office poses no objection to the bank’s proposal to exchange its participation interest in OREO for interest in an entity that would market and dispose of the OREO. (Updated in version 1.2)

If the supervisory office is not comfortable issuing a supervisory non-objection to a request pursuant to Interpretive Letter No. 1123, the supervisory office should contact the OCC’s Licensing division regarding the bank’s ability to follow the well-established licensing procedures in 12 CFR 5.36 for making a noncontrolling investment. The notice process in 12 CFR 5.36(g)(1) is available to well-capitalized and well-managed banks and requires that the banks make certain representations and certifications, including that the activities of the SPE are conducted consistent with OCC policy and guidance. The 12 CFR 5.36 application process requires banks to make additional representations and certifications, including that the SPE agrees to be subject to OCC supervision and examination. (Updated in version 1.2)

Examiners should work with the district office of the Chief Counsel’s office to assist on issues with respect to the SPE agreements and representations.

Exchanging OREO Interests for Other Assets (National Banks and FSAs)

(Heading updated in version 1.2)

Certain third-party companies market OREO exchange programs to banks as a purported means to reduce problem assets by exchanging OREO for an interest in another asset that is represented to be performing. This “performing asset” is often an equity interest in the entity acquiring the OREO or a trade for a large volume of loans, such as home equity lines of

credit. These programs can raise significant safety and soundness, legal, and accounting concerns, and the OCC strongly encourages banks to consult with their supervisory office before entering into any such agreements.

Common issues associated with the exchange of OREO assets for an equity interest (generally in an LLC) include

- the loss of control over OREO assets.
- the exchange of OREO for an asset of questionable liquidity and value.
- the commingling of OREO with real estate assets that may be of poorer quality.
- significant up-front and recurring management fees paid to the organizing company.
- unfavorable priority of payments between the bank and equity investors.

In addition, the entity acquiring the OREO may be involved in activities that are not permissible for banks, making the asset acquired by the bank impermissible. Moreover, the structure of the exchange transaction typically does not meet the accounting definition of a sale. Thus, rather than improving its position, the bank ends up in an economically inferior situation, with additional legal and accounting issues. (Updated in version 1.1)

Another example of transactions offered to banks to reduce their nonperforming asset balances is an “adjusted price trade.” This type of transaction involves an offer to purchase the bank’s nonperforming real estate loans or OREO at book value, with the stipulation that the bank purchase other assets, at inflated values, from the same party. An adjusted price trade is not only unsafe and unsound but may constitute fraud if it results in the misrepresentation of the bank’s financial statements. The bank needs to use caution when looking at novel methods of trading nonperforming OREO for other assets. Before entering into any type of OREO exchange, the bank should have a detailed, documented plan. At a minimum, bank management or the board of directors should⁴³ (updated in version 1.1)

- document how the exchange is permissible and in the best interest of the bank, and how it would improve the bank’s ability to recover or limit its loan loss. This determination should address how the transaction aligns with board-established strategies to reduce nonperforming assets. The board of directors should review the determination before approving the transaction.
- determine whether the exchange qualifies as a sale under ASC Topic 860, “Transfers and Servicing.” Policies and procedures should be in place to support that the bank is following GAAP, and the accounting policies and procedures should also address how to value and account for expenses related to the OREO and the exchanged asset at the consummation of the transaction and on an ongoing basis.
- identify the factors preventing the bank from selling the OREO and provide documentation supporting why the exchange will make the real estate more marketable.
- establish an accurate value of the exchanged asset and determine whether a schedule or trigger points are in place for when to update the value.

⁴³ This guidance was originally issued as OCC Bulletin 2011-10, “Other Real Estate Owned: Exchanging Other Real Estate Owned for Other Assets.” OCC Bulletin 2011-10 was rescinded and incorporated into this appendix in 2013. (Footnote added in version 1.2)

- oversee the implementation of adequate risk management, measurement systems, and controls to enable the bank to exchange for, hold, and dispose of the acquired interest in a safe and sound manner.
- set parameters and methods for tracking assets received in the OREO exchange to avoid multiple exchanges for interests in any other real or personal property.
- confirm that any entity in which the bank acquires an interest considers guidance governing OREO, and properly handles additional expenditures and appraisals or evaluations.
- conduct due diligence to determine and document that all activities are permissible banking activities. The activities to be performed by any entity in which the bank acquires an interest in exchange for the OREO should be clearly documented, and the bank should obtain a commitment from the third party regarding activities performed.
- have processes in place for disposing of its interest in any such entity that are consistent with prescribed OREO holding periods.

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Appendix B: Guidance on Potential Issues With Foreclosed Residential Properties as Servicer or Trustee

This appendix highlights legal, safety and soundness, and community impact considerations of foreclosed properties as a servicer or trustee.⁴⁴ Although the primary focus is residential, many of the same principles apply to commercial properties.

A bank's obligations with respect to foreclosed residential properties may differ depending upon the bank's role in the foreclosure—as owner of the foreclosed property, servicer or property manager, or securitization trustee—and the contractual agreements under which it operates. Understanding the requirements Fannie Mae and Freddie Mac or HUD impose on servicers is particularly crucial given the current role of these entities in the mortgage market.

Considerations

As a matter of safe and sound banking practices, a bank should have robust policies and procedures in place to address risks associated with foreclosed (or soon to be foreclosed) properties as servicer. Acquiring title to properties through foreclosure—either for the bank or as servicer for another mortgagee—results in new or expanded risks, including operating risk (which may include market valuation issues), compliance risk, and reputation risk. The bank should be sure it has identified all the risks and has policies and procedures for monitoring and controlling these risks. In establishing and implementing the policies and procedures, bank management and the board of directors should consider, at a minimum, the following obligations and risks.

Obligations and Actions

Fannie Mae and Freddie Mac each have detailed guides setting forth servicer obligations and responsibilities for foreclosed properties and vacant properties in the process of foreclosure. In the case of private securitizations, the obligations are detailed in a document often called a pooling and servicing agreement (PSA).

- Servicers of foreclosed properties may be required to undertake many of the responsibilities of an owner, including providing maintenance and security, paying expenses, serving as the landlord for rentals, and marketing the property.
 - Servicers may be required to advance funds for taxes, insurance, and homeowners' association dues, as well as for maintenance and security expenses, some or all of which may be reimbursable.
 - Although rehabilitation, maintenance, and marketing of foreclosed properties acquired on behalf of Fannie Mae and Freddie Mac are typically handled by Fannie Mae and Freddie Mac, servicers may be required to perform routine upkeep—

⁴⁴ The guidance in this appendix was issued in OCC Bulletin 2011-49, "Foreclosed Properties: Guidance on Potential Issues With Foreclosed Residential Properties." OCC Bulletin 2011-49 was incorporated into this appendix when this booklet was revised in 2013. (Footnote added in version 1.2)

- including winterization, as needed—until the property is assigned by Fannie Mae and Freddie Mac to a property manager.
- Servicers should follow Fannie Mae and Freddie Mac’s applicable requirements or PSA requirements and guidelines for performing necessary maintenance and upkeep on the property. (Updated in version 1.1)
 - Appropriate insurance on the property should be maintained. (Updated in version 1.1)
 - Servicers may be required to file claims with any mortgage insurers.
 - Some localities may require registration of foreclosed properties, properties in foreclosure, or vacant properties. Under the PSA or the Fannie Mae and Freddie Mac servicing guidelines, this requirement may be the responsibility of the servicer. Servicers should communicate with localities about other specific requirements with respect to foreclosed residential properties.
 - When disposing of foreclosed properties, servicers should look to the PSA or other servicing documents for specific requirements and responsibilities. Servicers may have responsibilities under the Protecting Tenants at Foreclosure Act or applicable state law requirements that provide protections to tenants from eviction as a result of foreclosure on the property they are renting.

Additional Issues as Servicer

- A bank acting as a servicer should have sufficient staffing and appropriate third-party vendor oversight to manage the portfolios of foreclosed properties.
- Rehabilitation or improvement of foreclosed properties should comply with local building codes, licensing requirements, and any requirements specified in servicing agreements.
- When disposing of foreclosed residential properties, a bank acting as a servicer should consider
 - contractual requirements for valuing and marketing the properties and addressing defects found at inspection. The servicer may be required to advance funds for these activities, though these funds may be recovered.
 - that disposition practices may carry reputation and litigation risks. Even when the servicer follows the disposition requirements in the servicing agreements, the impact of the dispositions reflects on the servicer and could result in reputation risk and risk of litigation.
 - opportunities to participate in and coordinate with state and local land bank programs, neighborhood stabilization programs, redevelopment programs, and other anti-blight programs, consistent with servicing agreements.

Bank as Trustee of Securitization Trust Holding Title to Foreclosed Property

The securitization trustee is primarily responsible for (1) holding a lien on trust assets for the benefit of investors who purchase securities issued pursuant to the securitization and (2) administering the trust in conformance with requisite agreements. The trustee’s duties and responsibilities are established by a PSA, trust agreement, or indenture. These agreements

direct a securitization trustee to perform various complex ministerial functions. Such functions may include ensuring the timely receipt of payments from the servicer, calculating payments, remitting payments to investors, circulating information to investors, monitoring compliance, and determining if an event of default is triggered.

As permitted by the PSA, the trustee should work with the servicer to monitor the performance of the servicer's responsibilities. The securitization agreements may require a trustee to appoint a successor servicer or to take over servicing in the event the original servicer fails to perform its duties or defaults. These agreements generally do not grant the trustee any powers or duties with respect to the foreclosure or the maintenance, sale, or disposition of foreclosed properties. Instead, these responsibilities typically reside with the servicer. (Updated in version 1.1)

Nevertheless, a bank trustee should be aware of potential reputation and litigation risks when a servicer undertakes foreclosure actions in the trustee's name as the secured party. Additionally, if the securitization agreements require a bank trustee to act as a replacement servicer until a successor servicer is appointed, the bank trustee will also be exposed to credit risk.

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Appendix C: Accounting for Sales of OREO

(Section updated in versions 1.1 and 1.2. Section moved to this appendix in version 1.2.)

In May 2014, the FASB issued ASU 2014-09, which created ASC Topic 606 and ASC Topic 610.⁴⁵ ASC Topic 610 applies to a bank's sale of repossessed nonfinancial assets, such as OREO. Pursuant to ASU 2014-09, sales of OREO should be accounted for in accordance with ASC Subtopic 610-20.

Sales of OREO by non-public business entities⁴⁶ in fiscal years beginning after December 15, 2018, and sales of OREO by all public business entities should be accounted for in accordance with ASC Subtopic 610-20 (for sales not accompanied by a leaseback) and ASC Topic 606.

Under ASC Subtopic 610-20, a bank has an accounting sale with full gain or loss recognition and derecognition of the OREO asset at the time of sale if the transaction meets certain requirements within ASC Topic 606. Otherwise, at the transaction date, the bank should generally record any payments received as a liability to the buyer and continue reporting the OREO as an asset until the requirements in ASC Topic 606 are met. When the transaction does not qualify for a sale, but a loss would have been recognized if it did qualify as a sale, bank management should evaluate whether a loss on the OREO should be recognized through a valuation allowance to reflect fair value less costs to sell.

⁴⁵ ASC Topic 606 and ASC Topic 610 were effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, for banks that meet the definition of a public business entity under U.S. GAAP. For banks that are not public business entities, the guidance was effective for fiscal years beginning after December 15, 2018, and for interim periods within fiscal years beginning after December 15, 2019.

⁴⁶ A public business entity is defined under U.S. GAAP as a business entity meeting any one of the following criteria:

- It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
- It is required by the Securities Exchange Act of 1934, as amended, or rules or regulations promulgated under this act, to file or furnish financial statements with a regulatory agency other than the SEC.
- It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including notes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion. For more information on the definition of a public business entity, refer to ASU 2013-12, "Definition of a Public Business Entity," issued in December 2013. See call report glossary entries for business combinations, equity method of accounting, and variable interest entities for more information.

This appendix presents a summary of the provisions of ASC Subtopic 610-20, which requires the application of specified portions of ASC Topic 606 to a bank's sale of OREO. Please refer to the FFIEC call report instructions and the OCC's *Bank Accounting Advisory Series* for more information on accounting for the disposition of OREO. This appendix also includes a summary of ASC Subtopic 360-20 for reference.

Accounting for sales of OREO in accordance with ASC Subtopic 610-20 requires significant judgment. Under ASC Subtopic 610-20, if the buyer of the OREO is a legal entity, bank management should first assess whether the bank has a controlling financial interest in the legal entity buying the OREO by applying the guidance in ASC Topic 810, "Consolidation." If bank management determines that the bank has a controlling financial interest in the buying legal entity, it should not derecognize the OREO and should apply the guidance in ASC Subtopic 810-10.⁴⁷

When the bank does not have a controlling financial interest in the buying legal entity, or the OREO buyer is not a legal entity, which is expected to be the case for most sales of OREO, the bank should recognize the entire gain or loss, if any, and derecognize the OREO at the time of sale if the transaction meets certain requirements of ASC Topic 606. Otherwise, the bank generally should record any payments received as a liability to the buyer and continue reporting the OREO as an asset at the time of the transaction until it meets the requirements of ASC Topic 606.

When applying ASC Subtopic 610-20 and ASC Topic 606, bank management needs to exercise judgment in determining whether a contract (within the meaning of ASC Topic 606) exists for the sale or transfer of OREO, whether the bank has performed its obligations identified in the contract, and the transaction price for calculation of the amount of gain or loss. These standards apply to all sales or transfers of real estate by banks, but greater judgment is generally required for seller-financed sales of OREO.

Under ASC Subtopic 610-20, when the bank does not have a controlling financial interest in the buying legal entity or the OREO buyer is not a legal entity, the bank's first step in assessing whether it can derecognize an OREO asset and recognize revenue upon the sale or transfer of the OREO is to determine whether a contract exists under the provisions of ASC Topic 606. In the context of an OREO sale or transfer, in order for a bank's transaction with the party acquiring the property to be a contract under ASC Topic 606, the transaction must meet all of the following criteria:

- a. The parties to the contract have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their respective obligations.
- b. The bank can identify each party's rights regarding the OREO to be transferred.
- c. The bank can identify the payment terms for the OREO to be transferred.
- d. The contract has commercial substance (that is, the risk, timing, or amount of the bank's future cash flows is expected to change as a result of the contract).

⁴⁷ See call report glossary entries for business combinations, equity method of accounting, and variable interest entities for more information.

- e. It is probable that the bank will collect substantially all of the consideration to which it is entitled in exchange for OREO that is transferred to the buyer, that is, the transaction price. In evaluating whether collectability of an amount of consideration is probable, the bank shall consider only the buyer's ability and intention to pay that amount of consideration when it is due.

These five criteria require careful analysis for seller-financed sales of OREO. In particular, criteria a and e on the previous page may require significant judgment. When determining whether the buyer is committed to perform its obligations under criterion a and collectability under criterion e, all facts and circumstances related to the buyer's ability and intent to pay the transaction price should be considered. These may include the following:

- Amount of cash paid as a down payment.
- Existence of recourse provisions.
- Credit standing of the buyer.
- Age and location of the property.
- Cash flow from the property.
- Payments by the buyer to third parties.
- Other amounts paid to the bank, including current or future contingent payments.
- Transfer of noncustomary consideration (i.e., consideration other than cash and a note receivable).
- Other types of financing involved with the property or transaction.
- Financing terms of the loan (e.g., reasonable and customary terms, amortization, any graduated payments, or any balloon payment).
- Underwriting inconsistent with the bank's underwriting policies for loans not involving OREO sales.
- Future subordination of the selling bank's receivable.

Although ASC Subtopic 610-20 does not include the prescriptive minimum down payment requirements in ASC Subtopic 360-20, the amount and character of a buyer's equity (typically the down payment) and recourse provisions remain important factors when evaluating criteria a and e. Specifically, the buyer's initial equity in the property immediately after the sale is an important consideration in determining whether the buyer is committed to perform its obligations under criterion a. Furthermore, the buyer's initial equity is a factor to consider under criterion e when evaluating the collectability of consideration that the bank is entitled to receive from the buyer.

In applying the revenue recognition principles in ASC Topic 606, all relevant factors are to be weighed collectively in evaluating whether the five contract criteria have been met as the first step in determining the appropriate accounting for a seller-financed OREO transaction. The down payment and financing terms are particularly important when making this determination. A transaction with an insignificant down payment and nonrecourse financing generally would not meet the definition of a contract (within the meaning of ASC Topic 606) unless there is considerable support from other factors.

Situations in which a bank receives an insignificant down payment and concludes that an accounting contract exists are expected to be uncommon. Examples of support from other factors that, when considered collectively, may lead to an accounting contract despite an insignificant down payment include, but are not limited to, liquid cash on hand relative to the size of the financing, minimal other debt service obligations, and underwriting terms consistent with a similar type of transaction where little or no down payment would be required in accordance with the bank's underwriting standards. Additionally, there may be instances when a bank sells and provides financing for two similar OREO properties to two unique buyers, and accepts the same down payment percentage from both buyers. Depending on the support from other factors related to each unique buyer, it is possible for bank management to conclude that one transaction meets the requirements for an accounting contract while the other transaction does not. The need for support from other factors recedes in importance for a transaction with a substantial down payment and recourse financing to a buyer with adequate capacity to repay.

If the five contract criteria in ASC Topic 606 have not been met, the bank generally may not derecognize the OREO asset or recognize revenue (gain or loss) because an accounting sale has not occurred. Bank management should continue to assess the transaction to determine whether the contract criteria have been met in a later period. Until that time, any consideration the bank has received from the buyer should generally be recorded as a liability. In addition, if the transaction price is less than the carrying amount of the OREO, bank management should consider whether this indicates a decline in fair value of the OREO that should be recognized as a new valuation allowance, or as an increase in an existing valuation allowance.

If bank management determines that the contract criteria in ASC Topic 606 have been met, it must then determine whether the bank has satisfied its performance obligations as identified in the contract by transferring control of the OREO asset to the buyer. Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. As it relates to a bank's sale of OREO, ASC Topic 606 includes the following indicators of the transfer of control:

- The bank has a present right to payment for the asset.
- The buyer has legal title to the asset.
- The bank has transferred physical possession of the asset.
- The buyer has the significant risks and rewards of ownership of the asset.
- The buyer has accepted the asset.

For seller-financed sales of OREO, the transfer of control generally occurs on the closing date of the sale when the bank obtains the right to receive payment for the property and transfers legal title to the buyer. Bank management must consider, however, all relevant facts and circumstances to determine whether control of the OREO has transferred, which may include the selling bank's

- involvement with the property following the transaction.
- obligation to repurchase the property in the future.

- obligation to provide support for the property following the sale transaction.
- retention of an equity interest in the property.

In particular, if a bank has the obligation or right to repurchase the OREO, the buyer does not obtain control of the OREO because the buyer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset, even though it may have physical possession. In this situation, the bank should account for the contract as either a lease in accordance with ASC Topic 840, “Leases,” or a financing arrangement in accordance with ASC Topic 606. In addition, situations may exist in which the selling bank has legal title to the OREO, while the borrower whose property was foreclosed upon under the original loan still has redemption rights to reclaim the property in the future. If such redemption rights exist, the selling bank may not be able to transfer control to the buyer of the OREO and recognize revenue until the redemption period expires.

When a contract exists and the bank has transferred control of the property, the bank should derecognize the OREO asset and recognize a gain or loss for the difference between the transaction price and the carrying amount of the OREO asset. Generally, the transaction price in a sale of OREO is the contract amount in the purchase/sale agreement, including for a seller-financed sale financed at market terms. The transaction price may, however, differ from the amount stated in the contract when there is a significant financing component. In accordance with GAAP, a significant financing component exists if the timing of the buyer’s payments explicitly or implicitly provides the selling bank or the buyer with a significant benefit of financing the transfer of the OREO. A seller-financed transaction of OREO at off-market terms generally indicates the existence of a significant financing component. If a significant financing component exists, the contract amount should be adjusted for the time value of money to reflect what the cash selling price of the OREO would have been at the time of its transfer to the buyer. The discount rate used in adjusting for the time value of money should be a market rate of interest considering the credit characteristics of the buyer and the terms of the financing.

The preceding discussion represents a brief summary of the considerations for accounting for sales of real estate. Refer to ASC Subtopic 610-20 for a more complete description of the accounting principles that apply to sales of real estate.

ASC Subtopic 360-20

The information regarding ASC Subtopic 360-20 is included for reference. Sales of OREO by banks that were non-public business entities in fiscal years beginning on or before December 15, 2018, were accounted for in accordance with ASC Subtopic 360-20, provided the bank did not elect to early adopt ASU 2014-09.

ASC 360-20-40-7 describes the conditions that must be met for a transaction to qualify as a sale: (1) the parties are bound by the terms of a contract, (2) all consideration has been exchanged, (3) any permanent financing for which the seller is responsible has been arranged, and (4) all conditions precedent to closing have been performed. A transaction

need only qualify as a sale under GAAP as described in ASC 360-20-40-7 to transfer the asset out of OREO, even when the seller finances 100 percent of the purchase price.

ASC Subtopic 360-20, which applies to all transactions in which the seller provides financing to the buyer of the real estate, establishes five methods to account for dispositions of real estate. If a profit (gain) is involved in the sale of the real estate, each method sets forth the manner in which the profit is to be recognized. Regardless of which method is used, any losses on the disposition of real estate must be recognized immediately.

Full accrual method: Under the full accrual method, the disposition is recorded as a sale. Any profit resulting from the sale is recognized in full and the asset resulting from the seller's financing of the transaction is reported as a loan. This method may be used when the following conditions have been met:

- A sale has been consummated.
- The buyer's initial investment (down payment) and continuing investment (periodic payments) are adequate to demonstrate a commitment to pay for the property.
- The receivable is not subject to future subordination.
- The usual risks and rewards of ownership have been transferred.

Appendix A in ASC 360-20-55-2 describes guidelines for the minimum down payment that must be made for a transaction to qualify for the full accrual method. Down payments vary from 5 percent to 25 percent of the property's sales value.⁴⁸ These guideline percentages vary by type of property and are primarily based on the inherent risk assumed for the type and characteristics of the property. To meet the continuing investment criteria, the contractual loan payments must be sufficient to repay the loan over the customary loan term for the type of property involved. Such periods may range up to 30 years for loans on single-family residential properties.

Installment method: Dispositions of foreclosed real estate that do not qualify for the full accrual method may qualify for the installment method. This method recognizes a sale and the corresponding loan. Any profits on the sale are recognized only as the bank receives payments from the purchaser/borrower. Interest income is recognized on an accrual basis, when appropriate.

The installment method is used when the buyer's down payment is not adequate to allow use of the full accrual method but recovery of the cost of the property is reasonably assured if the buyer defaults. Assurance of recovery requires careful judgment on a case-by-case basis. Factors that should be considered include the size of the down payment, loan-to-value ratios, projected cash flows from the property, recourse provisions, and guarantees.

Because default on the loan usually results in the seller's reacquisition of the real estate, reasonable assurance of cost recovery may often be achieved with a relatively small down payment. This is especially true in situations involving loans with recourse to borrowers who

⁴⁸ Sales value is the sales price adjusted by certain additions and deductions. See ASC 360-20-40-8 for instructions on determination of sales value.

have verifiable net worth, liquid assets, and income levels. Reasonable assurance of cost recovery may also be achieved when the purchaser/borrower pledges additional collateral.

Cost recovery method: Dispositions of foreclosed real estate that do not qualify for the full accrual or installment methods are sometimes accounted for using the cost recovery method. This method recognizes a sale and the corresponding loan, but all income recognition is deferred. Principal payments are applied as reductions of the loan balance, and interest increases the unrecognized gross profit. No profit or interest income is recognized until either the aggregate payments by the borrower exceed the recorded amount of the loan or a change to another accounting method (e.g., the installment method) is appropriate. Consequently, the loan is maintained in nonaccrual status while this method is being used.

Reduced-profit method: This method is used in certain situations in which the bank receives an adequate down payment but the loan amortization schedule does not meet the requirements for use of the full accrual method. The method recognizes a sale and the corresponding loan; like the installment method, however, any profit is apportioned over the life of the loan as payments are received. The method of apportionment differs from the installment method in that profit recognition is based on the present value of the lowest level of periodic payments required under the loan agreement. Because sales with adequate down payments are generally not structured with inadequate loan amortization requirements, this method is seldom used.

Deposit method: The deposit method is used when a sale of the foreclosed real estate has not been consummated. This method may also be used for dispositions that could be accounted for under the cost recovery method. A sale is not recorded and the asset continues to be reported as foreclosed real estate. Further, no profit or interest income is recognized. Payments received from the borrower are reported as liabilities until sufficient payments or other events have occurred that allow the use of one of the other methods.

Appendix D: Abbreviations

(Section added in version 1.1 and updated in version 1.2)

ACL	allowance for credit losses
ALLL	allowance for loan and lease losses
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
CFR	Code of Federal Regulations
CSA	covered savings association
Fed. Reg.	<i>Federal Register</i>
FFIEC	Federal Financial Institutions Examination Council
FHA	Federal Housing Administration
FSA	federal savings association
GAAP	generally accepted accounting principles
HUD	U.S. Department of Housing and Urban Development
ICQ	internal control questionnaire
LLC	limited liability company
OCC	Office of the Comptroller of the Currency
OREO	other real estate owned
PSA	pooling and servicing agreement
SPE	special purpose entity
USC	U.S. Code

References

(Section updated in versions 1.1 and 1.2)

Listed references apply to national banks and FSAs unless otherwise noted.

Laws

12 USC 29, “Power to Hold Real Property” (national banks and CSAs)
12 USC 1464(c), “Loans and Investments” (FSAs)
15 USC 1691 et seq., “Equal Credit Opportunity Act”
42 USC 3601 et seq., “Fair Housing Act”
50 USC 3901 et seq., “Servicemembers Civil Relief Act”
Pub. L. 111-22, “Helping Families Save Their Homes Act of 2009,” Title VII, sections 701-704, “Protecting Tenants at Foreclosure Act,” as amended by the Dodd–Frank Wall Street Reform and Consumer Protection Act, section 1484, and the Economic Growth, Regulatory Relief, and Consumer Protection Act, section 304

Regulations

12 CFR 5.36, “Other Equity Investments by a National Bank” (national banks and CSAs)
12 CFR 5.59, “Service Corporations of Federal Savings Associations” (FSAs)
12 CFR 7, subpart A, “National Bank and Federal Savings Association Powers”
12 CFR 34, subpart C, “Appraisals”
12 CFR 34, subpart E, “Other Real Estate Owned”
12 CFR 101, “Covered Savings Associations” (CSAs)
12 CFR 160.160, “Asset Classification” (FSAs)

Federal Register

83 Fed. Reg. 5409
84 Fed. Reg. 56369

Comptroller’s Handbook

Examination Process

“Bank Supervision Process”
“Community Bank Supervision”
“Federal Branches and Agencies Supervision”
“Foreword”
“Large Bank Supervision”
“Sampling Methodologies”

Safety and Soundness, “Asset Quality”

- “Commercial Real Estate Lending”
- “Concentrations of Credit”
- “Installment Lending”
- “Rating Credit Risk”

Safety and Soundness, “Management”

- “Corporate and Risk Governance”
- “Insider Activities”

Consumer Compliance

- “Protecting Tenants at Foreclosure Act”
- “Servicemembers Civil Relief Act”

OCC Issuances

Bank Accounting Advisory Series

- OCC Bulletin 2006-46, “Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices: Interagency Guidance on CRE Concentration Risk Management”
- OCC Bulletin 2010-24, “Incentive Compensation: Interagency Guidance on Sound Incentive Compensation Policies”
- OCC Bulletin 2010-42, “Sound Practices for Appraisals and Evaluations: Interagency Appraisal and Evaluation Guidelines”
- OCC Bulletin 2013-29, “Third-Party Relationships: Risk Management Guidance”
- OCC Bulletin 2017-43, “New, Modified, or Expanded Bank Products or Services: Risk Management Principles”
- OCC Bulletin 2018-39, “Appraisal and Evaluations of Real Estate: Frequently Asked Questions”
- OCC Bulletin 2019-31, “Covered Savings Associations Implementation: Covered Savings Associations” (CSAs)
- OCC Bulletin 2020-10, “Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29”
- OCC Bulletin 2020-29, “Joint Statement on Adjustment to the Calculation for Credit Concentration Ratios Used in the Supervisory Approach”
- OCC Interpretive Letter No. 1123, “Re: Exchange of interest in real property acquired DPC for interest in an entity which would dispose of the real property”

Accounting Standards

- ASC Topic 606, “Revenue From Contracts With Customers”
- ASC Topic 610, “Other Income”
- ASC Topic 840, “Leases”
- ASC Topic 860, “Transfers and Servicing”
- ASC Subtopic 310-40, “Receivables—Troubled Debt Restructurings by Creditors”
- ASC Subtopic 360-20, “Real Estate Sales”
- ASC Subtopic 820-10, “Fair Value Measurement”

ASC Subtopic 835-20, “Interest—Imputation of Interest,”
ASC Subtopic 970-340, “Real Estate—General—Other Assets and Deferred Costs”
ASU 2014-09, “Revenue From Contracts With Customers”
ASU 2016-13, “Financial Instruments—Credit Losses”

Other

FFIEC Call Report Instructions

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Table of Updates Since Publication

Refer to the “Foreword” booklet of the *Comptroller’s Handbook* for more information regarding the OCC’s process for updating and revising *Comptroller’s Handbook* booklets.

Version 1.0: Published September 13, 2013			
Version number	Date	Reason	Affected pages (listed for most recent version only)
1.1	August 31, 2018	Removed content regarding different OREO regulations	
		Clarifications regarding supervisory guidance, sound risk management, or legal language	
		Updated for consistency with the booklets in the <i>Examination Process</i> series of the <i>Comptroller’s Handbook</i>	
		Accounting changes	
		Updated referenced <i>Comptroller’s Handbook</i> booklet title from “Installment Loans” to “Installment Lending”	
		Moved paragraph about FSA salvage powers higher on the page for clarity	
		Reflect integration of FSAs into 12 CFR 7, subpart A	
		Updated for clarity	
		Reflect integration of FSAs into 12 CFR 3 and update content regarding OREO holding period for FSAs	
		Clarifications regarding the roles of the bank’s board or management	
		Reflect integration of FSAs into 12 CFR 34, subpart C	
		Reflect current Servicemembers Civil Relief Act grace period	
		Updated Servicemembers Civil Relief Act rent threshold. Refer to 83 Fed Reg. 5409	
		Third-party risk management guidance (OCC Bulletins 2013-29 and 2017-21)	
		Clarified OREO deposition requirements for national banks and FSAs	
		Updated examination procedure to include Fair Housing Act and Equal Credit Opportunity Act	
		Added “Abbreviations” section	
Updated “References” section for consistency with the content of the booklet. Removed references to rescinded issuances			

Version 1.0: Published September 13, 2013			
Version number	Date	Reason	Affected pages (listed for most recent version only)
1.2	September 2, 2020	Clarified applicability to federal branches and agencies	1
		CSAs implementation	1–2, 4, 18, 40
		Added references	1, 6, 10–12, 16–18, 27
		Changes to 12 CFR 34, subpart E	1–2, 4–6, 10–12, 16–18, 20, 25–26, 28, 30–31
		Changes to accounting standards	1
		Clarifications regarding supervisory guidance, sound risk management, or legal language	1–2, 4, 6, 13–17, 19–21
		Edited for clarity	2, 4, 6–7, 9, 10–16, 19–29, 32, 34–35, 37, 40, 42
		Updated for consistency with the “Bank Supervision Process” booklet of the <i>Comptroller’s Handbook</i>	2–3, 22–23, 34–35, 38
		Updated for consistency with the “Corporate and Risk Governance” booklet of the <i>Comptroller’s Handbook</i>	3–4, 17, 28–29, 31–32, 34–35
		Moved “Foreclosure Redemption Periods” section	5–6
		Updated terminology for consistency with call report instructions	7–8
		Added allowances for credit losses	7–8, 24
		Added more information regarding valuation allowances	8–9
		Moved detailed sales accounting information to appendix C	9, 48–54
		Reflect changes to appraisal threshold under 12 CFR 34, subpart C	10
		Updated Servicemembers Civil Relief Act rent threshold. Refer to 83 Fed Reg. 5409	14
		Reflect issuance of OCC Bulletin 2020- 10 and rescission of OCC Bulletin 2017-21	14, 17
		Revise definition of a concentration of credit for consistency with the “Concentrations of Credit” booklet of the <i>Comptroller’s Handbook</i> and OCC Bulletin 2020-29, “Joint Statement on Adjustment to the Calculation for Credit Concentration Ratios Used in the Supervisory Approach”	19
		Reflect rescission of OCC Bulletin 2004-25	20
		Updated for consistency with the “Sampling Methodologies” booklet of the <i>Comptroller’s Handbook</i>	24

Version 1.0: Published September 13, 2013			
Version number	Date	Reason	Affected pages (listed for most recent version only)
		Added information on environmental issues	27
		Added appraisals and evaluations to examination procedure about policies	28
		Consolidated former conclusion examination procedure 6 into procedure 4	34–35
		Added concentrations to conclusion examination procedures	35
		Updated for consistency with current OCC organizational structure	41–42
		Added reference to reflect origin of information in appendix	43, 45
		Updated because ASC Topic 606 and ASC Topic 610 are now effective for all banks	48–54
		Updated appendix D, “Abbreviations,” for consistency with the content of the booklet	55
		Updated “References” section for consistency with the content of the booklet	56–58