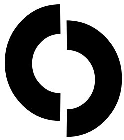

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

February 24, 2003

**Interpretive Letter #965**
**June 2003**
**12 USC 24(7)**

Subject: [ ] — [ *Co.* ]

Dear [ ]:

This is in response to your letter concerning a purchase of stock that [ ] ("Bank"), has made, through an operating subsidiary, in a reinsurance company domiciled in Bermuda. You requested that we review this purchase and permit the Bank to retain the stock. We have completed our review and have concluded that this is a permissible activity and the Bank may retain its shares of stock in the Bermuda company.

Background

You indicate that the Bank has a wholly-owned operating subsidiary, [ ] ("*Sub*"). [ *Sub* ] is a [ *State* ] general insurance agency and broker specializing in commercial lines of insurance. Last year, [ *Sub*] needed to obtain professional liability insurance for its insurance agents. Professional liability insurance in this context provides protection against legal liability and the cost of defending claims alleging errors and omissions of insurance agents. Under current market conditions, it is a highly specialized type of insurance that is difficult to obtain and as a result, distribution through surplus lines brokers is common. [*Sub*] contacted over 25 carriers in its search for professional liability coverage. Most declined to even offer quotes. Others offered only limited coverage, had higher deductibles, or had unacceptable ratings. In the end, [*Sub*] management concluded that obtaining the coverage through a program offered by [ ] ("*Co.*"), was the best option.

[*Co.*] is domiciled in Bermuda and is licensed under the Bermuda Insurance Act of 1978. It does not maintain any offices outside Bermuda. Under the [*Co.*] program, the insurance is underwritten by **[** *InsurCo.* **]**, a large American company whose principal office is in **[** *State* **]**, and reinsured through a wholly-owned subsidiary of [*Co.*]. According to [*Co.*]'s Private Placement Memorandum of May 22, 2002, [*Co.*]'s sole business is underwriting professional liability insurance through this program, and its success depends entirely on the extent to which its shareholders place their business through the program.

Coverage under the [*Co.*] program requires ownership of [*Co.*] stock, and ownership is limited to participants in the program.[1]

Thus, in order to obtain the coverage that it needed, [*Sub*] was required to purchase 3,470 shares of Class A stock in [*Co.*] in an amount equal to 20 percent of the first annual premium for the insurance, or $69,400. This amount represents less than 1 percent of the outstanding voting stock of [*Co.*]. Shares are subject to a call by [*Co.*] in the event the shareholder terminates its insurance policy, and to a put by any shareholder who has owned the shares for at least five years and is no longer insured.

Analysis

Under 12 U.S.C. § 24(Seventh), national banks possess "all such incidental powers as shall be necessary to carry on the business of banking." The Supreme Court's decision in *NationsBank of North Carolina, N. A. v. Variable Annuity Life Insurance Co. ("VALIC")*[2] established that the "business of banking" is not limited to the five powers that are enumerated in section 24(Seventh) but encompasses more broadly activities that are part of the general business of banking. The *VALIC* decision further established that national banks may engage in activities that are incidental to the business of banking as a whole, as well as those that are incidental to the enumerated activities. "Necessary" has been judicially construed to mean "convenient or useful."[3] Thus, since *VALIC*, it is clear that incidental powers under 12 U.S.C. § 24(Seventh) are those that are convenient or useful to carrying on the general business of banking.

There are several broad categories of activities that the courts have recognized as being incidental to the business of banking. One of these categories consists of activities that facilitate the operation of the bank as a business enterprise. Even though they are not substantive banking activities, they are necessary (*i.e.*, convenient or useful), to the operation of the bank as a business. These activities include such things as hiring employees, owning or renting business equipment, borrowing money, and advertising the bank's services.[4]

Purchasing insurance for the bank's own risk control needs is another such activity. Similar to any other business, there are certain risks involved with operating a bank, and banks must be able to manage these risks. The OCC has long recognized that national banks may purchase

---

[1] Ownership of **[***Co.***]**'s Class A shares is limited to two primary insurers, **[** *InsurCo.* **]** and another American insurance company, and insurance agencies that are insured under the program, all of which are large, domestic insurance agencies like **[***Sub***]**.

[2] 513 U.S. 251 (1995).

[3] *Arnold Tours, Inc. v. Camp*, 472 F.2d 427 (1st Cir. 1972).

[4] *Franklin Nat'l Bank v. New York*, 347 U.S. (1954) (advertising); *Wyman v. Wallace*, 201 U.S. 230 (1905) (borrowing money).

insurance for themselves as an activity that is incidental to banking.[5] Thus, it is permissible for [*Sub*] to acquire the liability insurance that it needs to conduct its business in a prudent manner.

Even though national banks generally may not purchase shares of stock for investment purposes, the ownership of stock is incidental to banking, and thus permissible, when it is convenient or useful to the operation of the bank as a business and there is no speculative or investment motive. For example, the OCC has found the ownership of equities to be permissible in instances where such ownership has facilitated the management of risk inherent in equity-related banking activities being conducted by the bank.[6] Stock ownership has also been held to be permissible when it was deemed to be necessary to facilitate a bank's participation in a permissible banking activity or, as in the present case, obtain a product or service that the bank needed for its business.[7]

Accordingly, the OCC has previously approved stock ownership in insurance carriers where it was necessary in order to obtain directors' and officers' liability insurance, a type of coverage analogous to that involved here.[8] The situation you describe in your letter falls squarely within these precedents. As in those letters, it was necessary for [*Sub*] to own shares of [*Co.*] stock in order to obtain coverage under the [*Co.*] program. [*Sub*] was unable to obtain the needed liability insurance from virtually any other source. The only other alternatives were to accept an inferior policy or self insure.

---

[5] *E.g.*, 12 C.F.R. § 7.2013; OCC Bulletin 2000-23, *reprinted in* 4 Fed. Banking L. Rep. (CCH) ¶ 35-491 (July 23, 2000); Interpretive Letter No. 845, *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-300 (October 20, 1998); Interpretive Letter No. 554, *reprinted in* [1991-1992 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 83,301 (May 7, 1990); letter of James M. Kane, Central District Counsel (June 8, 1988) (unpublished); Interpretive Letter No. 429, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,653 (May 19, 1988).

[6] The OCC has found that it is legally permissible for a national bank to purchase and hold equity securities that banks do not generally have authority to purchase in order to hedge customer-driven, bank permissible equity derivative transactions. "Equity derivative transactions" are transactions in which a portion of the return is linked to the price of a particular equity security or to an index of such securities. They include such things as equity and equity index swaps, equity index deposits, and equity-linked loans and debt issues. Interpretive Letter No. 935, [___ - ___ Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-460 (May 14, 2002); Interpretive Letter No. 924, [___ - ___ Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-449 (Jan. 2, 2002); Interpretive Letter No. 892, *reprinted in* [2000-2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-411 (Sep. 8, 2000).

[7] *E.g.,* Interpretive Letter No. 878, *reprinted in* [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-375 (Dec. 22, 1999) (national banks may invest in equity mutual funds in order to hedge employee deferred compensation obligations that are tied to the value of the same funds); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988) (ownership of shares of Government Securities Clearing Corporation to obtain securities clearing services); Interpretive Letter No. 380, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 (Dec. 29, 1986) (shares of an options clearing corporation in order to obtain options clearing services); letter of John E. Shockey, Deputy Chief Counsel (Dec. 19, 1975) (unpublished; purchase of shares in Depository Trust Company to obtain securities clearing and custody services).

[8] Interpretive Letter No. 554, *supra* note 5; letter of James M. Kane, *supra* note 5.

You note that there is no anticipated return on the [*Co.*] stock other than dividends and no market for the stock other than repurchase by the issuer at book value under certain circumstances. You believe this demonstrates that the Bank and [*Sub*] had no investment or speculative motive in purchasing the stock. The OCC has, in fact, viewed limits on the transferability of stock as evidence of a lack of investment motive,[9] and has found that the possibility of receiving dividends does not necessarily indicate the presence of such a motive.[10]

Under these circumstances, the Bank's indirect purchase of [*Co.*] stock through [*Sub*] should be treated as a cost of obtaining insurance for the Bank, an activity that is permissible under 12 U.S.C. § 24(Seventh). The investment is nominal, amounting to less than one percent of [*Co.*]'s outstanding shares and a tiny fraction of one percent of the Bank's capital. Accordingly, we conclude that it is permissible for [*Sub*] to retain the shares of [*Co.*] stock purchased in connection with obtaining liability insurance coverage for itself.

Regulation K of the Board of Governors of the Federal Reserve System, 12 C.F.R. Part 211, governs international operations of United States banks. The Bank should determine whether Federal Reserve approval for the purchase of [*Co.*] stock is required pursuant to this regulation, and we offer no opinion on that question.

This opinion is based on the representations in your letter. Any material change in the facts could require a different conclusion. I trust that this has been responsive to your inquiry. If you have further questions, please contact Christopher Manthey, Special Counsel, Bank Activities and Structure Division, at (202) 874-5300.

Sincerely,

-signed-

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

---

[9] Interpretive Letter No. 421, *supra* note 7.

[10] Interpretive Letter No. 554, *supra* note 5.