



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Corporate Decision #2004-12
August 2004

April 3, 1997

Mr. Robert G. Wall
President
The First National Bank
Conway Springs, Kansas 67031-0011

Re: Notification of Intent to Establish an Operating Subsidiary to Manage the Bank's
Investment Portfolio and Acquire a Fifty Percent Interest in an Insurance Agency
Application Control Number: 97-MW-08-0011

Dear Mr. Wall:

This is in response to your February 12, 1997 letter on behalf of The First National Bank, Conway Springs, Kansas (the "Bank"), concerning the Bank's establishment of Norcon Resource Corporation (the "Operating Subsidiary"). The Operating Subsidiary would manage the Bank's investment portfolio and hold a non-controlling, fifty percent interest in an insurance agency. Based on the information and representations you provided in your letter and subsequent telephone conversations with National Bank Examiner Jill K. Kennard, it is our opinion the activities of the Operating Subsidiary are legally permissible. Therefore, for the reasons discussed below, the Bank's application is hereby approved.

I. Background

The Bank would own one hundred percent of the Operating Subsidiary, which would be located in the Bank's main office at 124 West Spring Avenue, Conway Springs, Kansas. As stated above, the purpose of the Operating Subsidiary would be twofold. First, the Operating Subsidiary would hold and manage the Bank's investment portfolio. Specifically, the Operating Subsidiary would manage, invest, and reinvest cash, U.S. government obligations, and other marketable securities in accordance with the Bank's investment guidelines.

Second, the Operating Subsidiary would acquire and hold a non-controlling, fifty percent interest in an insurance agency. The Bank presently owns one hundred percent of the assets of The Farmers Insurance Agency, an independent insurance agency operating from the Bank's branch in Norwich, Kansas.¹ The Bank proposes to contribute The Farmers

¹ According to the 1990 decennial census, Conway Springs, Kansas, has a population of 1384 inhabitants and Norwich, Kansas, has a population of 455 inhabitants.

Insurance Agency's non-cash assets to the Operating Subsidiary. The Operating Subsidiary would then contribute these assets to the Bennett Agency, Inc. (the "Insurance Agency"), in exchange for fifty percent of the Insurance Agency's common stock. The Insurance Agency is a Kansas corporation located in Conway Springs and is currently wholly-owned by an individual named Brad A. Bennett. After the consummation of the above transaction, the Insurance Agency would be the successor to the Bank's current insurance operations.

You indicate that the Bank's investment in the Insurance Agency would enable it to decrease its expenses and enhance the insurance services that it provides to its customers. For example, the Bank would be able to reduce the resources that it presently commits to providing capital, funding, and personnel for its own insurance operations. Furthermore, some insurance companies will only deal with, and underwrite for, insurance agencies of a certain size. By joining forces, the Bank and Mr. Bennett would be able to attract larger underwriters and obtain more competitive insurance rates for their customers. Finally, both the Bank and its customers would be able to utilize and benefit from Mr. Bennett's expertise in the insurance industry.

The Bank and Mr. Bennett have entered into a "Management Agreement" that governs the relationship between the Insurance Agency and the Bank. The Bank and Mr. Bennett have agreed to restrict the Insurance Agency's operations to those activities that are permissible for national banks. Specifically, the Management Agreement states that:

- The Insurance Agency will not undertake any new activities that are not legally permissible for a corporation having a national bank as a shareholder;
- The Insurance Agency's board of directors will consist of two individuals: Mr. Bennett and the Bank's Chief Executive Officer;
- If more than twenty-five percent of Mr. Bennett's ownership of the Insurance Agency's stock changes, the Bank shall have the right of first refusal to buy Mr. Bennett's shares at an agreed upon price. If the Bank and Mr. Bennett are unable to agree upon a price, the Bank shall have the right to purchase the stock at a price determined by a team of appraisers; and
- If either party wishes to terminate ownership in the Insurance Agency, the remaining stockholder shall have the right to purchase the other party's stock at an agreed upon price or, alternatively, at a price determined by a team of appraisers.

II. Discussion

A national bank may invest in an operating subsidiary if the parent bank owns more than fifty percent of the voting interest in the subsidiary.² 61 Fed. Reg. 60,342 at 60,374 (1996) (to be codified at 12 C.F.R. § 5.34(d)). Because the Bank will own one hundred percent of the Operating Subsidiary's stock, this requirement is satisfied. Furthermore, a national bank may establish an operating subsidiary to conduct activities that are part of, or incidental to, the business of banking as well as other activities permissible for national banks or their subsidiaries pursuant to other statutory authority. *Id.* (to be codified at 12 C.F.R. § 5.34(b)). The Operating Subsidiary's proposed activities are discussed below.

A. Managing the Bank's Investment Portfolio

The National Bank Act expressly provides that a national bank may purchase investment securities for its own account in accordance with the OCC's limitations and restrictions,³ 12 U.S.C. § 24(Seventh). Because a national bank clearly has the authority to hold and manage its investment securities portfolio, a national bank's operating subsidiary may also engage in these activities on behalf of the bank. Therefore, the Operating Subsidiary's holding and managing of the Bank's investment securities portfolio in accordance with the Bank's investment guidelines would be within the power of a national bank pursuant to 12 U.S.C. § 24(Seventh) and 12 C.F.R. Part 1. *See* OCC Interpretive Letter No. 754, [Current Binder] Fed. Banking L. Rep. (CCH) ¶ 81-118 (Nov. 6, 1996); OCC Interpretive Letter No. 745, [Current Binder] Fed. Banking L. Rep. (CCH) ¶ 81-110 (Aug. 27, 1996).

B. Making a Non-Controlling Investment in an Insurance Agency

The Bank's proposal to purchase a fifty percent interest in the Insurance Agency raises the issue of the authority of a national bank's operating subsidiary to hold a non-controlling interest in a corporation. A recent OCC interpretive letter extensively analyzed the authority of national banks pursuant to 12 U.S.C. § 24(Seventh) to own stock and reviewed OCC precedents on the ownership of stock in amounts less than that required for an operating subsidiary, *i.e.*, non-controlling stock investments. OCC Interpretive Letter No. 732, [1995-1996 Transfer Binder] Fed. Banking L. Rep. ¶ 81-049 (May 10, 1996).⁴ That letter

² A national bank may also invest in a corporation, limited liability company, or similar entity if the parent bank otherwise controls the subsidiary and no other party controls more than fifty percent of the voting (or similar type of controlling) interest of the subsidiary. 61 Fed. Reg. 60,342, at 60,374 (1996) (to be codified at 12 C.F.R. § 5.34(d)).

³ The OCC's revised Investment Securities Regulation, 61 Fed. Reg. 63,972 (1996) (to be codified at 12 C.F.R. Part 1), prescribes limitations and restrictions on a national bank's purchase of investment securities.

⁴ *See also* OCC Interpretive Letter No. 697, [1995-1996 Transfer Binder] Fed. Banking L. Rep. ¶ 81-013 (Nov. 15, 1995).

concluded that ownership of a non-controlling interest in a corporation is permissible provided four standards, drawn from OCC precedents, are satisfied.⁵ They are:

- (1) The activities of the enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking;
- (2) The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment;
- (3) The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise; and
- (4) The investment must be convenient and useful to the bank in carrying out its business and not a mere passive investment unrelated to *that bank's* banking business.

Each of these factors is discussed below and applied to your proposal.

1. *The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking.*

Our precedents on non-controlling stock ownership have recognized that the enterprise in which the bank takes an equity interest must confine its activities to those that are part of, or incidental to, the conduct of the banking business. *See, e.g.*, OCC Interpretive Letter No. 380, [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (Dec. 29, 1986) (because a national bank can provide options clearing services to customers, it can purchase stock in a corporation providing options clearing services); Letter from Robert B. Serino, Deputy Chief Counsel (Nov. 9, 1992) (because the operation of an ATM network is “a fundamental part of the basic business of banking,” an equity investment in a corporation operating such a network is permissible).

The Insurance Agency would engage in general insurance agency activities pursuant to 12 U.S.C. § 92. In response to operating subsidiary notifications submitted by First Union Corporation, the OCC thoroughly analyzed section 92 and concluded that a national bank insurance agency selling insurance pursuant to the authority of section 92 should be permitted the same marketing range and be able to use the same marketing tools and facilities as are generally available for licensed insurance agencies not affiliated with a bank, in the state or states in which the bank agency operates. OCC Interpretive Letter No. 753, [Current

⁵ *See also* 12 C.F.R. § 5.36(b). National banks are permitted to make various types of equity investments pursuant to 12 U.S.C. § 24(Seventh) and other statutes.

Binder] Fed. Banking L. Rep. (CCH) ¶ 81-107 (Nov. 4. 1996) (the “*First Union Letter*”). The *First Union Letter* sets forth the following general principles that define the scope of solicitation and sales activities permissible for national banks pursuant to 12 U.S.C. § 92:⁶

The agency located in the “place of 5,000” must, of course, be *bona fide* Agents will be managed through the agency and the “place of 5,000” will be the agency’s business location for licensing purposes. Each agency will be responsible for collecting commissions from insurance carriers and paying commissions to its licensed sales staff. The agency also generally will be responsible for processing insurance applications, delivery of insurance policies, and collection of premiums, where consistent with procedures of the relevant insurance carriers. In addition, business records of the agency, including copies of customer application and policy information, and licensing, customer complaint, and other compliance records, will be available at the “place of 5,000.”

The bank agency and its agents may seek the same market range and use the same marketing tools and facilities as generally available for a licensed insurance agency, not affiliated with a bank, that is based in the “place of 5,000.” This will generally allow the following:

- 1) Meetings with customers and solicitations and sales of insurance by agents of the bank agency may take place at locations inside the “place of 5,000” as well as at locations outside that “place,” provided the agents are managed and paid through the bank agency located in the “place of 5,000” and use that location as their place of business for licensing purposes. If an insurance company has adopted other procedures for its nonbank agents, however, the bank agency may follow the same procedures as other insurance agents selling the company’s policies.
- 2) Mailings to advertise and sell insurance may originate from inside or outside of the “place of 5,000,” and brochures, leaflets, and other literature alerting potential customers to the bank’s insurance activities may be distributed from locations both inside and outside of the “place of 5,000,” including other branches of the same bank. Personnel of bank branches outside of the “place of 5,000” also may make referrals to the bank’s insurance agency. Likewise, telephone and cybermarketing may be used and the calls and messages need not originate within the “place of 5,000.”
- 3) The bank may contract with third parties to assist the agency’s sales activities. For example, third parties might provide advertising support, direct mail marketing services, telemarketing services, payments processing, or other types of “back office” support.

⁶ The OCC recognizes that solicitation and sales techniques can vary with the different marketing strategies employed by different banks and still be consistent with the general principles described in the *First Union Letter*.

First Union Letter (footnotes omitted).⁷

The analysis and discussion set forth in the *First Union Letter* are equally applicable to the Bank's notification and are hereby incorporated by reference. By letter dated March 1, 1997, the Bank represented that it will conduct the Insurance Agency's activities in accordance with the principles set forth in the *First Union Letter*. Thus, we conclude that the activities to be performed by the Insurance Agency are activities that are part of, or incidental to, the business of banking, and the first standard is satisfied.

2. *The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.*

The activities of the enterprise in which a national bank may invest must be part of, or incidental to, the business of banking not only at the time the bank initially purchases stock, but for as long as the bank has an ownership interest. However, noncontrolling shareholders in a corporation do not ordinarily possess a veto power over corporate activities as a matter of corporate law.

The provisions set forth in the Management Agreement assure that the Insurance Agency will not engage in any activity that is not permissible for a corporation having a national bank as a shareholder. Furthermore, by having the Bank's chief executive officer be one of the two members of the Insurance Agency's board of directors, the Bank will effectively have veto power over any activities that are not permissible under this standard. For these two reasons the Bank will be able to prevent the Insurance Agency from engaging in any impermissible activity for as long as it continues to own shares in the Insurance Agency. Thus, the second standard is satisfied.

3. *The bank's loss exposure must be limited and the bank must not have open-ended liability for the obligations of the enterprise.*

A primary concern of the OCC is that national banks should not be subjected to undue risk. Where an investing bank will not control the operations of the entity in which the bank holds an interest, it is important that a national bank's investment not expose it to unlimited liability. Normally, this is not a concern when a national bank invests in a corporation, for shareholders are not liable for the debts of the corporation, provided proper corporate separateness is maintained. 1 William M. Fletcher, *Fletcher Cyclopedia of the Law of Private Corporations* § 25 (perm. ed. rev. vol. 1990). In the present case, both the

⁷ The *First Union Letter* does not address and is not intended to express any opinion on any state law preemption issues. The application of state law would be determined in accordance with recognized preemption standards. See *Barnett Bank of Marion County, N.A. v. Nelson*, 116 S. Ct. 1103 (1996), and the cases cited therein.

Operating Subsidiary and the Insurance Agency will be separate corporations, with their own capital, directors, and officers.

Further, the Bank has advised that the appropriate treatment for its investment in the Insurance Agency will be the equity method of accounting. Under this method, unless the bank has extended a loan to the entity, guaranteed any of its liabilities or has other financial obligations to the entity, losses are generally limited to the amount of the investment shown on the investor's books. *See generally*, Accounting Principles Board, Op. 18, § 19 (1971).

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure should be limited to the amount of its investment. Because that exposure would be quantifiable and controllable, the third standard is satisfied.

4. *The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.*

A national bank's investment in an enterprise or entity must also satisfy the requirement that the investment have a beneficial connection to the *bank's* business. *i.e.*, be convenient or useful to the investing bank's business activities, and not constitute a mere passive investment unrelated to that bank's banking business. Twelve U.S.C. § 24(Seventh) gives national banks incidental powers that are "necessary" to carry on the business of banking.

"Necessary" has been judicially construed to mean "convenient or useful". *See Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972). The provision in 12 U.S.C. § 24(Seventh) relating to the purchase of stock, derived from section 16 of the Glass-Steagall Act, was only intended to make it clear that section 16 did not authorize speculative investments in stock. *See OCC Interpretive Letter No. 697*, [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-013 (Nov. 15, 1995). Therefore, a consistent thread running through our precedents concerning stock ownership is that it must be convenient or useful to the bank in conducting *that bank's* banking business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment. *See, e.g.*, OCC Interpretive Letter No. 543, [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,225 (Feb. 13, 1991); OCC Interpretive Letter No. 427, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); OCC Interpretive Letter No. 421, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (Mar. 14, 1988).

As set forth in the "Background" section, the Bank's investment in the Insurance Agency would enable it to reduce the resources that it currently devotes to its own insurance operations, such as providing capital, funding, personnel, and training. Moreover, as a result of the Bank's investment in the Insurance Agency, the Bank would be able to continue offering insurance products to its customers and enhance the services available to them. For example, the Insurance Agency would be dealing with larger underwriters, and customers would also benefit from Mr. Bennett's expertise in the insurance industry. It is simply more

economical for the Bank and Mr. Bennett to combine their resources. Thus, the investment assists the Bank in efficiently and capably offering insurance services to its customers.

For these reasons, the proposed investment is convenient and useful to the Bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied.

III. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that the Bank may establish the Operating Subsidiary to provide investment portfolio management services for the Bank. Furthermore, the Operating Subsidiary may hold directly a fifty percent interest in the Insurance Agency in the manner and as described herein, provided:

- (1) The Insurance Agency will engage only in activities that are part of, or incidental to, the business of banking;
- (2) The Bank will have veto power over any activities and major decisions of the Insurance Agency that are inconsistent with number one, or will withdraw from the Insurance Agency in the event it engages in an activity that is inconsistent with condition number one;
- (3) The Bank will account for the investment in the Insurance Agency under the equity method of accounting; and
- (4) The Insurance Agency will be subject to OCC supervision, regulation, and examination.

Please be advised that the conditions of this approval are deemed to be “conditions imposed in writing by the agency in connection with the granting of any application or other request” within the meaning of 12 U.S.C. § 1818.

If you have any questions, please contact National Bank Examiner Jill Kennard at (816)-556 1860, or Madelynn R. Orr, Attorney, at (816) 556-1870.

Sincerely,

signed

Julie L. Williams
Chief Counsel