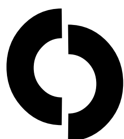

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #994
July 2004
12 USC 24(7)

June 14, 2004

Subject: **[*Inc.*]/[*State*]** Bankers Insurance Trust

Dear **[ ]**:

This is in response to your letter requesting confirmation that national banks may lawfully acquire and hold non-controlling equity interests in a **[*State*]** limited liability company ("**[*Co.*]**") that administers employee benefit plans for (1) its investors, which are primarily financial institutions (including national banks) but may also include non-financial companies; and (2) other companies that have no equity interest in **[*Co.*]**. As discussed below, we concur in your view that such an investment is permissible for national banks.

Facts

1. Current Structure

[*Inc.*] ("**[*Inc.*]**"), a **[*State*]** non-profit corporation, is the corporate trustee of **[*State*]** Bankers Insurance Trust ("**[*BIT*]**"). **[*BIT*]** is a tax-exempt "voluntary employees' beneficiary association" ("VEBA") established pursuant to section 501(c)(9) of the Internal Revenue Code, 26 U.S.C. § 501(c)(9).[1] **[*BIT*]**, operating by and through **[*Inc.*]**, provides health, dental, short and long-term disability and life insurance benefits to employees of its members, all financial institutions. **[*BIT*]**'s approximately one hundred sixty members include twenty-four national banks as well as state-chartered banks, state and federal credit unions and thrifts ("Participating Employers"). **[*Inc.*]**'s membership is identical to that of **[*BIT*]**.

[1] Under sec. 501(c)(9) of the Internal Revenue Code, a VEBA provides "for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual." Under Internal Revenue Service ("IRS") regulations, members of a VEBA must share an "employment-related common bond" such as an employer, labor union local, industry, or job classification under a collective bargaining agreement. *See* 26 C.F.R. § 1.501(c)(9)-2(a). **[*BIT*]**'s members are all employees of financial institutions.

All benefits provided to employees of Participating Employers are provided through the purchase of insurance contracts from unrelated third party insurance carriers ("Carriers"). **[*BIT*]** markets its services to employers within the financial services industry, collects and tabulates all enrollment and participation data for employees of Participating Employers and their dependents, calculates the premiums required to provide the benefits, negotiates and places insurance contracts with the Carriers, bills Participating Employers for the respective insurance premiums, and remits such premiums to the Carriers. **[*BIT*]** does not process insurance claims.

Over the past few years, **[*BIT*]** has frequently accrued more money from administration fees than needed to pay its expenses. As a trust and a VEBA subject to IRS restrictions, **[*BIT*]** is bound by strict limitations on what it may do with excess funds. It is not practical for **[*BIT*]** to credit such funds to the particular individuals whose contributions were applied to the premiums, as specified in IRS regulations.[2] Further, the recent expansion of **[*Inc.*]**'s own activities has created a situation in which both **[*Inc.*]** and **[*BIT*]** have accrued more money than their current legal and tax structures permit them to use.

[*Inc.*] has recently been licensed under **[*State*]** law as a third party administrator[3] in order to seek additional business by providing its services to employers who are not Participating Employers of **[*BIT*]** ("Other Employers").[4] It is anticipated that **[*Inc.*]**'s income from administration of the insurance programs for Other Employers will soon exceed the amount required to pay all of **[*Inc.*]**'s operating costs. **[*State*]** law prohibits **[*Inc.*]** from distributing profits to its members or returning such profits to **[*BIT*]**. And **[*BIT*]**, as a VEBA, also faces restrictions on what use it may make of excess funds and has no practical way to use its profits to reduce the cost of benefits to Participating Employers. Neither entity (**[*Inc.*]** as a non-profit corporation and **[*BIT*]** as a trust) is legally designed to be a profit-making enterprise.

Accordingly, you have explained that this confluence of factors—**[*Inc.*]**'s expertise in administering group insurance programs for Other Employers together with the legal and regulatory restrictions governing the accumulation and retention of funds by **[*Inc.*]** and **[*BIT*]**—has prompted the search for an alternate corporate structure.

2. Proposed Structure

[*Inc.*] has therefore proposed that the Participating Employers of **[*BIT*]**, all financial institutions, form a limited liability company under **[*State*]** law, to be called **[Co.]**. **[*Co.*]** will not be a

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[2] **[*BIT*]** is permitted to use excess funds (those above what is needed to pay operating costs) only to provide nondiscriminatory benefits to members or to credit the specific individuals whose contributions were applied to such premiums. *See* IRS Regulation § 1.501(c)(9)-4(c), 26 C.F.R. § 1.501(c)(9)-4(c). For a number of reasons (*e.g.,* employee turnover), it is not practical for **[*BIT*]** to credit excess funds to the specific individuals whose contributions were applied to particular premiums.

[3] **[ ]**

[4] As explained in n.1, *supra*, the IRS requires members of a VEBA to share a common industry. **[*Inc.*]** obtained its license as a third party administrator in order to provide its services to employers who are not financial institutions and are therefore not eligible to join **[*BIT*]**.

VEBA, and will therefore not be subject to the IRS restrictions imposed on such entities (*see* n.1 and 2, *supra*). **[*Co.*]** will assume the role of providing the administrative services for all the benefit plans maintained by Participating Employers and Other Employers.[5]

Interests in **[*Co.*]** will be offered to all Participating Employers. Those who accept will make a capital contribution to **[*Co.*]** in proportion to their respective interests in **[*BIT*]**.[6] As there are approximately one hundred sixty current members of **[*BIT*]**, including twenty-four national banks, the average ownership share in **[*Co.*]** would be unlikely to exceed two to three percent.

Initially, all members of **[*Co.*]** will be Participating Employers of **[*BIT*]**. However, at some point, interests in **[*Co.*]** may also be offered to Other Employers in order to induce them to purchase benefits through **[*Co*]**. In addition, up to a quarter of **[*Co.*]**'s total ownership may be set aside for potential incentive compensation to key **[*Co.*]** employees. A majority of the initial board of directors of **[*Co.*]** will be board members of **[*Inc.*]**.

[*Co.*] will apply under **[*State*]** law to be licensed as a third party administrator of benefit plans. The applicable **[*State*]** statutes clearly distinguish the administrator's duties and responsibilities from those of the insurance company and require the administrator to post a fidelity bond to protect customers.[7] After **[*Co.*]** receives this license, **[*Inc.*]** will assign to **[*Co.*]** its rights and obligations with respect to the administration of insurance contracts for Other Employers. **[*Co.*]** will also take over all administrative services for **[*BIT*]** members (the current Participating Employers) and will receive all fees and commissions paid by the Carriers and Participating Employers for those services. Any profits realized by **[*Co.*]** will be distributed to the owners of **[*Co.*]** in proportion to their respective ownership interests.

At this point, **[*BIT*]** and **[*Inc.*]** will elect one of two options, depending on the response of the IRS to a pending request for a ruling regarding **[*Co.*]**'s tax status. The preferred alternative is for **[*BIT*]** and **[*Inc.*]** to remain in existence, but with limited roles that would allow preservation of the goodwill and marketing power in the financial services industry that they have accumulated since they have been in business. **[*BIT*]**'s activities would be limited merely to marketing **[*Co.*]** membership to financial institutions, and **[*Inc.*]** would revert to its original role as **[*BIT*]**'s corporate trustee. However, in the event of an adverse IRS ruling on **[*Co.*]**'s tax status, then the parties will elect the other alternative, which is simply to dissolve both **[*BIT*]** and **[*Inc.*]** completely.[8]

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[5] The subsequent roles of **[*Inc.*]** and **[*BIT*]** will be determined based on a pending request for an IRS ruling. *See* discussion at n. 8, *infra*.

[6] It is expected that periodically, new Participating Employers of **[*BIT*]** will be offered interests in **[*Co.*]** and that **[*Co.*]** members who cease to be Participating Employers of **[*BIT*]** would have their interests in **[*Co.*]** retired.

[7] **[ ]**.

[8] Section 4986 of the IRC, 26 U.S.C. § 4986, imposes a one hundred percent excise tax on any portion of a welfare benefit fund (*i.e.,* **[*BIT*]**) that reverts to the employer. **[*Inc.*]** and **[*BIT*]** have requested an IRS determination whether the Participating Employers of **[*BIT*]**, upon becoming members of **[*Co.*]**, will be subject to this excise tax. If the IRS decides that the tax is owed, then **[*BIT*]** will simply be dissolved. Since the excise tax applies only if there is an existing "welfare benefit fund," **[*BIT*]**'s dissolution will render the issue moot.

Discussion

The OCC has traditionally recognized the authority of national banks to organize and perform any of their lawful activities in a reasonable and convenient manner not prohibited by law.[9] In a number of interpretive letters, the OCC has concluded that national banks are legally permitted to make a non-controlling investment in an enterprise provided four criteria or standards are met. These standards, which have been distilled from our previous decisions in the area of permissible non-controlling investments for national banks and their subsidiaries, 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 (or otherwise authorized for a national bank).

(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.

(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.

Based upon the facts presented, a national bank's investment in **[*Co.*]**, as proposed by **[*Inc.*]**, satisfies these four standards.

(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 (or otherwise authorized) for a national bank.

The National Bank Act, in relevant part, provides that national banks shall have the power:

> [t]o exercise…all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing and circulating notes….

The Supreme Court has held that this powers clause of 12 U.S.C. § 24(Seventh) is a broad grant of authority to engage in the business of banking, which is not limited to the five enumerated

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[9] *See, e.g.,* Interpretive Letter No. 943, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-468 (July 24, 2002); Interpretive Letter No. 890, *reprinted in* [2000-2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-409 (May 15, 2000); Interpretive Letter No. 854, *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-311 (Feb. 25, 1999); Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (Nov. 1, 1995).

powers. Further, national banks are authorized to engage in an activity if it is incidental to the performance of the enumerated powers in the statute or if it is incidental to the performance of an activity that is part of the business of banking.[10]

The OCC has previously stated that national banks are permitted to engage in the provision of employee benefit services and the administration of employee benefit plans. In Interpretive Letter No. 909, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-434 (May 2, 2001), the OCC permitted a national bank to hold a non-controlling equity interest in a corporation providing employee benefit services (including purchasing health, life, and retirement related benefits for the customers' employees) to community banks and their small business customers.

In Corporate Decision No. 2001-2 (January 9, 2002), the OCC reiterated that national banks may offer employee benefit consulting services to companies wishing to establish qualified benefit plans, and also that they may provide administrative services as part of that process. The providing of such benefits counseling is viewed as a form of financial planning services, an activity that has long been permissible for national banks. *See, e.g.,* Corporate Decision No. 98-13 (February 9, 1998). Administrative services necessary to implement such benefit plans are incidental to and a part of the permissible employee benefit services. Corporate Decision No. 98-51 (November 30, 1998); Conditional Approval No. 384 (April 25, 2000).

Since the proposed activities are permissible for a national bank, 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.

This is an obvious corollary to the first standard. It is not sufficient that the entity's activities are permissible at the time a bank initially acquires its interest; they must also remain permissible for as long as the bank retains an ownership interest.

You have represented that the limitations on activities of a third party administrator imposed on **[*Co.*]** under **[*State*]** law, as well as those set forth in its own governing documents, will serve to prevent **[*Co.*]** from deviating from the scope of permissible activities. However, in the unlikely event that **[*Co.*]** should undertake to exceed the permissible limits on its activities, every national bank Participating Employer will be able to withdraw its investment without incurring liability. Accordingly, the second standard is satisfied.

(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.

(a) Loss exposure from a legal standpoint.

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[10] *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.,* 513 U.S. 215 (1995).

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 the national bank's investment not expose it to unlimited liability. Normally, it is not a concern when a national bank invests in a corporation, since it is generally accepted that a corporation is an entity distinct from its shareholders, with its own separate rights and liabilities, provided proper corporate separateness is maintained.[11] That is the case here. As a limited liability company under **[*State*]** law, the corporate veil will protect the national bank Participating Employers from liability or loss associated with their ownership interests in **[Co.]**.[12] Further, as noted above (n. 7, *supra*), **[Co.]** will be required under **[*State*]** law to post a bond with the state as a condition of its licensure as a third party administrator. This will further insulate **[Co.]** shareholders from loss.

(b) Loss exposure from an accounting standpoint.

In assessing a bank's exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's less than twenty percent interest in a corporate entity is to report it as an unconsolidated entity under the equity or cost method of accounting. *See, e.g.,* Interpretive Letter No. 943, n. 9, *supra*.

You have advised OCC staff that of the twenty-four national banks that are currently Participating Employers and that are expected to invest in **[*Co.*]**, most will likely use the equity method of accounting. However, some may eventually choose the cost method of accounting. Since the OCC has noted that either method is appropriate for this type of investment, it is not necessary that each national bank elect between them at this time. As long as each national bank uses one of these two methods, the OCC's requirements in this matter will be satisfied.

Therefore, for both legal and accounting purposes, the national banks' potential loss exposure arising from their investment in **[*Co.*]** should be limited to the amount of their investment. Since that exposure will be both 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 that is not an operating subsidiary of the bank 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

[11] 1 W. Fletcher, Cyclopedia of the Law of Private Corporations § 25 (rev. perm. ed. 1990).

[12] **[ ]**

"convenient or useful."[13] OCC precedents on non-controlling investments by national banks have indicated that the investment must be convenient or useful to the bank in conducting *that bank's* business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.[14]

In this instance, the national bank Participating Employers' investment in **[*Co.*]** will allow them to operate more economically by reducing the cost of administering their employee benefit plans.[15] As discussed above, legal and regulatory constraints existing under the current structure prevent **[*Inc.*]** and **[*BIT*]** from remitting excess funds to the Participating Employers. The **[*Co.*]** arrangement, by permiting the remission of such funds to the participating banks, offers a more cost-effective alternative.

Further, the investment in **[*Co.*]** will allow participating national banks the opportunity to increase their marketability by enhancing the services they provide their business customers. Participating Employers will be able to add **[*Co.*]**'s employee benefit plan services to the list of financial planning and other services they offer, and thereby expand their potential customer base. *See* Interpretive Letter No. 909, *supra* at 5.[16]

Therefore, the investment is not a mere passive investment unrelated to the national banks' business, and the fourth standard is satisfied.

Conclusion

Based upon the information and representations you provided, and for the reasons discussed above, it is my opinion that national banks may make a non-controlling equity investment in **[*Co.*]**, subject to the following conditions:

(1) **[*Co.*]** will engage only in activities that are permissible for a national bank;

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[13] *See Arnold Tours, Inc., v. Camp*, 472 F. 2d 427, 432 (1st Cir., 1972).

[14] *See, e.g.,* Interpretive Letter No. 943, n. 9, *supra*; Interpretive Letter No. 875, *reprinted in* [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-369 (Oct. 31, 1999); Interpretive Letter No. 909, *supra* at 5; Interpretive Letter No. 890, n. 9, *supra*; Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (Feb. 13, 1991).

[15] *See* Letter from Julie L. Williams, Chief Counsel (April 3, 1997) (unpublished) (non-controlling investment in insurance company enables bank to reduce resources it currently devotes to its own insurance operations) ("Williams Letter"); Interpretive Letter No. 756, *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-120 (Nov. 11, 1996) (non-controlling investment in software vendor will give bank access to cost-effective software that will perform cash management product functions.)

[16] *See* Interpretive Letter No. 889, *reprinted* in [2000-2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-408 (April 24, 2000) (minority investment in electronic funds transfer network will allow banks to provide customers with access to convenient on-line services); Interpretive Letter No. 831, *reprinted in* [1997-1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-285 (June 8, 1998) (minority investment in limited purpose trust bank will allow bank to provide wider scope of trust services and to expand into new markets); Williams Letter, n. 15, *supra*.

(2) National banks will divest their respective interests in **[*Co.*]** in the event that **[*Co.*]** engages in any activity that is inconsistent with condition (1);

(3) National banks will account for their respective investments in **[*Co.*]** under the equity or cost method of accounting; and

(4) **[*Co.*]** will be subject to OCC supervision and examination, pursuant to 12 U.S.C. § 1867(c).

These conditions are conditions imposed in writing by the OCC in connection with this opinion letter stating that national banks' investment in **[*Co.*]** is permissible under 12 U.S.C. § 24(Seventh). As such, these conditions may be enforced in proceedings under applicable law.

If you have any questions, please contact Sue Auerbach, Counsel, Bank Activities and Structure Division, at 202-874-4662.

Sincerely,

signed

Eric Thompson
Director
Bank Activities and Structure Division