

Interpretive Letter #747

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12 U.S.C. 83

September 11, 1996

Dear []:

This is in response to your letter of June 20, 1996. I apologize for the delay. You requested an opinion as to whether it would be permissible for a national bank to purchase life insurance on a major shareholder for the purpose of providing liquidity to the shareholder's estate upon his or her death. Unfortunately, I cannot give you an affirmative response.

In your letter, you noted that a deceased stockholder's heirs may be liable for large estate taxes, forcing them to sell the shares to pay the taxes. Yet frequently, there is no market for a large block of shares in a closely held bank except to sell to an acquiring institution. You suggested a plan whereby a bank would purchase life insurance on its major stockholder, with the bank as owner and beneficiary of the policy. The bank would agree, upon the insured shareholder's death, to use the insurance death benefits to purchase the stock from the stockholder's estate. The shares would then be held as treasury stock. In your view, such a plan would benefit the bank, the decedent's estate, and the surviving shareholders. It would provide the shareholder's estate with the liquidity to pay taxes, while the bank and other shareholders would benefit because it would enable the bank to remain independent.

A national bank's legal authority to purchase life insurance is based on 12 U.S.C. 24(Seventh), which gives national banks the power to engage in activities that are incidental to the business of banking. The purchase of life insurance is incidental to banking if it is convenient or necessary in the conduct of the bank's business. Life insurance that is purchased primarily to accommodate the estate planning or cash flow needs of a bank or bank holding company shareholder, rather than the needs of the bank itself, does not meet this standard. <**NOTE:** The OCC's principal issuance on this subject is Banking Circular 249 (Rev.), May 9, 1991. This circular lists several uses for bank-owned life insurance that the OCC has found to be incidental to banking. These are key person life insurance, life insurance on a borrower, and life insurance purchased in conjunction with providing employee compensation or benefits.>

We have in the past considered various proposals containing elements of the plan that you suggest. For instance, in one case a national bank was to purchase life insurance on a major shareholder for the purpose of using the insurance proceeds to redeem the shareholder's stock upon his death, in order to prevent a possible decline in the price of

the stock if the shareholder's estate were to sell the shares. In analyzing this plan, we recognized that a national bank may have an interest in the share price of its stock due to its reflection of market sentiment about the bank. Nevertheless, we concluded that the purchase of life insurance for this purpose is not incidental to the business of banking. Letter from Horace G. Sneed, Senior Attorney, September 22, 1994 (unpublished).

Another plan that we could not approve was one in which a bank purchased life insurance on its president, who was the majority shareholder of the bank's holding company. Upon the president's death, the bank was to dividend the insurance death benefits to the holding company to enable it to redeem its shares from the president's estate. We concluded that this was not a purpose that was incidental to banking under 12 U.S.C. 24(Seventh). Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division, November 14, 1990 (unpublished). *See also* letter from Stephen B. Brown, Attorney, Southwestern District, May 2, 1989 (unpublished) (bank purchase of life insurance on its president, who was also majority shareholder of BHC, to pay BHC debt and avoid "earnings pressure" on the bank); letter of John R. Powers, District Administrator, Midwestern District, January 21, 1992 (unpublished) (bank purchase of life insurance on holding company directors to fund stock redemption agreements between directors and holding company).

A further drawback to your proposal is the fact national banks generally are prohibited by 12 U.S.C. 83 from repurchasing their shares and holding them as treasury stock. The OCC recognizes certain limited exceptions to this prohibition if the holding of treasury stock is for a legitimate corporate purpose. Interpretive Ruling 7.2020, 61 Fed. Reg. 4849, 4868 (1996) (to be codified at 12 C.F.R. 7.2020). Such purposes may include holding shares in connection with an officer or employee stock option or bonus plan, holding stock for sale as qualifying shares to a potential director, or purchasing director qualifying shares upon the death or resignation of a director if there is no ready market for the shares. Any share repurchases must be accomplished as a reduction in capital under 12 U.S.C. 59, which requires shareholder approval. Interpretive Letter No. 660, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,608, December 19, 1994. In my opinion, repurchasing bank shares simply to accommodate the estate planning or cash flow needs of a bank shareholder would not qualify for an exception to 12 U.S.C. 83. < **NOTE:** The exception for repurchasing director qualifying shares would probably be of little help in the situations you describe, since the amount of stock that directors are required by law to own is fairly minimal. *See* 12 U.S.C. 72.>

Please note, however, that a national bank may certainly purchase life insurance upon a shareholder who is also a director, officer, or employee as part of a reasonable compensation or benefit plan as described in Banking Circular 249, and the insured may designate his or her heirs as beneficiaries. This would at least partially accomplish the objectives that you outlined, especially if supplemented by the shareholder's personal insurance.

I am sorry that I could not give you a more positive response. However, I hope that this was responsive to your inquiry. If you have further questions, please feel free to contact me at (202) 874-5300, or National Bank Examiner Morris Morgan at (202) 874-5170.

Sincerely,

/s/

Christopher C. Manthey
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Bank Activities and Structure Division