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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

**Corporate Decision #97-79  
September 1997**

July 11, 1997

Ms. Linda M. Crouch  
Baker, Donelson, Bearman & Caldwell  
First Tennessee Building  
165 Madison Avenue  
Suite 2000  
Memphis, TN 38103

Re: Application of First Tennessee Bank, N.A., to Establish a New Operating Subsidiary through the Acquisition of Federal Flood Certification Corporation  
Application Control No: 97-SE-08-0025

Dear Ms. Crouch:

This responds to the application of First Tennessee Bank, N.A., Memphis, Tennessee ("Bank"), to acquire Federal Flood Certification Corporation ("Federal Flood") as an operating subsidiary. Federal Flood conducts flood hazard determinations which mortgage lenders are required to make or obtain in connection with their real estate lending. Once acquired by the Bank, Federal Flood will make flood hazard determinations for the Bank, its affiliates, and other mortgage lenders. Based on the information and representations you provided and the reasons discussed below, the Bank's application is hereby approved.

**Background**

The Bank has applied for permission to acquire 100 percent of the outstanding common stock of Federal Flood pursuant to 12 C.F.R. § 5.34(d). To accomplish the acquisition, the Bank's parent holding company, First Tennessee National Corporation ("FTNC") will form an acquisition subsidiary that will merge with Federal Flood. FTNC will direct that the stock of the surviving corporation be issued to the Bank. Thus, FTNC will never directly own the Federal Flood shares. The transaction will not require any investment by the Bank, since the purchase price will be funded by FTNC and the Bank will acquire the stock of Federal Flood through this merger procedure.<sup>1</sup>

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<sup>1</sup> The Federal Reserve Board has informally taken the position that a donation to a subsidiary bank by a holding company of stock of a non-bank affiliate, when the affiliates has liabilities owed to affiliates of the bank, is a

Federal Flood performs certain services that are essential for making loans in flood-prone areas. The National Flood Insurance Program<sup>2</sup> mandates that lenders making loans, or servicing loans for the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation, require borrowers to purchase flood insurance if their loans are secured by improved real estate or a mobile home located in an area designated by the Federal Emergency Management Agency (“FEMA”) as a special flood hazard area. In order to determine which borrowers are required to purchase flood insurance, a lender must obtain a flood hazard determination for the property.

Federal Flood reviews residential and commercial real property to determine whether such properties require flood insurance coverage in accordance with applicable federal law, rules and regulations. It provides flood zone information to mortgage lenders by identifying the location of the collateral on a FEMA flood map and by providing certification to the mortgage lenders as to whether such property is located in a special flood hazard area. Federal Flood monitors the status of the flood zone during the term of the loan. Along with the standard flood hazard determination, Federal Flood prepares a borrower flood notice whereby the lender informs the borrower of the requirement to purchase flood insurance on the property. Once this notice is returned, signed by the borrower, the lender keeps it in its file for the term of the loan. If the borrower does not purchase such insurance, the lender must do so on behalf of the borrower.

Once acquired by the Bank, Federal Flood will provide flood plain certification services to the Bank and its affiliates, in connection with their real estate lending programs. In addition, Federal Flood will continue to market its services to other unaffiliated mortgage lenders throughout the United States. The Bank plans to retain Federal Flood’s current management, while one Bank officer will become the company’s sole director.

## **Discussion**

### *A. Statutory Framework*

The National Bank Act 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

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purchase of assets and thus a “covered transaction” under section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, the value of which is measured by the amount of the interaffiliate liabilities. The Bank’s counsel has represented that Federal Flood has no liabilities to affiliates of the Bank.

<sup>2</sup> See the National Flood Insurance Act of 1968, the Flood Disaster Protection Act of 1973 and the National Flood Insurance Reform Act of 1994, 12 U.S.C. §§ 4001-4129.

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 . . . .

12 U.S.C. § 24(Seventh).

The Supreme Court has held that this clause is a broad grant of power to engage in the business of banking, which is not limited to only the five specifically recited activities. National banks therefore have the ability to conduct activities beyond those specifically enumerated in the statute. *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.*, 115 S.Ct. 810 (1995) (“VALIC”).

Judicial precedent reflects three general principles used to determine whether an activity is part of the business of banking: (1) whether the activity is functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) whether the activity would benefit bank customers or is convenient or useful to banks; and (3) whether the activity involves risks similar in nature to those already assumed by banks. See, e.g., *Merchants’ Bank v. State Bank*, 77 U.S. 604 (1871); *M & M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978); *American Insurance Association v. Clarke*, 865 F.2d 278, 282 (2d Cir. 1988).

#### *B. Flood Hazard Determination is Part of the Business of Banking*

The Bank is required by law to determine whether a property held as security against a loan is located in a special flood hazard area. The OCC has issued regulations at 12 C.F.R. Part 22 to implement this requirement. Under these regulations, “[a] bank shall not make, increase, extend, or renew any designated loan unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan.” 12 C.F.R. § 22.3(a). The regulations also recognize that banks can either make this determination themselves, or hire a servicer to do it, and charge borrowers a reasonable fee for these services. 12 C.F.R. § 22.8(a).

Because a national bank clearly has the authority to make flood hazard determinations, and indeed it must do so, a national bank’s operating subsidiary may also engage in these activities on behalf of the bank. In short, the Bank can either engage in the activity itself or rely upon Federal Flood to provide the service for it. See generally 12 C.F.R 5.34(d)(1) (an operating subsidiary can engage in activities that are part of or incidental to the business of banking pursuant to 12 U.S.C. § 24(Seventh)).

#### *C. Providing Flood Hazard Determinations as a Correspondent Service to Mortgage Lenders is Part of the Business of Banking*

Providing mortgage lenders with flood hazard determination services to meet their real estate lending needs satisfies each of the three general business of banking principles.

*1. The activities are functionally equivalent to or a logical outgrowth of a recognized banking activity.*

The flood hazard determination and certification service that Federal Flood will offer to other lenders is related to and a logical outgrowth of the service it will render to the Bank in the Bank's own mortgage lending. It is a correspondent service similar to many others that national banks have traditionally performed for financial institutions with whom they maintain relationships.

In *United States v. Citizens and Southern Nat'l Bank*, 422 U.S. 86, 114-15 (1975), the Supreme Court observed:

Dating back to colonial times, correspondent banking originally provided an extended network of independent unit banks with a link to financial centers, and at the same time furnished substitute central banking functions. Today, as a vital component of the era of electronic banking, it enables city correspondents to provide customers with a range of services that is varied, extensive and constantly expanding; one survey lists as many as fifty different categories.

The Court then noted that “[a]mong the services typically provided within a conventional correspondent arrangement are check clearing, help with bill collections, participation in large loans, legal advice, help in building securities portfolios, counseling as to personnel policies, staff training, help in site selection, auditing, and the provision of electronic data processing.” *Id.*

The OCC too has long recognized that national banks are authorized to offer correspondent services to others that involve activities that the banks themselves do on behalf of their own customers or as an aspect of conducting their own business operations. See, e.g., Interpretive Letter No. 513, *reprinted in [1990-1991 Transfer Binder]* Fed. Banking L. Rep. (CCH) ¶ 83,215 (June 18, 1990) (permitting national banks to provide other financial institutions with loan application and disclosure documents, mail room processing, bank communication support services, and courier services); Interpretive Letter No. 493, *reprinted in [1989-1990 Transfer Binder]* Fed. Banking L. Rep. (CCH) ¶ 83,078 (November 22, 1989) (permitting national banks to perform traditional back office operations and customer services for other financial institutions); Interpretive Letter No. 467, *reprinted in [1988-1989 Transfer Binder]* Fed. Banking L. Rep. (CCH) ¶ 85,691 (January 24, 1989) (permitting national banks to offer real estate appraisal services to other financial institutions); Interpretive Letter No. 137, *reprinted in [1981-1982 Transfer Binder]* Fed. Banking L. Rep. (CCH) ¶ 85,218 (December 27, 1979) (permitting national banks to pass on the benefits of their experience in managing a bank, improving the efficiency of internal operations, and marketing bank services).

Interpretive Letter No. 467, *supra*, approved an operating subsidiary to perform real estate appraisals as a correspondent service for other financial institutions. In doing so, the letter stated that “[t]he performance of real estate appraisals for a bank’s own loans is an activity traditionally engaged in by banks. Such appraisals are obviously a necessary element of real estate lending . . . . Thus, a national bank may perform real estate appraisals . . . for other financial institutions pursuant to 12 U.S.C. § 24(Seventh).” Likewise here, flood hazard determinations are a necessary element of real estate lending and the operating subsidiary may perform these determinations for its parent Bank and for other lenders.

*2. The activities benefit bank customers or are convenient or useful to banks.*

Federal Flood will respond to the needs of banks and other mortgage lenders by providing them with flood hazard determinations for use in connection with their real estate loans. This will be a convenient and useful service for these lenders. Moreover, by marketing its services to others as well as to the parent Bank, Federal Flood will be able to fully utilize its resources and expertise. This is similar to the situation contemplated by Interpretive Ruling 7.1019, 12 C.F.R. § 7.1019, involving the furnishing of products and services by electronic means and facilities. This ruling permits a national bank, “in order to optimize the use of the bank’s resources, [to] market and sell to third parties electronic capacities acquired or developed by the bank” for its own use. See also Interpretive Letter No. 754, reprinted in [Current] Fed. Banking L. Rep.(CCH) ¶ 81,118 (November 6, 1996) permitting an operating subsidiary to provide computer networking packages for other financial institutions. This was viewed as being beneficial to the parent bank because it allowed it to “utilize and be compensated for its expertise” in maintaining current account information on customers by electronic means.

*3. The activities involve risks similar in nature to those already assumed by banks.*

A lender who makes an erroneous flood hazard determination may be liable for losses suffered by the borrower as a result of the error. If the lender makes a determination that a property is outside of a flood hazard zone when it is actually in a flood hazard zone, and the property is subsequently flooded and damaged or destroyed, the lender could be liable for losses up to what would have been paid had the property been properly insured. If the determination states that a property is in a flood hazard zone when it is not, then the lender could be liable for the amount paid for unneeded insurance. These risks associated with making erroneous flood hazard determinations are undertaken by banks and other mortgage lenders under the law. They are the same risks that will be undertaken by Federal Flood.

While the extent of the risk will be increased because of the greater number of flood hazard determinations Federal Flood will perform for other lenders besides the Bank, the nature of the risk remains exactly the same as if Federal Flood only provided flood hazard determination services for the Bank. An analogy can be drawn to making loans. Just as a bank incurs a credit risk when it makes one loan to a borrower, it incurs the same kind of risk, credit risk, when it makes many more loans to many different borrowers. The risk is the same, *i.e.*, the

risk that the borrower or borrowers will not repay their loans, but the likelihood of borrower default increases. The greater risk of loss is compensated for by the fact that the lender is receiving interest on many more loans that are being repaid on schedule.<sup>3</sup>

### **Conclusion**

Based upon the foregoing facts and analysis, and the commitments and representations made by the Bank in connection with its request, the Bank's application to acquire Federal Flood as an operating subsidiary to perform flood hazard determinations for the Bank, its affiliates, and other mortgage lenders, is hereby approved.

If you have any questions regarding this decision, please contact Senior Bank Structure Analyst John W. Graetz at (202) 874-5060 or Licensing Manager John O. Stein in our Southeastern District at (404) 588-4525.

Sincerely,

/s/

Julie L. Williams  
Chief Counsel

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<sup>3</sup> We also note that Federal Flood maintains a substantial errors and omissions insurance coverage and contractually obligates itself to its clients to maintain in effect at all times at least \$5 million of such insurance coverage.