Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

March 17, 1998

Interpretive Letter #826
May 1998
12 U.S.C. 24(7)

Re: [ ] Insurance Company Separate Account Product

Dear [ ]:

This responds to your letter dated August 20, 1997, requesting an opinion from the Office of the Comptroller of the Currency ("OCC") that a national bank may purchase an interest in an insurance company separate account that will in turn invest in bank-eligible securities, and a clarification of the appropriate risk-based capital treatment for the interest. You made this request on behalf of the creator of this separate account product, [ ], Inc. ("*subsidiary*"), a wholly-owned subsidiary of [ ] Insurance Company ("*parent* "). Based upon your representations in your request for interpretive advice, we have concluded that the proposed investment is permissible for national banks. Our conclusion might differ if the activity is in any way materially different from what you have described.

I. BACKGROUND

The [ ] separate account (" ") is a pool of assets [*parent*] holds for the benefit of multiple account holders. A bank would enter into a contractual agreement ("Funding Agreement") with [*parent*], under which [*parent*] would receive funds from the bank to purchase securities permissible for direct investment by a national bank pursuant to 12 C.F.R. Part 1 ("bank-eligible investments"). These securities consist of U.S. Treasury securities, Agency notes and debentures and government sponsored enterprise ("GSE") obligations.[1] [*Subsidiary*] would actively manage the account, and [*parent*]

[1] [*Parent*] has represented that the separate account will, for purposes of hedging price and interest rate exposure, enter into exchange-traded and over-the-counter futures and options transactions; interest rate swaps, caps and floors; short sales of U.S. Treasury and Agency securities; and covered dollar rolls, with the proceeds reinvested in short-term

would make monthly payments to the bank consisting of a return of principal plus interest. [*parent*] provides a guarantee that it will pay the participating bank the book value of the bank's investment, less any principal previously returned, either at the specified maturity date, or at the time of early termination of the Funding Agreement by [*parent*], pursuant to its terms. [*Parent*] would not guarantee the payment of interest. [*Parent*] would receive an expense charge and [*subsidiary*] would receive a performance-based incentive fee as compensation, both paid monthly.

Pursuant to the terms of the Funding Agreement between a bank and [*parent*], securities held by [*parent*] in the [ ] separate account for the benefit of a bank may not be charged with liabilities arising from other business of [*parent*]. [*Parent*] has procured an opinion of the Massachusetts Division of Insurance ("Division of Insurance"), in which the Division of Insurance represents that this outcome is dictated by applicable Massachusetts law (Mass. Gen. L. ch. 175 §§ 132F and 132G), and that the Division of Insurance would handle any receivership proceeding in accordance with its ruling. The Division of Insurance has also stated that the "funds [in the separate account] … would be available exclusively, to the extent necessary, to satisfy claims of the holders of such separate account products . . ."[2]

II. DISCUSSION

A. Qualification as a Permissible Investment

In our view, a bank's investment in the [ ] account represents a permissible investment. A national bank may purchase "investment securities" for its own account, subject to limitations prescribed by the OCC. See 12 U.S.C. § 24(Seventh). The OCC defines an investment security to be "a marketable debt obligation that is not predominantly speculative in nature. A security is not predominantly speculative in nature if it is rated investment grade. When a security is not rated, the security must be the credit equivalent of a security rated investment grade." 12 C.F.R. § 1.2(e). A security is considered to be "marketable" if it is "offered and sold pursuant to Securities and Exchange Commission ("SEC") Rule 144A," and is "rated investment grade or the credit equivalent of investment grade." 12 C.F.R. § 1.2(f)(3).

Funding Agreements qualify as Type III investment securities. See 12 C.F.R. § 1.2(k). There is no definition of a debt security in 12 C.F.R. Part 1. Paragraph 137 of Financial Accounting Standard 115 defines a debt security as "any security representing a creditor

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investments maturing within five days of the maturity date of the corresponding dollar roll.

[2] See letter of Daniel R. Judson, Deputy General Counsel, Massachusetts Division of Insurance (July 13, 1994).

relationship with an enterprise." [*Subsidiary*] has obtained an accounting opinion that Funding Agreements are debt securities for purposes of this definition.[3] Although Funding Agreements are not rated securities, you have represented that because [*parent*]'s debt has investment grade ratings (AA + by Standard & Poors, AAA by Duff & Phelps, and Aa2 by Moody's), Funding Agreements are the credit equivalent of investment grade securities. [*Parent*] also would privately place Funding Agreements to banks pursuant to SEC Rule 144A, 17 C.F.R. § 240.144A, thus making them marketable for purposes of Part 1. See 12 C.F.R. § 1.2(f)(3). A bank must limit its holdings of the Type III securities of any one issuer to 10% of the bank's capital and surplus. See 12 C.F.R. § 1.3(c).

As an investment security, an [ ] Funding Agreement is comparable to investments in mutual funds composed of bank-eligible securities. A national bank may purchase shares of mutual funds which invest solely in bank-eligible securities, subject to the investment limitations set forth in 12 C.F.R. § 1.4(e). See 12 C.F.R. § 1.3(h).

With both a mutual fund and [ ], an identifiable entity (either an investment company or a separate account) holds a pool of assets for the benefit of holders of shares of the identifiable entity. However, [ ] differs from a mutual fund in that [*parent*] provides a guarantee of principal for holders of [ ] Funding Agreements, a feature that shares of a mutual fund generally do not possess. The [ ] separate account is not a registered investment company under the Investment Company Act of 1940, because the separate account qualifies for an exemption from registration. An exemption from registration is available for issuers whose securities are owned exclusively by "qualified purchasers," and where there is no public offering of the securities. See 15 U.S.C. § 80a-3(c)(7). A "qualified purchaser" includes, among other things, any person, acting for its own account or the accounts of other qualified purchasers, who in the aggregate owns and invests on a discretionary basis, not less than $25 million in investments. See 15 U.S.C. § 80a-2(a)(51)(A)(iv). [*Parent*] requires that investors in [ ] be "qualified purchasers" to maintain the separate account's exemption from registration.

The assets held by [*parent*] in the separate account are also securities which a national bank is authorized to purchase directly. [*Subsidiary*] uses the funds deposited in the [ ] account to purchase bank-eligible U.S. Treasury, Agency and GSE debt securities, and the bank receives a return on its investment based on the interest earned on those bank-eligible securities. Although [*parent*] retains legal title to the securities in the separate account, it holds those securities for the benefit of the holders of Funding Agreements. In the event that [*parent*] becomes insolvent, its receiver may not apply

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[3] See letter of Arthur Andersen, LLP to [*subsidiary*] (May 27, 1997), stating that it is appropriate to classify an interest in the [ ] account as a debt security due to its fixed maturity date, fixed guaranteed principal amount, and payment of interest on a monthly basis.

those securities in satisfaction of any general creditor of [*parent*]. Instead, the funds in the separate account are available to satisfy claims of the account holders. Thus, the benefits of owning the bank-eligible securities in the separate account pass through to the bank, while the guarantee of principal by [*parent*] protects the bank against loss in the value of its investment. At its most elementary level, the [ ] separate account is simply another conduit through which a bank can purchase bank-eligible securities, with the additional safety that [*parent*]'s guarantee provides.

B. Capital Treatment

The [ ] separate account is comparable to an investment in a mutual fund composed of bank-eligible securities, and as such would qualify for a 20% risk weight. The appropriate risk weight for an indirect holding in a pool of assets is the risk category of the highest risk-weighted assets that the pool is permitted to hold pursuant to its stated investment objectives. See 12 C.F.R. Part 3, Appendix A, § 3. [*Parent*] has stated in its draft prospectus that the [ ] account will hold only assets qualifying for risk weights no greater than 20%.

It is the responsibility of individual bank participants to obtain sufficient information to demonstrate that the Funding Agreement qualifies for a 20% risk weight. If sufficient information is not available to make this determination, the bank must apply the default risk weight of 100%. [*Parent*] will provide information on a quarterly basis to each bank that enters into a Funding Agreement, concerning the market value of the securities in the [ ] separate account. It is the bank's responsibility to ensure that it adjusts its risk weight calculations to account for any drop in the market value of the securities below the book value of the investment.

III. CONCLUSION

Based upon the foregoing facts and analysis, and the representations in your request for interpretive advice, we conclude that an interest in the [ ] account proposed by [*parent*] would be a bank-eligible product, providing that for a particular institution, entry into the [ ] Funding Agreement is consistent with safe and sound banking practices. Our conclusion might differ should the [ ] program differ in any material way from what you have described.

Sincerely,

/s/

Julie L. Williams
Chief Counsel

[12 USC 24(7)92]