



Comptroller of the Currency
Administrator of National Banks

Licensing Department
250 E Street, SW
Washington, DC 20219

Corporate Decision #2012-11
June 2012

May 22, 2012

Mr. Charles A. Beard
President and CEO
Commercial Banking Company
Post Office Box 100
Valdosta, Georgia 31603-0100

Subject: Contribution to Capital – Bank-Owned Life Insurance
NATS No: R2-2012-0028 Charter Reference No: 713248

Dear Mr. Beard:

This is in response to your letter of January 31, 2012, requesting OCC approval for Commercial Banking Company (CBC) to treat the cash surrender value (CSV)¹ of certain bank-owned life insurance (BOLI) policies as a contribution to capital. CBC is a federal savings association formerly regulated by the Office of Thrift Supervision (OTS) and now regulated by the OCC.² After careful consideration under the applicable standards as discussed herein, the OCC approves this request pursuant to the guidelines contained in section 110 of the Examination Handbook (Handbook) of the former OTS, which continue to be applicable.³

Background

In March 2010, CBC's holding company transferred ownership of seven whole life BOLI policies with a CSV of \$2,874,926 to CBC, with the intention that the CSV of these policies should count as a contribution to CBC's capital.⁴ The current CSV is \$3,073,667. You have

¹ CSV is the amount available to a whole life insurance policyholder if the policy is surrendered (term life does not have a CSV). CSV normally increases every year unless a policy loan has been taken out.

² Under Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub L. No. 111-203, 124 Stat. 1376 (2010), the OCC assumed all functions of the OTS relating to federal savings associations effective July 21, 2011 ("Transfer Date").

³ All OTS regulations, guidelines, procedures, and other advisory materials remain in effect until modified, terminated, set aside, or superseded by the OCC. Dodd-Frank Act § 316(b)(2). The OCC has not rescinded or modified this section of the Handbook.

⁴ The BOLI policies are on certain key officers of CBC.

Mr. Charles A. Beard
NATS No: R2-2012-0028
May 23, 2012

stated that CBC did not need to raise additional capital. Rather, the contribution was made to enhance CBC's capital levels for possible long term growth. Subsequently, CBC was advised by the OTS that it should have received OTS approval under section 110 of the Handbook for this transaction. CBC then requested such approval, but no decision was made prior to the Transfer Date. You have now renewed this request with the OCC.

Legal Analysis

Federal savings associations are authorized to hold BOLI as an activity incidental to powers granted under section 5 of the Home Owners' Loan Act, 12 U.S.C. § 1464. Thus, BOLI is legally permissible for CBC to hold. Moreover, the BOLI in question here complies with the legal requirements and supervisory guidance of the 2004 *Interagency Statement on the Purchase and Risk Management of Life Insurance (Interagency Statement)*, which was issued jointly by the OCC, OTS, and other federal financial regulators.⁵ Therefore, the only remaining issue is its treatment for capital purposes. There is no former OTS regulation that specifically applies to noncash contributions to capital. However, Handbook section 110, Capital, provides that a federal savings association may accept noncash forms of contributed capital if the association receives prior approval from the OTS Regional Director. Section 110 then lists a number of criterion that the OTS would consider in making such a decision.

As previously noted, section 110 of the Handbook is still in effect for institutions formerly regulated by the OTS so it is the governing regulatory authority for this transaction. The OCC has considered the criteria in section 110 and finds that they are consistent with approval of CBC's request. The factors, along with our analysis, are:

- The assets are separable and capable of being sold apart from the savings association or from the bulk of the savings association's assets.

The policies in question are clearly identifiable, individual policies that can be sold separately from CBC's other assets. A whole life policyholder has the absolute right to surrender the policy to the insurance carrier and receive the CSV without penalty, generally within 60 days. In our opinion, this ability to redeem a BOLI policy with the insurance carrier in an easy and expeditious manner is equivalent to being able to sell it. In addition, there are investors who purchase life insurance policies, so an actual sale is also possible.

- The savings association has established an independent market value of the assets and demonstrated that such assets are likely to hold their market value in the future or that the association has established a process for periodic, independent revaluation of the assets.

⁵ OCC Bulletin 2004-56 (Dec. 7, 2004); OTS Thrift Bulletin 84 (Dec. 14, 2004).

The CSV of a whole life policy generally sets the lower bound for its market value,⁶ so CBC has, in this case, established an independent market value for the BOLI. CSV is readily ascertainable at any time by contacting the insurance company, so BOLI policies can be revalued periodically. As noted in footnote 1, *supra*, the CSV of a life insurance policy normally increases every year unless the policyholder has borrowed against the policy. Therefore, BOLI policies are likely to hold their market value, as required by section 110.

- The transaction is in compliance with 12 C.F.R. 563.41 (now section 163.41).

Section 163.41 refers federal savings associations to the regulations of the Board of Governors of the Federal Reserve System governing transactions with affiliates. CBC's holding company is an affiliate of CBC, but it donated the BOLI to CBC. Therefore, this is not a purchase of assets from an affiliate or other type of covered transaction under Federal Reserve Regulation W, 12 C.F.R. Part 223.

- The financial condition and adequacy of capital of the savings association.

As of March 31, 2012, CBC is well-capitalized, with a Tier 1 (Core) Capital ratio of 17.55 percent and a Total Risk-Based Capital ratio of 18.80 percent. CBC is also profitable, reporting net income of \$1.3 million in calendar year 2011. We therefore find that this criterion is satisfied.

In addition, pursuant to section 110, the OCC generally will not approve noncash contributions to capital that constitute more than 25 percent of capital, unless good cause is demonstrated.⁷ Here the proposed noncash contribution to capital is less than 25 percent, and therefore within the concentration limitation.

Having ascertained that these BOLI policies satisfy the criteria for approval set forth in the Handbook, we must also look to applicable capital regulations to see if BOLI is disqualified from being included in a federal savings association's capital. We find that it is not. BOLI, like other assets, is included in common stock surplus, an element of common stockholders' equity.⁸ Common stockholders' equity is part of a federal savings association's core (Tier 1) capital.⁹ Various items must be deducted from Tier 1 capital, but BOLI is not such an item.¹⁰ Accordingly, the CSV of BOLI is includable as part of Tier 1 capital.

⁶ See ASC 820-10-15-4&5 (Fair Value Measurements of Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)).

⁷ With respect to BOLI, this threshold is consistent with the *Interagency Statement* that it is generally not prudent for an institution to hold BOLI with an aggregate CSV that exceeds 25 percent of the institution's capital.

⁸ 12 C.F.R. § 167.1.

⁹ 12 C.F.R. § 167.5(a) (1). "Core capital" is equivalent to Tier 1 capital. 12 C.F.R. § 167.1.

¹⁰ 12 C.F.R. § 167.5(a) (2).

Mr. Charles A. Beard
NATS No: R2-2012-0028
May 23, 2012

There is also no policy reason not to allow the CSV of this BOLI to be counted as capital. If the holding company had injected cash into CBC and CBC had then purchased the BOLI itself, there would be no question that it would count as capital. Therefore, we believe it is not appropriate to treat this BOLI differently simply because it was contributed instead of purchased, as long as the BOLI continues to adhere to the guidance outlined in the 2004 *Interagency Statement*, including the 25 percent concentration limitation.

Conclusion

For the reasons discussed above, I conclude that the CSV of the BOLI policies discussed in your letter of January 31, 2012, may be included in CBC's Tier 1 capital.

If you have any questions, you may contact Patricia Roberts, Senior Licensing Analyst, at (202) 874-5637.

Sincerely,

Stephen A. Lybarger

Stephen A. Lybarger
Deputy Comptroller for Licensing