



# Office of the Comptroller of the Currency

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## Interpretive Letter #755

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October 3, 1996

**12 U.S.C. 24(7)68**

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Dear [ ]:

This is in response to your letter requesting permission, on behalf of [ ] ("Bank"), (**NOTE:** [ Bank ] is a wholly-owned subsidiary of [ ] Corporation ("C"). [ C ] is also the sole shareholder of one other national bank, [ Bank 2 ], [ City ], [ State ] and seven state-chartered banks. On [date], the Bank received OCC approval to merge with its bank affiliates. [ Bank ] will be the surviving charter of the merger. Accordingly, the term "Bank" refers to both national bank subsidiaries of [ C ] prior to the merger, and to [ Bank ] after the merger.) to hold Federal Home Loan Bank ("FHLB") stock in excess of the minimum amount necessary for FHLB membership and in excess of the minimum amount required to support existing borrowings from the FHLB. Based on the analysis below, we have determined that national banks may purchase and hold FHLB stock ("Stock") in excess of the minimum required for FHLB membership, where those purchases would facilitate plans, as documented in banks' business plans or similar documents, to fund residential housing finance assets.

### **Background**

The Bank is a FHLB member and borrows from the FHLB to fund residential housing finance assets. The Bank currently holds Stock in excess of the minimum amount required for membership in the FHLB system. Moreover, it holds Stock in excess of the amount required to support its present level of FHLB borrowings. According to your letter, the excess Stock is being held in anticipation of future FHLB borrowings which will be used to support additional residential mortgage lending. [ C ] management represents that its current business plan shows an anticipated increase in residential mortgage loans for the Bank.

### **Analysis**

*Authority of National Banks to Acquire Stock Required for FHLB Membership Under the Federal Home Loan Bank Act and Implementing Regulations*

The Federal Home Loan Bank Act expressly allows national banks and other insured depository institutions to become members of individual FHLBs and further requires stock holdings as a condition

of such membership. In the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"), P.L. 101-73, 103 Stat. 415, Congress amended the Federal Home Loan Bank Act, 12 U.S.C. § 1421 *et seq.*, to permit insured depository institutions, including national banks, to become FHLB members. *See* 12 U.S.C. §§ 1422(12), 1424(a), and 1813(c)(2). (NOTE: ". . . [A]ny insured depository institution . . . shall be eligible to become a member of a Federal Home Loan Bank if such institution -- (A) is duly organized under the laws of . . . the United States; (B) is subject to inspection and regulation under the banking laws . . . of the United States; and makes such home mortgage loans as, in the judgment of the Board, are long term loans. . . ." 12 U.S.C. § 1424(a)(1). An "insured depository institution" as used in section 1424(a)(1) has the same meaning as in 12 U.S.C. § 1813, i.e., "any bank . . . the deposits of which are insured by the [FDIC]." 12 U.S.C. § 1813(c)(2). FIRREA also repealed section 27 of the Federal Home Loan Bank Act, 12 U.S.C. § 1447, which had expressly prohibited national banks from becoming members of, and subscribing for Stock in, FHLBs.) The basic advantage to membership in FHLBs is the ability to obtain advances from a FHLB to fund "residential housing finance assets," defined in FHLB regulations to include mortgage loans, mortgage-backed securities, and participations in loans secured by residential real property. 12 C.F.R. § 935.1. A FHLB can make advances to a member that is not a savings association in an amount up to 20 times the amount paid in by such member for Stock, multiplied by a member's "actual thrift investment percentage" ("ATIP"). (NOTE: "Actual thrift investment percentage" is defined in 12 U.S.C. § 1467a(m)(4) as the amount of qualified thrift investments (loans made to purchase, refinance, construct, improve or repair domestic residential or manufactured housing; home equity loans; mortgage-backed securities; or existing obligations of deposit insurance agencies) divided by the amount of total portfolio assets.) 12 C.F.R. § 935.13(a).

The Federal Home Loan Bank Act requires national banks that become FHLB members to purchase and own Stock. 12 U.S.C. § 1426(b)(1). Members must make a "minimum" Stock purchase in an amount equal to one percent of the member's aggregate outstanding mortgage loans, but not less than \$500. *Id.*; 12 C.F.R. § 933.7(a)(1). FHLBs adjust annually the minimum amount of Stock they require members to hold. 12 U.S.C. § 1426(b)(1) ; 12 C.F.R. § 933.9(b)(1). If the investment of any member in Stock is greater than that required under the statute, the FHLB "may . . . in its discretion and upon application of such member retire the stock of such member in excess of the amount so required." 12 U.S.C. § 1426(b)(1) (emphasis added); *see* 12 C.F.R. § 933.9(b)(2). Since the statute and regulations provide for the retirement of Stock only after application by a member and at the FHLB's discretion, this regulatory scheme contemplates that a FHLB member can in some circumstances retain, rather than retire, Stock in amounts that exceed the minimum amount required for membership in any given year. FHLB regulations also permit a member to purchase stock in excess of the minimum holding requirement if the laws under which the member operates permit such excess holdings. 12 C.F.R. § 933.10.

### *National Banks May Retain Stock in Excess of the Minimum Required for Membership in a Federal Home Loan Bank.*

The Federal Home Loan Bank Act clearly provides insured depository institutions, including national banks, the authority to hold that amount of Stock required initially for membership in a Federal Home Loan Bank. (NOTE: The National Bank Act generally prohibits banks from owning equity securities, with limited enumerated exceptions. Stock is not among the enumerated securities that national banks may purchase. The Federal Home Loan Bank Act only authorizes national banks that are FHLB members to purchase Stock.) *See* 12 U.S.C. § 1426(b)(1). The statute also imposes continuing minimum Stock ownership requirements and permits members to make additional Stock purchases to meet those requirements. The statute by its terms does not provide a mechanism in subsequent years for the automatic sale or retirement of a member's Stock that exceeds minimum required levels for membership, whether due to decreased levels of mortgage lending or for any other reason. Rather, the statute gives the FHLBs the discretion, but not a mandate, to

retire members' excess Stock holdings. Thus, there is an implicit recognition in the language of the statute itself that members may *retain* Stock that exceeds the amount necessary for membership, unless the member applies, and the FHLB in its discretion agrees, to retire the shares of Stock. This interpretation is essential in cases where a national bank FHLB member has applied to retire Stock and an individual FHLB denied the request or where a bank has not exhausted the process required in the Federal Home Loan Bank Act to retire Stock. (**NOTE:** Banking law does not restrict a national bank's ability to buy or retain Stock purchases since the Federal Home Loan bank Act provides the affirmative authority necessary for a national bank to hold Stock. Section 24(Seventh) generally restricts the purchase by national banks of investment securities and stock, with enumerated exceptions or as otherwise permitted by law. Although Stock is not one of the securities enumerated in Section 24(Seventh) as a permissible national bank investment, the purchase of Stock is authorized separately under the Federal Home Loan Bank Act. )

Federal Home Loan Bank regulations similarly do not bar members from retaining Stock holdings in excess of the minimum membership requirements. They provide the member with the discretion, but not the obligation, to apply to dispose of any excess holdings and confirm the individual FHLB's discretion to redeem such holdings. 12 C.F.R. § 933.9(b)(2).

Required minimum levels of Stock ownership for members by necessity will change annually, given the dynamics of the mortgage market and the changing nature of interest rates. It is inevitable that a national bank's mortgage activities will vary over time, due to both mortgage market conditions and a member's own financial condition, including changes in capital levels, resulting in changing minimum levels of required Stock ownership over time. Bank levels of mortgage assets reflect economic conditions, including varying customer demand. Because a bank's mortgage lending will vary over time, the amount of Stock that it must hold as a Federal Home Loan Bank member similarly will vary. Congress did not mandate, however, that members *reduce* Stock holdings annually to meet changing minimum levels of mortgage lending activity. Rather, Congress only provided for increases in Stock ownership to reflect increased mortgage lending activity. Accordingly, we do not believe that national bank members of FHLBs are required to reduce annually Stock ownership levels to reflect reduced mortgage lending activity, provided that the bank has some foreseeable need to hold that level of Stock for its future operations. (**NOTE:** The OCC has stated that national banks may purchase Stock to satisfy membership requirements, but "neither encourages nor discourages membership and investment in Federal Home Loan Banks." *See* Interpretive Letter No. 580 (April 9, 1991), reprinted in [1992 - 1993 Transfer Binder] Fed. Banking L. Rep. ¶ 83,401. The OCC observed in that letter that "ownership of stock when the bank is not a member, ownership of stock to an extent greater than that required for membership, or ownership of stock when the bank is not utilizing its Home Loan Bank membership but treating the stock ownership only as a passive investment . . . would raise additional concerns for the OCC," but did not identify what those concerns might be.)

#### *National Banks May Purchase Additional Stock in Advance of Planned Increases in Mortgage Lending.*

National banks' purchase of Stock in excess of minimum membership requirements is part of or incidental to the business of banking in cases where those purchases would facilitate plans, as documented in banks' business plans or similar documents, to fund residential housing finance assets. The Supreme Court expressly held that the business of banking is not limited to the enumerated powers in Section 24(Seventh), but encompasses more broadly activities that are part of the business of banking. *See NationsBank v. Variable Annuity Life Insurance Co.*, 513 U.S. , 115 S.Ct. 810, 130 L. Ed. 2d 740 (1995)(" *VALIC* "). *VALIC* further established that banks may engage in activities that are incidental to the enumerated powers as well as the broader business of banking.

Prior to *VALIC* , the standard often used in determining whether an activity was incidental to banking

was the one advanced in *Arnold Tours, Inc., v. Camp*, 472 F.2d 427 (1st Cir. 1972) ("*Arnold Tours*"). The *Arnold Tours* standard defined an incidental power as one that is "convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act." Id. at 432. Even prior to VALIC, the *Arnold Tours* formula represented a narrow interpretation of the "incidental powers" clause of Section 24(Seventh). See OCC Interpretive Letter No. 494 (Dec. 20, 1989). VALIC has established that the *Arnold Tours* formula provides that an incidental power includes one that is convenient and useful to the business of banking as well as a power incidental to the express powers enumerated in Section 24(Seventh).

The proposed purchase of Stock in excess of minimum FHLB membership requirements is part of or incidental to the business of banking under the *Arnold Tours* standard. The OCC and the courts long have recognized that making mortgage loans is part of the business of banking. See, e.g., *Security Pacific v. Clarke, supra*. Similarly, national banks long have been able to purchase mortgage-backed securities and engage in loan participations. See 12 U.S.C. § 24(Seventh). One of the principal benefits of FHLB membership is the ability to obtain advances from FHLBs to fund mortgage loans and purchase other residential housing finance assets. FHLB members that are not savings associations may obtain advances up to 20 times the amount that they pay in for Stock, multiplied by their ATIP. 12 C.F.R. § 935.13(a). Therefore, because the amount of advances national banks may obtain varies in part according to the amount of Stock they hold, purchases of Stock in amounts that exceed the minimum required for FHLB membership would be "convenient" and "useful" to national banks' activities in making mortgage loans and holding other residential housing finance assets. However, national banks planning any acquisitions of Stock beyond the minimum required for FHLB membership should be prepared to demonstrate that the acquisitions are part of a business plan to expand their mortgage business by funding or purchasing residential housing finance assets.

## Conclusion

In summary, national banks which are members of a FHLB may purchase Stock in excess of the minimum required for FHLB membership, where those purchases would facilitate plans, as documented in banks' business plans or similar documents, to fund residential housing finance assets. Here, the Bank is a FHLB member and its business plan shows an anticipated increase in residential mortgage lending. Thus, the Bank may hold excess Stock to the extent the Stock supports the Bank's existing and projected level of residential housing finance assets, as documented in its business plan.

If you have any questions, please feel free to contact Lee Walzer, Senior Attorney, Securities and Corporate Practices Division at (202) 874-5210 or Christopher G. Sablich, Senior Attorney, Central District at (312) 360-8805.

Very truly yours,

/s/

Julie L. Williams  
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