Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Corporate Decision #99-03
January 1999

December 21, 1998

Ms. Karol K. Sparks
Krieg DeVault Alexander & Capehart
One Indiana Square
Suite 2800
Indianapolis, Indiana 46204-2017

Re: Application by Old National Bank in Evansville, Indiana, to establish Old National Insurance Company of Vermont
Application Control Number: 98-WO-08-0029

Dear Ms. Sparks:

This responds to the application filed by Old National Bank in Evansville, Indiana (the "Bank"), to establish an operating subsidiary, Old National Insurance Company of Vermont ("Subsidiary"), to provide insurance coverages on the business risks of the parent bank and its bank affiliates; and to reinsure credit life, credit health and accident, and credit unemployment insurance. The Bank is a subsidiary of Old National Bancorp., Inc. ("ONBI"). Based on the information and representations made by the Bank in its application, and for the reasons discussed below, we have approved the Bank's application to establish the Subsidiary to engage in the proposed activities.

I. BACKGROUND

A. Operating a Bank as a Business Enterprise

National banks are authorized to be formed to carry on the business of banking,[1] and once formed are not only empowered to conduct that business but to exercise all such "incidental

[1] 12 U.S.C. §§ 21, 24(Seventh).

powers" as are needed to enable them to conduct the banking business.[2] For example, as part of the "business of banking" a national bank is specifically permitted to acquire and hold property "necessary for its accommodation in the transaction of its business."[3] National banks are also authorized to make contracts,[4] sue and be sued as fully as natural persons,[5] and elect or appoint directors.[6] The board of directors of the bank may appoint presidents, vice presidents, cashiers, and other officers; define their duties; require bonds of them, and dismiss these officers at will and appoint others to fill their places.[7]

B. The Risks Associated with Operating a Bank as a Business Enterprise

In connection with operating the "business" of a bank, *e.g.*, owning property, bringing and defending against suits related to the bank's business, and hiring and managing employees, a national bank assumes certain risks associated with its business. Similar to any other business organization, the bank must manage these risks. The OCC assesses banking risk relative to its impact on capital and earnings, and has defined nine categories of risk for bank supervision purposes. These categories of risk are: credit, interest rate, liquidity, price, foreign currency translation, transaction, compliance, strategic, and reputation.[8] The risks associated with operating the "business" of a bank primarily are transaction and compliance risks. Examples of these types of risks include losses from damage to the bank's property; losses in connection with suits resulting from injury or death of both employees and the public, suits alleging official misconduct, and individual or class action suits alleging mistreatment or the violation of laws or regulations; and losses resulting from the loss of key personnel.

The OCC defines "transaction risk," which also is referred to as "operating" or "operational risk," as the risk to earnings and capital arising from fraud, error, and the inability to deliver products or services, maintain a competitive position, and manage information.[9] Risk is

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[2] 12 U.S.C. § 24(Seventh).

[3] 12 U.S.C. § 29(First). *See also* 12 C.F.R. § 7.1000.

[4] 12 U.S.C. § 24(Third).

[5] 12 U.S.C. § 24(Fourth).

[6] 12 U.S.C. § 24(Fifth).

[7] *Id*.

[8] *See* Comptroller's Handbook, Large Bank Supervision (July 1998); *see also* Comptroller's Handbook, Bank Supervision Process (April 1996).

[9] *See* Comptroller's Handbook, Large Bank Supervision, *supra*, at 74; Comptroller's Handbook, Bank Supervision Process, *supra*, at 20.

inherent in efforts to gain strategic advantage, and in the failure to keep pace with changes in the financial services marketplace. Transaction risk encompasses: product development and delivery, transaction processing, systems development, computing systems, complexity of products and services, and the internal control environment.

The OCC defines "compliance risk" as the risk to earnings or capital arising from violations of, or noncompliance with, laws, regulations, prescribed practices, internal policies and procedures, or ethical standards.[10] Compliance risk can lead to diminished reputation, reduced franchise value, limited business opportunities, reduced expansion potential, and lack of contract enforceability. Specifically, this risk includes exposure to litigation from all aspects of banking and blends into operational risk.

Banks effectively assume these operational risks since they are a component -- an unavoidable aspect -- of conducting a banking business. To manage these risks, a bank may purchase insurance,[11] assume the risks directly, or transfer these risks to a subsidiary or affiliate. Several factors may influence a bank's decision to purchase insurance coverage or to self-insure: the cost of coverage versus the probability of the occurrence of a loss; the cost of coverage versus the size of the loss of each occurrence; and the cost of coverage versus the cost of correcting a situation that could result in a loss.

As discussed below, inherent in the power of national banks to carry on a "business" under 12 U.S.C. § 24(Seventh), is the authority to assume risks associated with operating a bank. Thus, the business of banking necessarily includes the presence of those risks as well as the ability to manage them to the bank's best advantage.

C. The Proposed Insurance Activities

Under the proposal, the Bank will establish the Subsidiary as a captive insurance company authorized to provide insurance coverages exclusively on the risks of the Bank and its bank affiliates. The Subsidiary will be established in the State of Vermont and will be subject to applicable Vermont insurance laws and regulations, including capital and reserve requirements.[12] The Subsidiary also will be subject to requirements under Vermont law that restrict captive insurance companies to writing coverages for the parent company and its

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[10] *See* Comptroller's Handbook, Large Bank Supervision, *supra*, at 77; Comptroller's Handbook, Bank Supervision Process, *supra*, at 21.

[11] In addition to specialized forms of insurance that banks may require, such as fidelity bond coverage, banks may also need many of the same types of insurance coverages required by any business or individual.

[12] Vt. Stat. Ann. tit 8 §§ 6004 and 6005.

affiliates.[13] In addition, the Subsidiary will be issued a restricted license by the Department of Insurance of the State of Indiana limiting the Subsidiary's activities to serving as primary underwriter on non-life insurance policies with its parent and affiliates.[14] Accordingly, the Subsidiary will have no corporate authority in any jurisdiction to extend its underwriting business beyond affiliate risk.

The Subsidiary will primarily reinsure credit-related insurance in connection with loans made by the Bank and affiliated banks.[15] Further, the Subsidiary will insure 1) retentions (deductibles) on lines of property and casualty insurance (including fiduciary coverages) of the Bank and its bank affiliates; 2) other business risks, such as catastrophic loss on buildings utilized by the Bank and its bank affiliates; and 3) errors and omissions insurance on activities of the Bank's affiliates, to the extent the risk is "self-insured." The Subsidiary will reinsure the risks with its current insurance underwriter, except as to some or all of the retention amounts and self-insured amounts currently assumed by the Bank and its bank affiliates. Thus, the Subsidiary will not take on risks under the proposal greater than the risks currently undertaken by the Bank and its affiliates. The decision of ONBI to "self-insure" the risks of loss associated with its banking businesses through the Subsidiary, instead of managing the risks as an operating loss of each of its subsidiary banks, will offer ONBI an important risk management product and enable the Bank to benefit from business efficiencies that are accomplished by the proposed arrangement.

The Bank represents that the Bank and the Subsidiary will identify, measure, monitor and control the risks presented by the proposed self-insurance activities in a manner consistent with the policies that have been developed within ONBI and its affiliates with respect to risks. The Subsidiary will consult with ONB Insurance Group, a subsidiary of an affiliate bank that monitors all of ONBI's insurance needs and policies, in determining appropriate deductibles, self-insured risks and policies in place. In addition, the Bank will be obtaining a feasibility

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[13] Vt. Stat. Ann. tit 8 § 6001(12).

[14] The Bank represents that the Vermont Department of Insurance will not permit a captive insurance company of this type to underwrite life, accident or health coverages for the bank or its affiliates. The Subsidiary will comply with this restriction.

[15] The Subsidiary will initiate its credit life and credit health and accident reinsurance activities through the merger of Indiana Old National Insurance Company ("IONIC"), a credit life insurance company subsidiary of ONBI, into the Subsidiary. In addition, the Subsidiary will be authorized to reinsure credit unemployment insurance. IONIC reinsures credit life and credit health and accident insurance related to extensions of credit by its affiliates in accordance with, and pursuant to, approval of the Board of Governors of the Federal Reserve System under section 4(c)(8) of the Bank Holding Company Act of 1956, as amended, and regulations promulgated thereunder and currently codified as Section 225.28(11)(i) of Regulation Y.

study prepared by a qualified actuary to support the premiums the Subsidiary will charge its insureds.[16]

All of the Subsidiary's management information function systems will be performed by J&H Marsh and McLennan ("J&H"), which the Bank has represented is one of the largest managers of captive insurance companies. The reports and financial statements prepared by J&H on behalf of the Subsidiary will provide specific information as to the amount of gross captive risk, and compliance with specific requirements including the Subsidiary's required reserves.

II. LEGAL ANALYSIS

National banks have long been recognized to have broad authority to underwrite, reinsure, and sell as agent, credit-related insurance products.[17] In addition, as discussed below, the proposed self-insurance activities are part of, or incidental to, the business of banking. A national bank may establish or acquire an operating subsidiary to conduct, or may conduct in an existing operating subsidiary, activities that are part of or incidental to the business of banking, pursuant to 12 U.S.C. § 24(Seventh), and other activities permissible for national banks or their subsidiaries under other statutory authority.[18] Since we conclude that the proposed self-insurance activities are permissible for a national bank, they are therefore permissible for a national bank's operating subsidiary as well.

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[16] The feasibility study will also address the financial viability of the Subsidiary under an adverse loss scenario. In preparing the feasibility study, the Bank represents that the actuary, working with representatives of ONBI, will examine the historical loss experience of the Bank and its affiliates for the proposed coverages; and provide estimates of expected future losses for the proposed coverages.

[17] *See* Corporate Decision No. 98-28 (May 11, 1998) (authorizing Fleet National Bank's application to establish operating subsidiaries to underwrite and reinsure credit life insurance, credit disability insurance, and involuntary unemployment insurance sold to customers that borrow from the bank and its lending subsidiaries); Corporate Decision No. 97-92 (October 17, 1997) (authorizing Bank of America's application to establish an operating subsidiary to underwrite and reinsure credit disability and involuntary unemployment insurance sold to customers that borrow from the bank's lending affiliates); Interpretive Letter No. 812, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-260 (December 29, 1997) (authorizing the sale, as agent, of credit-related crop insurance); Letter dated March 31, 1995 (unpublished) (authorizing reinsurance of credit-related involuntary unemployment, life, and disability insurance); Letter dated June 17, 1993 (unpublished) (authorizing the sale, as agent, of credit-related mechanical breakdown insurance); Letter dated June 3, 1986 (unpublished) (authorizing the sale, as agent, of credit-related vendors double interest insurance); Interpretive Letter No. 283, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,447 (March 16, 1984) (authorizing the sale, as agent, of credit-related life, disability, involuntary unemployment, and vendors single interest insurance); Interpretive Letter No. 277, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,441 (December 13, 1983) (authorizing underwriting and reinsurance of credit-related life insurance); *see also* 12 C.F.R. Part 2 (Sales of Credit Life Insurance); *IBAA v. Heimann*, 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980) (confirming the OCC's authority to adopt its credit life insurance regulation at 12 C.F.R. Part 2).

[18] 12 C.F.R. § 5.34(d)(1).

A. The "Business of Banking"

Judicial cases reflect three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks.[19]

1. Functionally Equivalent to or a Logical Outgrowth of Recognized Banking Functions

Pursuant to 12 U.S.C. § 24(Seventh), a national bank is authorized generally to conduct the business of banking. Inherent within this authority is the ability, similar to any other company, to assume the risks of loss associated with operating its banking business, and to seek to manage and control those risks to the bank's best advantage. As previously discussed, those risks may include losses from damage to the bank's property; losses in connection with suits resulting from injury or death of both employees and the public, suits alleging official misconduct, and individual or class action suits alleging mistreatment or the violation of laws or regulations; and losses resulting from the loss of key personnel.

The responsibility for controlling operational risks is generally left with bank management, who have many options in managing a particular risk.[20] Banks may manage risks of a banking business by purchasing insurance covering potential losses or may retain these risks by not purchasing insurance or purchasing limited coverages. Through the proposed self-insurance arrangements, the Subsidiary will retain risks that could similarly be retained by the Bank by not purchasing insurance. These self-insurance activities thus are functionally equivalent to or a logical outgrowth of the Bank's authority to assume the risk of loss associated with conducting a banking business, and are part of the business of banking pursuant to 12 U.S.C. § 24(Seventh).

The Bank also proposes to reinsure its insurance coverages so that it will achieve the same risk exposures it currently holds through the purchase of insurance. At present, the Bank does not insure deductibles and manages the risk of loss (*i.e.*, self-insures) on the described activities of the Bank and its bank affiliates. Through the proposed reinsurance arrangements, the Bank will retain these same risks, and transfer other risks to its current insurance underwriter.

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[19] *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).

[20] *See* Comptroller's Handbook, Large Bank Supervision (July 1998); Comptroller's Handbook, Bank Supervision Process (April 1996).

Thus, the proposed self-insurance and reinsurance arrangements are functionally equivalent to and a logical outgrowth of existing insurance and *de facto* self-insurance arrangements.
The Subsidiary may assume risks arising from operating a banking business from both its parent and bank affiliates. As discussed above, each of the affiliated banks separately has the authority to self-insure risks arising from its banking operations. Each bank also may transfer those risks to a subsidiary to manage its risk exposure.[21] Similarly, each bank or its subsidiary may assume risks arising from banking operations from affiliates for a fee and establish reserves to cover potential losses.[22] Since a bank and its bank affiliates are separately able to assume the risks arising from their banking business, and since bank affiliates may transfer these business risks to one another, consolidating these risks within a national bank subsidiary is permissible. Consolidation is simply a business decision to take advantage of the benefits of a centralized operation.[23]

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[21] We note that the OCC has, on many occasions, permitted national banks to perform services for affiliates. *See* Interpretive Letter No. 513, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,215 (June 18, 1990) ("Allowing a bank holding company to consolidate servicing operations in a single entity permits all of the banks in the holding company to enjoy economies of scale in obtaining the services."). *See also* Corporate Decision No. 97-92 (October 17, 1997) (permitting Bank of America to establish a subsidiary to self-insure the safe deposit box liability insurance of the bank and its affiliates in the safe deposit business); Interpretive Letter No. 493, *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,078 (November 22, 1989) (a national bank may establish a subsidiary to provide deposit account services to an affiliated national bank); and Interpretive Letter No. 398, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,622 (September 28, 1987) (a bank holding company may consolidate security and guard services in a subsidiary of a national bank). We also note that bank holding companies are authorized to furnish services to, or perform services for, their affiliates under section 4(c)(1)(C) of the Bank Holding Company Act of 1956, as amended. 12 U.S.C. § 1843(c)(1)(C). The Board of Governors of the Federal Reserve System has specifically authorized bank holding companies to underwrite insurance coverages, including property and casualty insurance, for affiliates under this authority. 12 C.F.R. § 225(b)(2)(ix); *see also* Letter dated April 12, 1995, from J. Virgil Mattingly, Jr., General Counsel, to Michael Briggs, permitting Barnett Banks, Inc., to organize a wholly-owned subsidiary to engage in underwriting commercial general liability, automobile liability, workers compensation, property, and bankers' transportation coverages on the risks of the bank holding company and its subsidiaries.

[22] *See* Letter from James M. Kane, District Counsel, to Ballard W. Cassady, Jr. (June 8, 1988) (unpublished) (permitting national banks to participate in the ownership of a captive insurance company to provide officers liability and financial institution bond coverage); Letter from Larry A. Mallinger, Senior Attorney, to James R. Cameron (March 13, 1987) (unpublished) (permitting national banks to participate in a nonassessable mutual captive insurance company to provide directors' and officers' liability insurance); Letter from Richard V. Fitzgerald, Chief Counsel, to John J. Gill (October 22, 1986) (unpublished) (permitting national banks to participate in a nonassessable mutual, not-for-profit insurance company as policyholders, in order to obtain insurance protection for themselves and their management, although the policyholder banks were also considered insurers as well as insureds). *See also* Corporate Decision No. 97-92 (October 17, 1997) (permitting Bank of America to self-insure the safe deposit box liability insurance of the bank and its affiliates in the safe deposit business); OCC Bulletin 96-51 (September 20, 1996) on Bank Purchases of Life Insurance, Guidelines for National Banks (As an alternative to purchasing corporate-owned life insurance, a bank may choose to self-insure against the risk of potential loss arising from the untimely death of a "key-person.").

[23] Corporate Decision No. 97-92 (October 17, 1997).

The proposed self-insurance activities are similar to other self-insurance activities approved by the OCC for national bank subsidiaries. For example, the OCC has authorized a national bank subsidiary to underwrite and reinsure safe deposit box liability insurance for the bank and its affiliates engaged in the safe deposit box business.[24] The OCC's rationale for authorizing this activity was that self-insurance through the subsidiary is a way for the bank organization to pool the risks of the safe deposit business, and is essentially an internal risk management function that is being centralized for risk management efficiencies.[25] Thus, the fact that the banking companies had chosen for business reasons to consolidate this activity in a single bank subsidiary, did not limit the subsidiary's authority to engage in the proposed self-insurance activity. Similarly, as discussed above, the Bank may choose for business reasons to self-insure bank operating risks through the Subsidiary, rather than through each affiliate individually.

2. Respond to Customer Needs or Otherwise Benefit the Bank or its Customers

As discussed above, the responsibility for controlling operating risks is generally left with bank management, who have many options in managing a particular risk. Banks may manage these risks by purchasing insurance covering potential losses or may retain these risks by not purchasing insurance or purchasing limited coverages. The proposed self-insurance activities benefit the Bank and its Subsidiary because they enable the Bank and the Subsidiary to manage the risks in the banking business and to obtain new business efficiencies. The Subsidiary's involvement in these activities benefit the Bank by providing a more efficient risk management mechanism for the Bank's own business. It may also expand the options of the Bank and its bank affiliates in choosing their insurance coverages.

3. Risks Similar in Nature to Those Already Assumed by National Banks

The risk assumed by a bank when it underwrites insurance for its own business or for its affiliates is essentially the same type of risk a bank already assumes in its banking business. The OCC has previously recognized that a national bank may insure for itself the risks inherent

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[24] *Id.; see also* OCC Bulletin 96-51 (September 20, 1996) on Bank Purchases of Life Insurance, Guidelines for National Banks (As an alternative to purchasing corporate-owned life insurance, a bank may choose to self-insure against the risk of potential loss arising from the untimely death of "key-person.").

[25] *See* Corporate Decision No. 97-92 (October 17, 1997).

in its business.[26] In this case, the Bank will be transferring its own and its bank affiliates' risks to the Subsidiary.

Moreover, the Subsidiary will be reinsuring the risks with the Bank's current insurance underwriter, except as to some or all of the retention amounts and self-insured amounts currently assumed by the Bank and its bank affiliates. Thus, the proposed arrangements do not alter the nature of the risks involved, because the Subsidiary will not take on risks under the proposal different than the risks currently undertaken by the Bank and its affiliates.

B. The "Incidental to Banking" Analysis

While we conclude that national banks have the power, as part of their power to carry on a general banking business, to undertake the proposed self-insurance activities as part of the business of banking, even if that authority were not sufficient, the proposed activities clearly qualify as authorized by being incidental to the bank's banking business.

In *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.*,[27] the Supreme Court expressly held that the "business of banking" is not limited to the enumerated powers in 12 U.S.C. § 24(Seventh), but encompasses more broadly activities that are part of the business of banking.[28] The *VALIC* decision further established that banks may engage in activities that are "incidental" to the enumerated powers as well as to the broader business of banking as a whole.

Before *VALIC*, the standard often considered in determining whether an activity was incidental to banking was the one advanced by the First Circuit Court of Appeals in *Arnold Tours, Inc. v. Camp*.[29] 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 <u>express</u> powers under the National Bank Act."[30] The *VALIC* decision, however, has established that the *Arnold Tours* formula provides that an incidental power includes one that is

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[26] *See* Interpretive Letter No. 544, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,256 (February 14, 1991) ("[I]n general, participation in self-insurance plans is a permissible activity for national banks."). *See also* footnote 21, *supra*.

[27] 513 U.S. 251 (1995) ("*VALIC*").

[28] *Id*. at 258, n.2.

[29] 472 F.2d 427 (1st Cir. 1972) ("*Arnold Tours*").

[30] *Id*. at 432 (emphasis added). Even prior to *VALIC*, the *Arnold Tours* formula represented a narrow interpretation of the "incidental powers" provision of the National Bank Act. *See* Interpretive Letter 494, *reprinted in* [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,083 (December 20, 1989).

"convenient" and "useful" to the business of banking as a whole, as well as a power incidental to the express powers specifically enumerated in 12 U.S.C. § 24(Seventh).

A review of relevant case law indicates that there are at least three broad categories of recognizable activities that are incidental to the performance of the business of banking under 12 U.S.C. § 24(Seventh). The first broad category includes activities "incidental" to operating a bank as a business enterprise. These activities are permissible even though they are not necessarily substantive banking activities. Instead of relating to the delivery of a specific banking product or service, these activities are useful and incidental to the operation of the bank as a business. These types of activities, among others, include hiring employees, issuing stock to raise capital, owning or renting equipment, purchasing the assets and assuming the liabilities of other financial institutions, and borrowing money.[31]

To illustrate, for example, the power to borrow money for operations is not among the powers expressly granted to national banks in 12 U.S.C. § 24(Seventh) nor does it fall within the "business of banking" in the sense that it is a banking activity. While most businesses borrow money, this does not inherently make them banks. Until repealed in 1982, however, a provision in the National Bank Act restricted the scope of permissible borrowing (12 U.S.C. § 82) and, thus, implicitly recognized the power to borrow.[32] Accordingly, the courts uniformly have held that national banks do have the power to borrow funds in order to operate as a business.[33]

Thus, these incidental activities are performed, and are permissible powers, not because they relate to "banking" products and services, but because they are necessary, or at least convenient and useful, components of conducting the banking business. Similarly, various federal banking statutes implicitly recognize and regulate business activities of banks as businesses, without deeming it necessary to authorize the activities expressly.[34] These powers are incidental to the general grant of power to conduct a business under section 24(Seventh).

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[31] *See, e.g.*, *Wyman v. Wallace*, 201 U.S. 230 (1905) (borrowing is authorized under the statute permitting a national bank to conduct a general banking business);*City Nat'l Bank of Huron v. Fuller*, 52 F.2d 870 (8th Cir. 1931) (holding it permissible for the national bank to purchase the assets and assume the liabilities of another bank).

[32] 12 U.S.C.§ 82, *repealed by* Pub. L. 97-320, Title IV, § 402, 96 Stat. 1510 (1982).

[33] *See, e.g.*, *Aldrich v. Chemical Nat'l Bank*, 176 U.S. 618 (1900) (holding it permissible for the national bank to borrow money when necessary for banking business); *Auten v. United States Nat'l Bank of New York*, 174 U.S. 125 (1899) (borrowing money falls under the usual course of legitimate banking business).

[34] *See, e.g.*, 12 U.S.C. § 78 (defining persons ineligible to be bank employees); 12 U.S.C. § 83 (putting limitations on national bank's purchase of stock); 12 U.S.C. § 371d (limiting the amount of investment permitted in a bank premises corporation subsidiary); 12 U.S.C. § 371c (defining "affiliates" to include subsidiaries owned by national banks).

The self-insurance activities the Bank proposes qualify as incidental to the business of banking because they facilitate, and are convenient and useful to, the operation of the bank as a business. Further, these types of activities permit management of operational risks to the bank's best advantage by enabling the Bank and the Subsidiary to manage in a new way operating risks that arise from the business aspects of banking. Thus, overall, this approach for meeting the bank's insurance needs will increase business efficiencies for the Bank and is both convenient and useful.

A second broad category of "incidental" activities to the performance of the business of banking optimizes the use and value of a bank's facilities and competencies, and enables the bank to avoid economic waste. Reviewing the scope of national banks' incidental powers authority, courts have determined that, within reasonable limits, certain business-related activities may be incidental to banking when those activities enable a bank to realize gain or avoid loss from activities that are part of, or necessary to, the operation of the bank's banking business.[35] For example, as one court observed: "A national bank may lawfully do many things in securing and collecting its loans, in the enforcement of its rights and the conservation of its property previously acquired, which it is not authorized to engage in as a primary business."[36]

Similarly, the proposed self-insurance activities enable a bank to realize gain or avoid loss from activities that are part of or necessary to its banking business. Insuring coverages on the risks of the Bank and its bank affiliates enable the Bank and ONBI to take advantage of business efficiencies accomplished by conducting the proposed insurance activities. The ability to conduct this activity in a subsidiary of the Bank, instead of in a subsidiary of each affiliated bank, provides ONBI with organizational flexibility that enables ONBI to avail itself of benefits that result from conducting the activity in the most efficient manner, and thereby avoid economic waste.

A third identifiable category involves "incidental" activities that enhance the quality and efficiency of the content or delivery of banking products or services. Case authority holds that

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[35] *See, e.g., Morris v. Third Nat'l Bank*, 142 F. 25 (8th Cir. 1905), *cert. denied*, 201 U.S. 649 (1906) ("*Morris*") (national bank securing and collecting on loans lawfully may engage in activities to manage and protect its rights that the bank could not do as a primary business); *Cooper v. Hill*, 94 F. 582 (8th Cir. 1899) (where a national bank owned an abandoned mining property, bank had authority under its incidental powers to expend money to put the property in presentable condition to attract purchasers); *Cockrill v. Abeles*, 86 F. 505 (8th Cir. 1898) (national bank may purchase other undivided interests in property if necessary to manage or dispose of other previously acquired property to better advantage); *First Nat'l Bank v. National Exchange Bank*, 92 U.S. 122 (1875) (compromises to avoid or reduce losses may be necessary for national banks in certain situations).

[36] *Morris*, 142 F. at 25.

national banks have an incidental power to promote their banking products and services.[37] By improving the efficiency and profitability of its business operations, a bank can more effectively promote its banking products and services. The insurance activities proposed for the Subsidiary enhance the efficiency of the Bank's and its affiliates' business, and enhance their ability to promote banking products and services. Self-insurance through the Subsidiary is a way for the Bank to pool the risks associated with the business of banking, and essentially is an internal risk management function that is being centralized to achieve efficiencies in promoting banking products and services.

Thus, even if the proposed insurance activities were not part of the business of banking conducted by ONBI, they clearly are permissible "incidental" activities because they offer efficiencies that facilitate the operation of the bank as a business, promote profitability and avoid economic waste, and enhance the Bank's ability to promote its products and services.

III. CONCLUSION

Based on the foregoing facts and analysis, and the representations made by the Bank in connection with the Bank's request, we have approved the Bank's application to establish an operating subsidiary to engage in the proposed self-insurance and reinsurance activities in the manner described in this letter.

Sincerely,

/s/

Julie L. Williams
Chief Counsel

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[37] *See generally Franklin Nat'l Bank v. New York*, 347 U.S. 373 (1954); *Clement National Bank v. Vermont*, 231 U.S. 120 (1913); *Carbide v. Devon Bank*, 299 N.E.2d 521, 12 Ill. App. 3d 559 (1973).