



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

December 29, 1997

Interpretive Letter #812
January 1998
12 U.S.C. 24(7)41

Mr. John K. Sorenson
President
Iowa Bankers Insurance and Services, Inc.
418 Sixth Avenue, Suite 430
Des Moines, Iowa 50309-2438

Dear Mr. Sorenson:

This responds to your request that the Office of the Comptroller of the Currency (“OCC”) confirm that a national bank may offer, as agent, multiple peril crop insurance¹ and hail/fire insurance² (collectively, “crop insurance”) in connection with loans to its farmer customers. Your request is on behalf of the Iowa Bankers Insurance and Services, Inc. (“IBI”). For the reasons discussed below, it is our opinion that the proposed activity would be permissible for national banks because the sale of such credit related insurance is part of, or incidental to, the business of banking.

¹ Multiple peril crop insurance (“MPCI”), covers unavoidable losses on crops, including losses due to drought, excess moisture, insects, disease, flood, hail, wind and frost. MPCI guarantees a minimum average yield per acre for the insured crop. The deductible is determined by the insured level of production. If the producer’s average yield falls below the insured level, the insurance company pays the difference. According to the IBI, farmers can purchase up to a 75 percent guarantee of their past production. The rates payable to an insured farmer are determined by market analysis. For example, in 1996, the rates payable on corn were \$2.65 per bushel and the rates payable on soybeans were \$6.75 per bushel. Thus, if a farmer produced less than 75 percent of his/her average, the farmer was paid an amount that provided for \$2.65 or \$6.75 for each bushel short of the 75 percent guarantee.

² According to the IBI, hail/fire insurance is normally purchased in \$100 increments and pays a farmer a predetermined percentage of loss to the insured crop caused by hail or fire.

I. BACKGROUND

The IBI is a cooperative formed in 1972 to provide insurance services to customer banks and bank insurance agencies in Iowa, including life and health insurance, financial institution bonds, professional errors and omissions coverage, and directors and officers liability coverage. The IBI is jointly owned (99.6%) by the Iowa Bankers Association, a trade association representing the majority of commercial banks in Iowa, and by individual commercial banks (.4%). The IBI provides training to banks and loan officers in connection with banks' sales of credit related insurance, including crop insurance programs in Iowa. The IBI's training programs would be available for national banks interested in selling crop insurance.

Agricultural lenders frequently make loans to farm borrowers for the purpose of paying for operational expenses associated with farming, e.g., expenses for seeds, fertilizer, fuel, etc.³ According to the IBI, in assessing agricultural loans to crop producers, the projected cash flow of the producer is the critical element in a bank's assessment of the ability of a crop producer to repay the loan. Banks' loans to crop producing borrowers are not always collateralized by the borrowers' crops. If the farmer has crop insurance, crop insurance payments may be assigned to the banks that financed the planting of the farmer's crops.⁴ Even if crop insurance proceeds are not specifically assigned to a bank, these proceeds are taken into account in judging a borrower's ability to make repayments on a loan.

Crop insurance provides farmers with a financial risk management tool to protect against excessive losses resulting from crop failures or low yields. Historically, the federal government provided subsidies and price supports to the agriculture industry as a "safety net" to reduce some of the production and price risk inherent to the producer. Some minimal catastrophic insurance coverage was required to participate in these programs. However, those programs were phased out under the Federal Agricultural Improvement and Reform Act of 1996 (the "1996 Farm Bill"). Due to the repeal of the federal farm price guarantees on a host of crops, according to the IBI, farmers can no longer rely on the federal government for help in repaying a debt if their crops are destroyed in a natural disaster, and must look to the private sector to purchase crop insurance to provide the "safety net" once provided by government programs. Because of the elimination of traditional price support and crop subsidy programs, the degree of risk to banks from loans to agricultural producers has

³ The IBI represents that operational expenses do not include expenses for farm machines or real estate.

⁴ The coverage amount of crop insurance selected by the crop producer may not necessarily be the same amount as the borrower's outstanding loans from the bank. The term of the crop insurance also may be different from the term of the loan, because the term of the crop insurance generally is tied to the growing season, according to the IBI.

increased. Accordingly, both farmers and lenders have a heightened need to identify appropriate risk management approaches, including insurance coverage, that manages the risks of crop production. Crop insurance both protects a crop producer from loss of income due to damage or destruction of the producer's growing crops, and reduces lenders' agricultural credit risk.

The IBI has represented that farmers frequently inquire whether national banks can provide crop insurance coverage due to the lack of crop insurance agents in their area. Agricultural borrowers want to purchase crop insurance from their national bank lenders, because of their sense of familiarity with the bank and the confidence they have in the ability of the bank to identify appropriate crop insurance products for its customers.

II. DISCUSSION

A. The "Business of Banking"

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 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 powers clause is a broad grant of the power to engage in the business of banking, including, but not limited to, the five specifically recited powers and the business of banking as a whole. See NationsBank of North Carolina, N.A. v. Variable Life Annuity Co., 115 S.Ct. 810 (1995) ("VALIC"). Many activities that are not included in the enumerated powers are also part of 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. 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).

Further, as the Supreme Court established in the VALIC decision, national banks are also authorized to engage in an activity if that activity is incidental to the performance of the five

specified powers in 12 U.S.C. § 24(Seventh) or incidental to the performance of an activity that is part of the business of banking.

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

Crop insurance enhances or facilitates a bank's lending activity by protecting the bank's loans, and is therefore functionally part of, or a logical outgrowth of, a bank's lending operations. Banks make loans to farmers to cover operational expenses related to producing crops and expect to be repaid from proceeds from the sale of the farmer's crops. Crop insurance protects a bank's ability to recover on farm loans when farmers are unable to repay their loans because of their loss of income resulting from crop failure. Farm customers are interested in obtaining crop insurance to ensure that their farm loans are repaid in the event that they do not receive expected income from crop sales due to the destruction of their crops. Thus, crop insurance can be an integral part of the lending relationship that insures sources of repayment relied on by both the bank and the borrower. The proceeds of this insurance enhance borrowers' ability to fulfill their debt obligations to the bank, and protects the bank's loans even in cases where the borrower's crops are not collateral securing the borrower's loan, or where the crop insurance proceeds are not specifically assigned to a lending bank. Crop insurance sales that mitigate risks assumed by borrowers and lenders, and enhance a bank's ability to recover on farm loans, are directly related to, or are a logical outgrowth of, the lending relationship.

The involvement of state banks in selling crop insurance to farm customers illustrates how these insurance activities are a logical outgrowth of the lending relationship and are part of the business of banking. According to the IBI, state banks in Iowa and in other agricultural states already sell crop insurance, as agent, through licensed agents that are employed by the banks. Iowa Code Ann. § 524.710.1.b. (West 1997). The IBI represents that crop insurance programs have been successful because the insurance provides valuable risk management protections for farm borrowers when they assume debt obligations to produce crops, and because the insurance enhances a lender's future recovery on farm loans.

Crop insurance is similar to other previously approved credit related insurance products that the OCC and the courts have determined to be directly related to, and logical outgrowths of, a bank's authority to make loans because they protect a bank's ability to recover payment on loans to borrowers. See Interpretive Letter 283 (March 16, 1984) (credit life, disability, mortgage life, involuntary unemployment, and vendors single interest insurance); 12 C.F.R. Part 2 (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); Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division, June 3, 1986 (unpublished) (force placed vendors dual interest insurance); Letter of William B. Glidden, Assistant Director, Bank Operations and Assets Division, June 17, 1993 (unpublished) (mechanical breakdown insurance). See also Interpretive Letter 671 (July 10, 1995), and Interpretive Letter 724 (April 22, 1996) (vehicle

service contracts); Ruling 7495 (1963), Interpretive Ruling 7.013 (1996) (debt cancellation contracts); First National Bank of Eastern Arkansas v. Taylor, 907 F.2d 775 (8th Cir. 1990), cert. denied, 111 S. Ct. 442 (1990) (confirming the ability of national banks to enter into debt cancellation contracts).⁵

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

Crop insurance benefits a bank's farm customers because it protects those customers against financial losses resulting from crop failures or low yields, and therefore enables them to continue meeting their financial obligations. Farmers no longer may rely on the federal government for help in repaying a debt if their crops are destroyed in a natural disaster, due to the 1996 Farm Bill, which repeals federal farm price guarantees on several crops. As a result, crop producers will need to assess the level of risk management that is appropriate, and will have to look to private sector options, such as purchasing crop insurance, to provide the

⁵ Under 12 U.S.C. § 92, national banks in places of 5,000 inhabitants or less are authorized to sell various forms of insurance as agents for insurance companies. In 1968, the Fifth Circuit Court of Appeals ruled in Saxon v. Georgia Association of Independent Insurance Agents, Inc., 399 F. 2d 1010 (5th Cir. 1968) ("Saxon"), that a national bank located in a place of more than 5,000 inhabitants could not sell to borrowers "broad forms of automobile, home, casualty and liability insurance." In American Land Title Ass'n v. Clarke, 968 F.2d 150, 156 (2d Cir. 1992), cert. denied, 113 S. Ct. 2959 (1993), the Second Circuit, citing Saxon as support, concluded that "section 92 impliedly bars national banks in towns with more than 5,000 inhabitants from engaging in insurance agency activities in general." The IBI's proposal does not involve "broad forms" of insurance. It involves only one type of specialized, credit related insurance that is clearly connected to a bank's lending activities by protecting bank loans and enhancing and facilitating the lending function.

We also note that other courts have recognized the limits of the reasoning of Saxon and have held that 12 U.S.C. § 24(Seventh) does authorize insurance activities that are incidental to banking. The District of Columbia Circuit, while choosing to distinguish Saxon, expressly rejected the argument that 12 U.S.C. § 92 is the sole source of authority for national banks to engage in insurance activities, and held instead that there is incidental power to do so under 12 U.S.C. § 24(Seventh). IBAA v. Heimann, 613 F.2d 1164 (D.C. Cir. 1979), cert. denied, 449 U.S. 823 (1980). We also note that in the eighth circuit, where Iowa is located, the Court of Appeals has strongly suggested that the Saxon case was wrongly decided. Independent Insurance Agents of America, Inc. v. Board of Governors of the Federal Reserve System, 736 F.2d 468, 477 & n.6 (8th Cir. 1984) ("There is a strong argument that Saxon was wrongly decided. The legislative history [of 12 U.S.C. § 92] indicates that Congress was concerned only with providing small-town banks with an additional profit source, not with prohibiting city banks from selling insurance.").

“safety net” once provided by federal government programs. Permitting national banks to sell crop insurance will increase the availability of this important risk protection mechanism for crop producers and agricultural lenders.

Banks presently help farmers manage price risk by providing lines of credit and loans for hedging; holding seminars to educate farmers about risk management; and making referrals to risk management consultants. *See* Joanna Sullivan, *Farmers, Losing U.S. Aid, Ask Banks’ Help to Hedge*, *American Banker*, July 2, 1997, at 1. The IBI has represented that farmers frequently inquire whether national banks can provide crop insurance coverage. Permitting national banks to sell crop insurance will provide another way that banks may help farmers manage risks resulting from fluctuations in the market price of their crops, and enable farmers to manage their risks by purchasing insurance at the same time they assume debt obligations.

Crop insurance sold in connection with banks’ loans benefits banks by enhancing the safety and soundness of bank lending to farmers and providing an additional source of credit related income to the banks. The elimination of traditional price support and crop production deficiency programs has increased the degree of risk to banks from loans to crop producers. The need for actively managing revenue risk through insurance arrangements therefore has become more important for agricultural lenders. Additionally, crop insurance sold in connection with banks’ loans serve to mitigate the impact of banks’ concentrations in agricultural loans. Finally, the proposed insurance activities also benefit national banks by enhancing their ability to compete with other lenders that are authorized to sell crop insurance, as agent, to their borrowers.

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

National banks are already authorized to sell crop insurance, as agent, under 12 U.S.C. § 92. The risks associated with selling crop insurance, as agent, are therefore familiar to national banks. Also, national banks already have the authority to assume the risks arising from sales of credit related insurance in general. The OCC has approved numerous other credit related insurance activities that serve to protect bank loans. *See, e.g.*, Interpretive Letter 283, *supra.*; Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division, June 3, 1986, *supra.*; Letter of William B. Glidden, Assistant Director, Bank Operations and Assets Division, June 17, 1993, *supra.*; 12 C.F.R. Part 2, *supra.* *See also* Interpretive Letter 671, *supra.*; Interpretive Letter 724, *supra.*; Ruling 7495 (1963), Interpretive Ruling 7.013 (1996), *supra.* The risk assumed by a bank when it engages in the proposed credit insurance activity is the same risk already assumed by national banks when they sell other credit related insurance, as agent.

B. The “Incidental to Banking” Analysis

Even if the IBI’s proposal were not viewed as part of the business of banking, the proposal is incidental to the business of banking. The IBI’s proposal is incidental to a bank’s authority to

make loans, pursuant to 12 U.S.C. § 24(Seventh), because selling crop insurance enhances a bank's ability to receive repayment for its loans; promotes a bank's lending business by making available a credit related product sought by borrowers; and enables a bank to avoid economic waste in connection with its lending activities.

The OCC and the courts have long authorized national banks to engage in a host of credit related insurance activities. The OCC's approvals and court holdings concluded that these activities are incidental to a bank's lending activities because they protect banks' interest in their loans by reducing the risk of loss if borrowers cannot make their loan repayments. See Interpretive Letter 283, supra.; 12 C.F.R. Part 2, supra.; IBAA v. Heimann, supra.; Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division, June 3, 1986, supra.; Letter of William B. Glidden, Assistant Director, Bank Operations and Assets Division, June 17, 1993, supra. See also Interpretive Letter 671, supra.; Interpretive Letter 724, supra.; Ruling 7495 (1963), Interpretive Ruling 7.013 (1996), supra.; First National Bank of Eastern Arkansas v. Taylor, supra. The rationale behind the above OCC precedents and court cases on credit related insurance is applicable to the IBI's proposal. Specifically, crop insurance protects banks' interest in their loans by reducing the risk of loss if borrowers cannot make their loan repayments due to crop failure.

OCC precedent has also established that the provision of certain products and services is permissible as incidental to the business of banking when needed to successfully package or promote other banking services. See Interpretive Letter 754 (November 6, 1996) (national bank operating subsidiary may sell general purpose computer hardware to other financial institutions as part of larger product or service when necessary, convenient, and useful to bank permissible activities); Interpretive Letter 742 (August 19, 1996) (bank may provide full Internet access to customers and non-customers in order to create a package of related services needed to satisfy consumer demand and enable the bank to successfully market its home banking services); Interpretive Letter 653 (December 22, 1994) (national banks may offer non-banking products as part of larger product or service when necessary, convenient, and useful to bank permissible activities); Interpretive Letter 611 (November 23, 1992) (bank selling home banking service may also provide customer access to non-banking services "to increase the customer base and the usage of the program").

Case authority also holds that national banks have an incidental power to promote their banking services, including by offering incidental services desired by customers. See Franklin Nat'l Bank v. New York, 347 U.S. 373 (1954) (advertising of savings accounts); Clement National Bank v. Vermont, 231 U.S. 120 (1913) (promoting the bank's deposit services by computing, reporting and paying the state tax levied upon the interest earned by bank customers on their deposits); Corbett v. Devon Bank, 299 N.E.2d 521, 12 Ill. App. 3d 559 (1973) (as a means of promoting its banking business, a national bank may sell state motor

vehicle licenses).⁶ Customer convenience is one of the most important elements involved in competition among financial institutions. See Oklahoma v. Bank of Oklahoma, 409 F.Supp. 71, 88. Cf. Order of the Federal Reserve Board Approving Notice by Mellon Bank Corporation to Acquire an Employee Benefits Consulting Company (June 16, 1997) (The Federal Reserve Board's (the "Board") Order approved Mellon Bank Corporation's application to acquire an employee benefits consulting company that also provided insurance-related services. The Board determined that the provision of insurance-related activities was necessary and "incidental" to banking activities, because the employee benefits consulting company would operate at a competitive disadvantage if it could not provide the insurance-related services.).

The sale of crop insurance to farm borrowers similarly is incidental to a bank's lending activities to the extent offering this insurance is necessary to successfully package⁷ or promote the bank's lending activities.⁸ The IBI has represented that agricultural borrowers seek to purchase crop insurance from their national bank lenders, and that the availability of crop insurance can influence a borrower's choice of lenders. In this environment, to effectively market farm loan products, banks need to be able to provide the credit risk management products borrowers desire to protect their expected sources of repayment. Thus, national banks must be able to offer customers these credit risk management products to remain competitive.

Finally, in connection with reviewing the scope of national banks' incidental powers authority, the courts have also determined that, within reasonable limits, certain activities can 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 its banking business. See generally, Morris v. Third Nat'l Bank, 142 F. 25 (8th Cir. 1905), cert. denied, 201 U.S. 649 (1906); Birdsell Mfg. Co.

⁶ The concept of promotional incidental powers for bank holding companies was judicially approved in National Courier Ass'n v. Board of Governors, 516 F.2d 1229, 1240 (D.C. Cir. 1975) (analogizing to the powers of national banks under 12 U.S.C. § 24(Seventh), the court agreed that "[i]n enumerating the activities that could be carried on, [Congress] certainly could not have meant to forbid engagement in other 'incidental' activities as were reasonably necessary to carrying out those that were enumerated.")

⁷ Any packaging or promotion of a bank's loans must be consistent with any applicable anti-tying provisions of 12 U.S.C. § 1972.

⁸ Notably, since the IBI's proposal is related to a specific bank product, i.e., bank loans, the conclusion that the IBI's proposal is incidental to banking is particularly compelling. Compare Corbett v. Devon Bank, 299 N.E.2d 521, 12 Ill. App. 3d 559 (1973) (where the activity permitted by the court, i.e., selling state motor vehicle licenses, was not related to a specific bank product).

v. Anderson, 104 F.2d 340 (6th Cir. 1939); Bailey v. Babcock, 241 F. 501 (W.D. Pa. 1915); Cooper v. Hill, 94 F. 582 (8th Cir. 1899); Cockrill v. Abeles, 86 F. 505 (8th Cir. 1898); National Bank v. Case, 99 U.S. 628 (1879); First Nat'l Bank v. National Exchange Bank, 92 U.S. 122 (1875). Thus, for example, national banks as an exercise of their incidental powers related to their lending powers have been permitted to acquire and hold otherwise impermissible property and engage in otherwise impermissible business activities. 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." Morris v. Third Nat'l Bank, supra.

The general conclusion reached by the courts, i.e., that activities that enable a bank to realize gain or avoid loss from activities that are part of or necessary to its banking business are incidental activities to banking, is directly applicable to the IBI's proposal. The proposed activity is clearly related to a bank's express lending powers, and will enable a bank to avoid loss or economic waste in its banking franchise by both increasing the ability of bank customers to make timely repayments on their loans, and by enhancing the competitiveness of national banks to promote their lending business. Additionally, the proposed activity will serve to mitigate the impact of banks' concentrations in agricultural loans, and thereby enable banks to avoid loss.

III. CONCLUSION

Based on the foregoing facts and analysis, we conclude that selling crop insurance, as agent, in connection with the bank's loans, is permissible for national banks.

Sincerely,

/s/

Julie L. Williams
Chief Counsel