Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #1022
March 2005
12 USC 24(7)

February 15, 2005

Subject: Group Self Insurance Program

Dear **[ ]**:

This is in response to your request for a legal opinion from the OCC concerning your organization's proposal to form a group self insurance program ("GSIP") in California that would provide worker's compensation insurance to members of the group. You have requested confirmation that it would be permissible for national banks to participate in this program. For the reasons discussed below, we conclude that such participation is permissible.

DESCRIPTION OF PROPOSAL

[ ] (" ") is a trade association of approximately 250 community banks and bank holding companies in nine western states. It is proposing to sponsor, through its subsidiary, **[*Corp.*]**, a GSIP in California that will make available a workers' compensation self insurance program to its member banks in that state. The following description of the program is based on materials that you have submitted to the OCC as well as representations that have been made by your organization during meetings and telephone calls with OCC staff.

You represent that it has become increasingly difficult for smaller banks in California to meet their workers' compensation insurance obligations. California banks have three ways to obtain insurance for potential workers' compensation claims, but each has drawbacks. The first is to purchase a traditional workers' compensation policy from an insurance company. However, you state that the insurance market has been in a state of extreme volatility since the early 1990s, when workers' compensation insurance rates were deregulated. In 2000, many insurance companies began to charge significantly higher premiums in order to recoup losses they sustained after deregulation, while others simply left the market. Individual banks may also self-insure themselves, but this is only practical for larger banks.

Finally, the State of California operates the Self-Insurers' Security Fund.[1] Employers may cover their workers' compensation obligations by becoming members of this fund. However, some have questioned the long-term financial stability of the fund.

Consequently, **[ ]** has investigated other alternatives for its members and has concluded that a group self-insurance plan — a GSIP — is the best option. You represent that GSIPs have operated successfully in California and other states for nearly 25 years. The GSIP would be a nonprofit, mutual benefit corporation organized under section 7110 *et seq.* of the California Corporations Code. Such a corporation has members and membership certificates rather than shareholders and stock certificates. Normally, each member has only one membership. There is a board of trustees that is selected by the members and is responsible for managing the corporation's assets and approving new members. In the present case, the board would be drawn from the presidents or CEOs of the founding banks. However, as sponsor of the GSIP, **[ ]** intends to maintain control of two of the five proposed seats. Membership in **[ ]** would be required for membership in the GSIP.

California law allows two or more private employers to form a nonprofit, mutual benefit corporation for the sole purpose of operating a group workers' compensation self-insurance fund to pool their compensation liabilities, *i.e.*, form a GSIP.[2] The GSIP retains a group plan administrator to run the day-to-day operations (including actuarial oversight and recommending premium rate adjustments) and a third-party claims administrator to manage claims administration. **[ ]** plans to use **[*Co.*]**, of **[*City, State*]**, a specialist in workers' compensation group self-insurance, as its group plan administrator. GSIPs are comprehensively regulated by the California Department of Industrial Relations ("DIR").

You represent that the advantage of a homogeneous group of employers such as banks forming a GSIP versus purchasing individual coverage from an insurance company is that in a GSIP, premiums can be based on the claims experience of the banking industry ("common risks"). In contrast, a bank purchasing traditional coverage from an insurance company will be paying, through its premiums, to cover the risks of other, more dangerous industries ("diversified risks"). For this reason, **[ ]** estimates that the GSIP would save its members 25% to 35% a year over comparable private insurance carrier rates.

In a GSIP, each prospective member is individually underwritten and premiums are priced accordingly. Prospective members are screened by the GSIP and may be rejected for membership, for example, if they present a high risk or are financially unstable. Members make premium contributions to fund payment of claims and administrative expenses. Under California law, after the third year of operations any surplus, including interest income, may be returned to

[1] California Labor Code § 3701.8 (West 2003).

[2] Cal. Code Regs. tit. 8, § 15470 *et seq.*

the members in the form of a dividend. Members may withdraw for any reason, although they may be subject to a penalty if certain conditions apply.[3]

The **[ ]** GSIP would provide coverage for individual claims up to $500,000 for each occurrence. Under California DIR regulations, each member of a GSIP must assume joint and several liability for the group's obligations.[4] Moreover, a withdrawing member remains liable for claims against the GSIP arising from years in which it was a member.[5] Should the assets of the group be insufficient to cover the GSIP's obligations, each member theoretically would be subject to an assessment in order to fund the shortage. Therefore, the proposed GSIP incorporates a number of measures to address the possibility of claims exceeding the $500,000 limit or the fund otherwise becoming exhausted:

- *Excess insurance*. The GSIP will obtain excess insurance from an "A"-rated carrier that will provide unlimited funds for individual claims that exceed $500,000. This will eliminate catastrophic claim assessment exposure. Excess insurance is required by DIR regulations.[6]

- *Aggregate insurance*. The GSIP also will obtain aggregate insurance coverage from an "A"-rated carrier. This coverage is optional under DIR regulations. *Id.* § 15478(b). If claims payout reaches 90% of the claims fund, the aggregate insurance carrier would provide an additional $2 million to pay claims falling within the $500,000 limit. In other words, this would be a backup source of liquidity for the payment of ordinary claims. According to WIB's actuary, the likelihood of losses exceeding the $2 million of aggregate coverage is less than 1%.

- *Conservative premium rates*. The premium level will be set at more than double what the actuary has estimated will be needed to cover claims and expenses. The actuary has estimated that premiums of $0.94 per $100 of payroll will be sufficient to cover expected claims, while the actual premium the GSIP intends to charge will be $1.99. In addition, 60% of all premiums will be held as a reserve for future claims, while the industry norm for self-insured groups is 50%. These measures are intended to generate a surplus funding position that will reduce the risk of deficiency assessments on members and permit a premium reduction in later years.

- *Prepayment of first year's premium*. Members will pay all first-year premiums in full at the inception of the GSIP. This will eliminate "uncollected premium exposure," that is,

---

[3] Members withdrawing during their first year of membership would forfeit 35% of their premium payment. After the first year, withdrawing members would pay a 15% of premium penalty, but only if they fail to give 60 days notice of their intent to withdraw.

[4] California Code of Regulations tit. 8, § 15479.

[5] *Id.* § 15480.

[6] *Id.* § 15478(a).

the risk that large claims might be sustained at the inception of the GSIP before it is fully funded.

In the event (which you characterize as unlikely) that the board of trustees of the GSIP concludes that additional funds will be needed to cover claims liability, the board would simply declare a pro rata increase in premiums. You maintain that this is the same thing a private insurance company would do, so a bank that obtained traditional workers' compensation insurance would face the same risk. In fact, you believe there will be less risk of this happening with the GSIP because of the program features outlined above.

[ ] further represents that any premium increases would be declared well in advance of any projected payment of claims so there will be, at all times, sufficient reserves to pay all projected claims. In an extreme case, a high-risk member that is driving up costs can be terminated from the group, just as an insurance company could cancel the policy of such a company. You believe there will never be a time when the GSIP's reserves are depleted, and therefore the risk of joint and several liability actually occurring is statistically insignificant, *i.e.*, less than 1%.

In sum, **[ ]** believes that a GSIP is a superior alternative to either private insurance or the state fund because:

- It can charge lower premiums because it has common risks rather than diversified risks;
- Since it will be started *de novo*, it will not have embedded losses from prior years;
- Excess funds can be returned to the members.

LEGAL ANALYSIS

There is no doubt that national banks have the authority, under 12 U.S.C. § 24(Seventh), to purchase insurance to meet their business needs.[7] The OCC also has approved, on a number of occasions, national bank ownership of or investment in captive insurance companies to provide for the insurance needs of the owning banks.[8]

However, the OCC has not previously approved national bank participation in a self-insurance group such as you propose, primarily because of the possible liability for obligations of other members of the group. Nevertheless, we conclude that your proposal is permissible for national banks. The OCC recognized long ago that issues of structure or organization do not control whether an activity is permissible. For example, we once considered whether national banks

[7] *See, e.g.*, 12 C.F.R. § 7.2013 (fidelity bonds); OCC Bulletin 2004-56, December 7, 2004 (life insurance); former Interpretive Ruling 7.7115, 12 C.F.R. § 7.7115, removed as unnecessary in 1996 (key person insurance); Interpretive Letter No. 965, Feb. 24, 2003 (liability insurance for a national bank operating subsidiary).

[8] *See, e.g.*, Corporate Decision No. 99-3, Dec. 21, 1998 (operating risks of parent bank and its affiliates); Interpretive Letter No. 845, Oct. 20, 1998 (same); Corporate Decision No. 97-92, Oct. 17, 1997 (safe deposit box liability insurance for parent bank and its bank affiliates); Letter of Richard V. Fitzgerald, Chief Counsel, Oct. 22, 1986 (unpublished) (directors' and officers' liability insurance for member banks).

could become members of a mutual insurance company in order to obtain directors' and officers' liability insurance. Since mutual insurance companies are owned by their policyholders, the issue that confronted the OCC was whether a national bank could be part owner of an insurance company. We concluded that there was no reason to limit national banks to stock insurance companies in obtaining insurance coverage. In substance, the banks were simply purchasing needed insurance coverage and so, ignoring the form and looking to the substance of the transaction, the proposal was approved.[9]

The same holds true here. The GSIP form is somewhat novel and has not been approved before. However, looking to the substance of your proposal rather than the form, it is simply a way for banks to obtain necessary workers' compensation insurance for themselves. This activity is clearly permissible.

The cross-liability aspect of your proposal can be viewed as a permissible guarantee. Although courts have held that national banks lack authority to assume unlimited liability for the acts of others as a general partner,[10] and have no power to issue guarantees solely for the benefit of another party,[11] the courts have recognized that national banks do have implied power to issue a

---

[9] Letter of Richard V. Fitzgerald, *supra* note 8.

[10] In *Merchants National Bank v. Wehrmann*, 202 U.S. 295 (1906), the Supreme Court held that the national bank did not have the power to assume unlimited liability for the acts of others and thus could not be a member of the general partnership firm. Because of this precedent, the OCC has taken the position that national banks cannot assume joint and several liability for the acts of others. *See* Interpretive Letter No. 544, Feb. 14, 1991; Interpretive Letter No. 589, June 16, 1992 (affirming previous decision).

This proposal is distinguishable from the situation in *Wehrmann*. The plan incorporates so many safeguards (discussed on pages 3 and 4, *supra*) that the possibility of a bank actually sustaining joint and several liability appears to be *de minimis*. In addition, as you have pointed out, if the GSIP were to experience a shortfall in its claims fund, it would simply raise members' premiums the following year, the same as a commercial insurance company would do.

Most importantly, this is not a partnership; the theoretical joint and several liability here is limited to workers' compensation claims. There is no general liability for any and all acts of the other members of the GSIP as would be the case in a general partnership. This is in sharp contrast to *Wehrmann*, in which the bank was a general partner in a partnership, exposed to liability for any acts of the other partners, and where no safeguards that could protect the bank from liability existed.

Although the unlimited liability rule and the guarantee rule both relate to banks assuming liability for the obligations of others, the guarantee rule is not an exception to *Wehrmann.* They are separate concepts, arising from different lines of case law. The *Wehrmann* rule relates to the unlimited personal liability that is an inherent aspect of a general partnership, while a guarantor's liability is based upon and limited to the obligations described in its contract.

[11] *See*, *e.g.*, *Border National Bank v. American National Bank*, 282 F. 73 (5th Cir. 1922), *cert. denied*, 260 U.S. 701 (1922); *Commercial National Bank v. Pirie*, 82 F. 799 (8th Cir. 1897); *First National Bank v. Crespi & Company*, 217 S.W. 705 (Tex. Civ. App. 1920).

guarantee that is not solely for the other party's benefit, *i.e.*, if the bank has a substantial interest of its own in the transaction.[12]

These cases have been codified in the OCC's regulation at 12 C.F.R. § 7.1017 on permissible national bank guarantees which provides, in part:

> A national bank may lend its credit, bind itself as a surety to indemnify another, or otherwise become a guarantor . . . if:
>
> (a) The bank has a substantial interest in the performance of the transaction involved . . . .

Your proposal satisfies this requirement. A "substantial interest" exists if the guarantee provided by the bank is incidental to an authorized activity.[13] To put it another way, the nexus between the bank permissible transaction and the guarantee provides the substantial interest for the bank.[14] OCC precedents have found a substantial interest in a guarantee to exist in a variety of circumstances.[15]

In particular, your proposal is similar to OCC precedents on national bank membership in securities and commodities exchanges. The OCC has long permitted national banks (or their operating subsidiaries) to be members of such exchanges even if membership requires liability for defaults by other members of the exchange. As long ago as 1975, the OCC approved membership by a national bank operating subsidiary in commodity and mercantile exchanges which carried the possibility of liability for defaults by other

---

[12] *See, e.g., Dunn v. McCoy*, 113 F.2d 587 (3d Cir. 1940) (guarantees entered into by banks for the furtherance of their own rights or as an incident to the transaction of their own business will be enforced notwithstanding the absence of an express grant of power); *American National Bank v. National Wall Paper Co.*, 77 F. 85 (8th Cir. 1896) (a national bank may lend its credit where the bank was to receive and did receive benefit therefrom); *Southern Exchange Bank v. First National Bank*, 141 S.E. 323 (Ga. App. 1928) (national bank has implied power to make a valid contract of guarantee for its own benefit).

[13] *Dunn v. McCoy*, *supra* note 12; Interpretive Letter No. 929, Feb. 11, 2002; Interpretive Letter No. 376, Oct. 25, 1986.

[14] Interpretive Letter No. 1010, Sep. 7, 2004; Interpretive Letter No. 929, *supra* note 13.

[15] *See, e.g.*, Interpretive Letter No. 1010, *supra* note 14 ("financial warranties" provided to mutual fund advised by the bank); Interpretive Letter No. 542, Feb. 6, 1991 (guaranteeing loans made by bank's foreign subsidiary); Interpretive Letter No. 376, *supra* note 13 (guaranteeing owners of securities loaned by bank against loss); Interpretive Letter No. 218, Sept. 18, 1981 (bill of lading guarantee; substantial interest in facilitating liquidation of goods after previous issuance of a letter of credit); Interpretive Letter No. 177, Jan. 14, 1981 (guarantee of reimbursement to payors of direct deposit pension payments in case recipient not entitled to payment).

exchange members. The OCC found this possible liability to be a permissible guarantee because the subsidiary had a substantial interest in being a member of the exchanges.[16]

In 1986, the OCC approved the acquisition by a national bank of an operating subsidiary that was a member of the clearing corporations or associations of several securities and options exchanges. For each of these entities, the operating subsidiary was required to make deposits to a guarantee fund that would be used to satisfy the outstanding obligations of any member that was unable to satisfy its debts. The OCC found that this potential liability for the obligations of other members was not an impermissible guarantee; rather, the subsidiary had a substantial interest in satisfying this guarantee fund requirement in order to retain its ability to provide clearing services to its customers.[17]

More recently, the OCC found that it was permissible for the foreign branch of a national bank to become a member of a securities clearing exchange in order to engage in permissible securities activities. Membership in the exchange required contribution to a default fund to cover losses caused by any defaulting member of the group. The OCC found that contributing to the default fund in order to guarantee the national bank's own obligations as well as those of other exchange members was consistent with the "substantial interest" requirement of 12 C.F.R. § 7.1017.[18]

A similar conclusion can be drawn here. Like the members contributing to the securities and commodities exchange default funds in the precedents discussed above, members of the GSIP will contribute insurance premiums to establish a reserve fund that will be used to pay claims against any member of the group. Contributing to this fund in order to guarantee a national bank's own obligations as well as those of other members of the GSIP satisfies the "substantial interest" test because there is a nexus between the guarantee — which is required for membership — and the permissible activity of obtaining worker's compensation coverage for the bank. Thus, the possible liability for obligations of the GSIP constitutes a permissible guarantee.[19] In addition, your proposal

[16] Letter of J. T. Watson, Deputy Comptroller of the Currency, July 11, 1975 (unpublished). This letter discussed membership in two exchanges. It appears that the subsidiary's potential liability was limited in one case, but not in the other.

[17] Interpretive Letter No. 380, Dec. 29, 1986.

[18] Interpretive Letter No. 929, *supra* note 13.

[19] Although some guarantees that the OCC has found to be permissible involved specific dollar amounts, this is not a requirement for a permissible guarantee. *See, e.g.*, Interpretive Letter No. 1010, *supra* note 14 (financial warranties); Interpretive Letter No. 376, *supra* note 13 (securities lending); Letter of J. T. Watson, *supra* note 16 (commodities exchange default fund).

includes enough safeguards that the possibility of any liability under this guarantee actually coming to pass appears *de minimis*.[20]

Accordingly, we conclude that participation in the workers' compensation GSIP that you describe is permissible for national banks. This conclusion is based on the information and representations that you have provided. A significant change in the facts could require a different conclusion.

I trust that this has been responsive to your inquiry. If you have any questions, please contact Christopher Manthey, Special Counsel, Bank Activities and Structure Division, at (202) 874-5300.

Sincerely,

/s/ *Daniel P. Stipano*

Daniel P. Stipano
Acting Chief Counsel

[20] Interpretive Letter No. 376, *supra* note 13, noted that the guarantee found to be permissible in that case was only a minor part of a much larger package of banking services. Similarly, the guarantee involved in GSIP membership is a very minor part of a much larger program.