Office of the Comptroller of the Currency

Washington, DC 20219

July 10, 2014

Interpretive Letter #1142
July 2014

Subject: Request for Legal Opinion from **[ ]**

Dear **[ ]**:

This letter is in response to your request on behalf of **[ ]** ("Bank"), addressing the Bank's proposal to expand railcar leasing activities through an existing leasing operating subsidiary, **[ ]** ("**[*Sub*]**"). As described below, the Bank proposes that **[*Sub*]** would arrange for third-party repair and maintenance service providers to service on-lease railcars and act as an intermediary between railcar lessees and third-party service providers. We believe that the Bank's proposal is consistent with the OCC's personal property leasing regulation, 12 C.F.R. Part 23.

To accommodate the business needs of its railcar leasing customers, the Bank proposes that **[*Sub*]** would maintain a segregated cash account (hereafter referred to as the "segregated account") for the expected repair and maintenance costs for certain railcar leases that **[*Sub*]** enters into as lessor. **[*Sub*]** would cover the expected repair and maintenance costs for these railcars by collecting fees through an additional rent charge added to each railcar lease payment from its lessees. **[*Sub*]** would establish and maintain the segregated account such that it would be sufficient to cover the anticipated repair and maintenance costs for the company's railcars subject to these third-party service arrangements, plus a reasonable cushion.[1] The Bank represents that the size of the segregated account would be guided by **[*Sub*]**'s expertise in the

[1] At all times, **[*Sub*]** would maintain sufficient funds within the segregated account to cover one month's anticipated costs, plus a reasonable cushion. **[*Sub*]**'s assumptions would be based on average maintenance costs for a fleet of cars consistent with the company's fleet, including new cars as well as older cars that have had some maintenance and upgrades. **[*Sub*]** generally would not purchase for lease older railcars, with larger expected maintenance charges, for which it is arranging servicing and maintenance; in the event **[*Sub*]** did so, however, higher estimated maintenance costs would be included in the fee added to lessees' lease payments. The Bank represents that the size of the segregated account would be maintained with regard only to these expected costs, and that any additional cushion would be designed to protect against cost volatility.

railcar leasing business and extensive historical data on the size and variation of railcar maintenance expenses available in the rail market.[2] If repair and maintenance expenses for the railcars subject to these third-party service arrangements exceed anticipated levels, then at the inception of a new lease term the Bank would increase the rent charge added to each lessee's lease payments to cover the anticipated higher maintenance costs. In addition, the Bank further represents that, in the unlikely event that railcar repair and maintenance expenses were to exceed the amount collected to cover such costs, its holding company, **[*Inc.*]**, would indemnify **[*Sub*]** for the difference.

Under the proposal, **[*Sub*]** would arrange for third-party service repair and maintenance companies to provide services for the leased railcars. When a railcar requires services, the repair or maintenance would be performed by one of these third-party service companies. **[*Sub*]**, having established the segregated account and collected the rent charges from its lessees, would pay the service provider.[3] As such, **[*Sub*]** would serve as a payments intermediary between the lessees and the service providers.

The OCC has long permitted national banks and their subsidiaries to engage in personal property leasing on the theory that it is functionally equivalent to secured lending and thus permissible under 12 U.S.C. § 24(Seventh). This position was upheld in *M&M Leasing Corp. v. Seattle First National Bank*.[4] In *M&M Leasing,* the court held that

> [The] 'business of banking,' which 12 U.S.C. § 24(Seventh) authorizes [national banks] to conduct, includes leases of personal property when, in the light of all relevant circumstances, the transaction constitutes the loan of money secured by the properties leased…. A lease ceases to be a secured loan when the lessor assumes material burdens other than those of a lender of money and is subject to significant risks not ordinarily incident to a secured loan.[5]

The OCC has codified its personal property leasing interpretations and the requirements of *M&M Leasing* in its regulations at 12 C.F.R. Part 23.[6] Section 23.3(a) requires that a permissible section 24(Seventh) lease be a "net lease." A net lease is a lease "under which the national bank will not, directly or indirectly, provide or be obligated to provide for … servicing,

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[2] **[*Sub*]** has been in the leasing business, including railcar leasing, for approximately three decades.

[3] The American Association of Railroad's Interchange Rules require that each railcar bear the service mark of the party who is responsible for repair and maintenance of the railcar. See Rule 1, § 4(a), which provides that railcars "shall be treated as belonging to companies or individuals whose reporting marks are stenciled on the car." To avoid potential customer confusion as to the entity responsible for performing the repairs and maintenance, **[*Sub*]** represents that all on-lease railcars will bear the mark of the designated service provider or intermediary who will work directly with the service provider.

[4] *M&M Leasing Corp. v. Seattle First National Bank,* 563 F.2d 1377 (9th Cir. 1977), *cert. denied,* 98 S.Ct. 3069 (1978).

[5] *Id.* at 1380.

[6] The OCC issued Interpretive Ruling 7.3400 in 1979; that ruling was replaced by 12 C.F.R. Part 23 in 1991.

repair, or maintenance of the leased property during the lease term."[7] However, a national bank may enter into a lease pursuant to which it arranges for a third party to provide servicing, repair, and maintenance of the property at the expense of the lessee.[8] That is what is proposed here. **[*Sub*]** would arrange for third-party service providers to provide maintenance and repair services to railcar lessees, with **[*Sub*]** establishing the segregated account and collecting the additional rent charges to cover the expenses. Neither the Bank nor **[*Sub*]** would provide the repair and maintenance services – third parties would do so – and the lessees would bear responsibility for paying for the services as part of their agreed-upon rent charges paid to **[*Sub*]**. **[*Sub*]**'s role would be limited to arranging for the service and maintenance; establishing and maintaining the segregated account; collecting the additional rent charges from the lessees to cover the expected expenses; and ensuring that the segregated account balance is established at a level adequate to cover one month's anticipated maintenance and repair expenses, plus a reasonable cushion.[9]

The OCC expects that the Bank will conduct its railcar leasing business in a safe and sound manner, including maintaining expertise and experience with respect to the assets acquired for leasing, structuring lease contracts, perfecting security interests in the leased property, and mitigating significant risks that arise out of the leasing activity.[10]

Accordingly, in consideration of the foregoing analysis, based upon the facts and representations provided by the Bank, we conclude that the Bank's proposal is consistent with 12 C.F.R. Part 23 and constitutes permissible exercise of its section 24(Seventh) leasing authority.

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[7] 12 C.F.R. § 23.2(f)(1).

[8] 12 C.F.R. § 23.3(b)(3). In adding this provision in 1991, the OCC noted that it was "consistent with the parameters set forth in [*M&M Leasing*], since the lessee, and not the bank, will remain responsible for paying the cost … for all repairs and maintenance." 56 Fed. Reg. 28314, 28315 (June 20, 1991). Moreover, a national bank lessor has a strong interest in protecting the leased property while it is in the lessee's possession. Arranging for the provision of repair and maintenance services and ensuring that the lessee bears the costs for the services provides the national bank with an efficient means by which it may exercise greater control over the leased property while it is in the hands of the lessee, thereby protecting the residual value of the property. *See* 56 Fed. Reg. at 28325-16.

[9] Banks have long acted in a similar financial intermediary role in other lending areas, such as credit card lending and mortgage lending. In the latter, banks often collect, and subsequently distribute, payments for insurance and taxes.

[10] The industry is subject to significant regulation. In light of the regulatory environment and the nature of **[*Sub*]**'s leased property, maintenance for the railcars is generally conducted on a regularized basis. The American Association of Railroads ("AAR") certifies maintenance providers, and the Bank represents that all third-party service providers with which **[*Sub*]** would arrange for repair and maintenance services would be AAR-certified. The Bank notes that, as a general matter under the AAR Interchange Rules, the primary responsibility for the failure of a railcar is with the railroad moving the car. The Bank further represents that lessees are required to carry liability insurance, that **[*Sub*]** also carries liability insurance, and that the railcar portfolio would be covered under the Bank's general liability coverage.

Our conclusions herein are specifically based on the Bank's representations and written submissions describing the facts and circumstances of the subject transactions, and any change in facts or circumstances could result in a different conclusion.[11]

Sincerely,

signed

Amy S. Friend
Senior Deputy Comptroller
and Chief Counsel

[11] This approval and the activities and communications by OCC employees in connection with this approval, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, the United States, any agency or entity of the United States, or any officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory, and examination authorities under applicable law and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.