Attachment A

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

March 17, 1997

Corporate Decision #97-15
March 1997

Mr. Victor M. DiBattista
Chief Regional Counsel
PNC Bank, N.A.
Fifth Avenue and Wood Street
Pittsburgh, Pennsylvania 15265

Re: Notification by PNC Bank, N.A., Pittsburgh, Pennsylvania, of its intent to establish an operating subsidiary to reinsure mortgage insurance
Application Control Number: 97-NE-08-0008

Dear Mr. DiBattista:

This responds to the notification filed by PNC Bank, N.A., Pittsburgh, Pennsylvania (the "Bank"), of the Bank's intent to establish an operating subsidiary (the "Subsidiary") to reinsure a portion of the mortgage insurance on loans originated or purchased by the Bank or the Bank's lending affiliates. Based upon the representations made by the Bank in writing and in subsequent telephone discussions, we have no objection to the Bank's plan to establish the Subsidiary to engage in the proposed activity.[1]

BACKGROUND

A. Mortgage Insurance Generally

[1] As discussed in the "Analysis" section of this letter, the OCC concluded in Corporate Decision No. 97-06 (January 22, 1997) (the "Chase Letter") and in Interpretive Letter 743 (October 17, 1996) ("IL 743"), that reinsuring a portion of the mortgage insurance on loans originated or purchased by the parent bank of an operating subsidiary, or by affiliates of that bank, is generally permissible under the National Bank Act as part of, or incidental to, the business of banking.

Mortgage insurance protects an investor holding a mortgage loan against default by the mortgagor. Banks and mortgage lenders generally require that borrowers obtain mortgage insurance from third-party mortgage insurers on low down payment loans.[2]

Mortgage insurance has played a vital role in helping low and moderate-income families become homeowners by allowing families to buy homes with less cash. Mortgage insurance also has expanded the secondary market for low down payment mortgages and the funding available for these loans. Government sponsored enterprises such as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, and most other purchasers in the secondary market, typically will not consider purchasing low down payment conventional loans unless the loans have mortgage insurance. Secondary market purchases of low down payment loans with mortgage insurance helped fuel the expansion in home construction and sales during the 1970s and 1980s, aiding many first-time and other home buyers. See Mortgage Insurance Companies of America 1995-1996 Fact Book.

B. The Proposed Reinsurance Activities

1. The Reinsurance Relationship Generally

Under the Bank's proposal, the Subsidiary will enter into reinsurance agreements[3] with a number of unaffiliated insurance carriers that issue mortgage insurance on mortgage loans originated or purchased by the Bank or its affiliates. Under the Bank's proposal, therefore, the Subsidiary is agreeing to accept from a mortgage insurer a portion of the risk of default associated with certain mortgage loans made or purchased by the Bank or the Bank's affiliates.[4] In return for accepting risk of default, the Subsidiary will receive a share of premiums paid under reinsurance agreements between the Subsidiary and one or more primary mortgage insurers (each an "Insurer").

2. Terms of the Reinsurance Agreements

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[2] For purposes of this letter, "low down payment loans" are those loans with down payments of less than 20 percent of the property's value, or loans with loan-to-value ratios in excess of 80 percent.

[3] Reinsurance is a process whereby an original insurer reduces its underwriting risk by passing all or part of this risk on to another insurance company. The first underwriter may retain only a portion of the risk and reinsure the balance with a second company that then owns the cash flow and assumes that portion of the risk. See 13A John Alan Appleman & Jean Appleman, Insurance Law and Practice § 7681 (1976).

[4] The Bank, either directly, or through its affiliates, will originate or purchase all the residential mortgage loans covered by mortgage insurance that the Subsidiary will reinsure.

Under the reinsurance agreements, the Subsidiary will become liable to the extent provided in the reinsurance agreement to the Insurer when a loan insured by an Insurer goes into default (i.e., the borrower does not make a scheduled payment of principal and/or interest by the stated due date or within the stated grace period). The Bank represents that under the terms of the reinsurance agreements between the Subsidiary and the Insurers, the Subsidiary's maximum contractual exposure will be limited to an exact percentage of the mortgage insurance risk for a designated pool of loans.[5] Additionally, the Bank represents that its potential liability for the Subsidiary's reinsurance obligation will not exceed the Bank's investment in the Subsidiary.

The Subsidiary will not reinsure insurance on mortgage loans that have not been originated or purchased by the Bank or its affiliates, and will not underwrite such insurance as a primary insurer.

3. Capitalization and Reserve Requirements

The capitalization of the Subsidiary will be subject to both initial and ongoing requirements, which may vary depending on its size and expected book of business, and other factors. The Subsidiary will maintain a statutory contingency reserve as required by state insurance authorities. This reserve is essentially a "reservation of capital" that restricts dividend payments. The Bank represents that in most states, the contingency reserve is accumulated by retaining 50 percent of earned premiums each year.[6] In most states, the Subsidiary may make withdrawals from the contingency reserves to the extent that losses exceed 35 percent of earned premiums in any year.

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[5] In order to properly allocate risk between Subsidiary and an insurance company, the Bank proposes that loans will be categorized by: (i) origination date; (ii) loan-to-value ratio; and (iii) loan type. For example, all fixed-rate loans with a loan-to-value ratio of 90% originated in a calendar year would comprise a single book of business for reinsurance purposes. For each calendar year, the aggregate risk for each book would be determined by multiplying the original principal balance of each loan in such book by the applicable coverage percentages. Thus, a book comprised of 1,000 loans, each having an original principal balance of $100,000 and mortgage insurance with a 30% coverage ratio (i.e. the amount the insurer would be required to pay upon default) would present an aggregate risk of $30 million. Subsidiary proposes to reinsure a relatively small portion of such risk pursuant to the terms of a reinsurance agreement with the insurer. The reinsurance arrangement would vary from a ratable distribution of such risks to a stratification of such risks on a senior/subordinate basis. For example, the reinsurance may be structured so that insurer would be responsible for the first 5% of incurred loss, the Subsidiary for the next 5%, and the insurer again for all losses in excess of 10%.

[6] All investments made by the Subsidiary will be limited to those investments which are permissible for national banks.

Also, the OCC requires that national banks hold capital commensurate with the level and nature of all the risks of their business, including the operation of operating subsidiaries. If the OCC determines that the Bank's capital levels do not adequately protect the Bank from any risks of the reinsurance business of its Subsidiary, the OCC may use its authority under 12 C.F.R. Part 3 to require the Bank to maintain additional capital.[7] The Bank has made a commitment to evaluate the risks presented by the Subsidiary's reinsurance activities and to maintain appropriate levels of capital for the Bank and the Subsidiary.[8] The Bank represents that it will have in place management information systems that will enable the Bank, and the OCC as part of its supervision of the Bank, to monitor, on a quarterly basis, the amount of the Bank's risk-based capital and the amount of reinsurance risk in force at the Subsidiary to verify that the level of Bank capital is sufficient to support the risk. Moreover, the Bank represents that the Subsidiary has made a commitment to establish and maintain adequate contingency and specific case basis reserves as required under the reinsurance agreements with the account balance supported by an analysis of the appropriate factors.

The Bank represents that under standard insurance accounting practices and the applicable reinsurance agreements, the reinsurer or the primary insurer is required to establish the following types of reserves for reinsurance risks: an unearned premium ("UEP") reserve, a loss reserve, and an incurred but not reported ("IBNR") loss reserve. The UEP reserve represents the unearned portion of premiums assumed. The loss reserve represents estimated future loss payments for loans that are delinquent but for which an insurance claim has not yet been perfected and paid. The IBNR loss reserve is a liability for future estimated losses and loss adjustment expenses for loans which are delinquent, but not yet reported as such to the primary mortgage insurer.

4. Consumer Provisions

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[7] Section 3.10 specifically authorizes the OCC to require higher capital ratios for an individual bank in view of its circumstances. For example, higher capital ratios may be required for "a bank with significant exposure due to the risks from concentrations of credit, certain risks arising from nontraditional activities, or management's overall inability to monitor and control financial and operating risks presented by concentrations of credit and nontraditional activities." 12 C.F.R. 3.10(d).

[8] The OCC will treat the Subsidiary's reinsurance obligation as recourse with respect to loans that the Bank originates or acquires, and subsequently sells, and will apply a capital requirement for the obligation equivalent to the Bank's maximum contractual obligation, which, in this case will be limited to its investment in the Subsidiary. To the extent that the Bank believes and can demonstrate to the satisfaction of the OCC that its actual risk is less than this amount, the OCC will consider whether a different approach to determining the Bank's capital requirement would be more appropriate.

The Bank has relationships with various mortgage insurance companies and purchases mortgage insurance directly from an insurer. The borrower is charged for the cost of such insurance. Charges for mortgage insurance are included in the monthly payments and annual percentage rates disclosed by banks to customers who are shopping for a low down payment mortgage. Mortgage insurance fees thus are a component of the costs customers consider when comparing competitive loan products. The Bank has represented that, in the highly competitive market for residential mortgage loans, the Bank and its affiliates have an overriding incentive to arrange for reasonably priced mortgage insurance fees in order to offer competitively priced loans. The Bank has also represented that mortgage insurers are regulated under state laws that include requirements for rate filings and approval.

The Bank also represents that the Bank and its affiliates will disclose to borrowers prior to loan closing that the Subsidiary will reinsure a portion of the mortgage insurance issued in connection with the loan and, in return for assuming such risk, the Subsidiary will receive a portion of the insurance premium. These disclosures will assure borrowers that the reinsurance arrangement does not affect the costs of such insurance to the borrower. The Bank further represents that it will allow its borrowers the option to exclude their mortgage insurance from the reinsurance arrangement with the Subsidiary.

5. Safety and Soundness Considerations

The Bank's proposal includes safeguards to limit its mortgage reinsurance risk. The Subsidiary will be a state-chartered monoline company (that is, its business will be restricted to the reinsurance of mortgage insurance) and will reinsure mortgage insurance only on loans originated or purchased by the Bank or one of its affiliates. The Subsidiary will not reinsure other mortgage loans and it will not underwrite mortgage insurance as a primary insurer.

The Bank's own credit standards and credit underwriting experience will provide valuable tools to manage risk since the Subsidiary will only accept home mortgage loan credit risks consistent with the Bank's underwriting standards. At present, the Bank and its mortgage lending affiliates purchase mortgage insurance from several different underwriters. These mortgage insurance underwriters have accepted the mortgage lending standards of the Bank and the Bank's mortgage lending affiliates[9] as a sufficient basis for determining if they will issue mortgage insurance coverage. Under this process, commonly referred to as "delegated underwriting," the mortgage insurance companies rely on the same underwriting standards and the same personnel used by the Bank and the Bank's mortgage lending affiliates in determining whether to approve a particular mortgage loan in the first instance. Thus, the approval of mortgage loans by the Bank and the Bank's mortgage lending affiliates is accepted by the mortgage insurance companies as the basis upon which to issue mortgage insurance coverage.

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[9] The Bank has represented that its affiliates use underwriting standards comparable to the Bank's for their mortgage loans.

The Subsidiary will also be subject to regulation and oversight by regulatory authorities. As a state-chartered reinsurer, the Subsidiary will be subject to regulation by the state insurance authorities and state law requirements including licensing, capital, and reserve requirements. The Bank has represented that its current intention is for the Subsidiary to be chartered in Vermont. The Bank also represents that under the reinsurance agreements between the Subsidiary and the mortgage insurers, the Subsidiary will comply with the reinsurance regulatory requirements of the mortgage insurer's state of domicile.

In return for accepting the limited credit risk associated with the proposed reinsurance arrangement, the Subsidiary will receive insurance premiums, as well as investment income from its cash flow, providing a potentially important source of revenue for the Bank and the Subsidiary.

ANALYSIS

A. "Business of Banking" Analysis

The OCC previously has determined that reinsuring a portion of the mortgage insurance on loans originated or purchased by the parent bank of an operating subsidiary, or by the parent bank's lending affiliates, is generally permissible under the National Bank Act because this activity is part of, or incidental to, the business of banking. See Chase Letter and IL 743. In both the Chase Letter and IL 743, the OCC concluded that, in general, this kind of reinsurance activity is part of the business of banking because the activity (1) is functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) responds to customer needs or otherwise benefits the bank or its customers; and (3) involves risks similar in nature to those already assumed by banks. The OCC also concluded in the Chase Letter and IL 743 that, even if the activity were not part of the business of banking, it would be permissible as an activity incidental to banking, particularly to a national bank's express power to make loans, because it optimized the use of the bank's credit underwriting capacities.

In determining whether this activity is permissible in the Bank's particular case, we will discuss each of the "business of banking" factors analyzed in the Chase Letter and IL 743, and apply them to the specific facts of the Bank's proposal.

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

The Bank's reinsurance, through its Subsidiary, of mortgage loans made or purchased by the Bank or its affiliates, is functionally equivalent to, or a logical outgrowth of, the Bank's business of underwriting mortgage loans. National banks are expressly authorized to make loans under 12 U.S.C. § 24(Seventh) and to underwrite mortgages under 12 U.S.C. § 371.

The proposed reinsurance arrangements are comparable to the extension of low down payment mortgage loans without mortgage insurance, but with higher interest rates to cover the risk of nonpayment. Through the reinsurance vehicle, the Bank is engaged in credit judgments and assumes credit risks comparable to those involved in making these mortgage loans without mortgage insurance. With both arrangements, the Bank's decision to accept those credit risks are determined by the Bank's underwriting standards, which are derived from the Bank's lending experience and expertise.[10] Moreover, the risks assumed by the Bank are credit risks rather than actuarial risks. Unlike many traditional forms of insurance, which relate to casualties, death, disability, etc., the Subsidiary's reinsurance would relate to the ability of the mortgage borrower to pay the underlying mortgage obligation. Thus, when reinsuring a mortgage insurance risk, the Subsidiary essentially assumes credit rather than actuarial risk.

The Subsidiary's proposed reinsurance activities also are functionally equivalent to a partial repurchase of a national bank's own loans, a traditional banking activity. It is well established that banks may originate, purchase and sell mortgage and other loans. See 12 U.S.C. § 371(a); OCC Letter No. 418, reprinted in Fed. Banking L. Rep. (CCH) [1988-89 Transfer Binder] ¶ 85,642, at 78,011 (Feb. 17, 1988) (referring to origination, making, purchase and sale of real estate loans as "centrally traditional banking activities"); OCC, Mortgage Banking: Comptroller's Handbook 1-3, 9-10 (March 1996). Under the proposed reinsurance arrangements, the Subsidiary will accept from a primary mortgage insurer part of the credit risk from loans originated or purchased by the Bank or its affiliates. Both the proposed mortgage reinsurance and the repurchase of participations in the Bank's loans thus would involve credit decisions based on the same underwriting criteria and comparable credit risks. Both involve the receipt of income for assuming those credit risks and the assumption of losses when the borrower defaults for any reason. The proposed reinsurance activities thus are functionally equivalent to established bank lending activities.

The process of reinsuring mortgage insurance in the manner proposed by the Bank is "functionally interchangeable" with the process of lending and is essentially a new way of conducting an aspect of the very old business of banking. See M&M Leasing Corp. v. Seattle

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[10] As discussed previously, all of the mortgage insurers through which the Bank currently purchases mortgage insurance practice "delegated underwriting." Specifically, those insurers rely on the Bank's (or the Bank's affiliates') mortgage lending standards as a sufficient basis for determining if they will issue mortgage insurance. The approval of mortgage loans by the Bank and the Bank's mortgage lending affiliates is accepted by the mortgage insurance companies as the basis upon which to issue mortgage insurance coverage. Accordingly, when the Subsidiary engages in the proposed reinsurance activity, the Subsidiary will be relying on the same credit analysis and underwriting standards used by the Bank or the Bank's mortgage lending affiliates in determining whether to approve a mortgage loan in the first instance. Thus, the proposed reinsurance activity is functionally comparable to a lender's role, based on the same credit analysis and standards used by the lender.

First National Bank, 563 F.2d 1377, 1382 - 1383 (9th Cir. 1977). In the M&M Leasing Corp. decision, the court affirmed the opinion of the Comptroller, holding that personal property leasing was a permissible activity for national banks. The court concluded that leasing, when the transaction constitutes a loan secured by leased property, is essentially the lending of money on personal security, an express power under the National Bank Act. Id. at 1382. In its analysis, the court discussed how financial leasing is similar to lending on personal security, serves the same purpose as lending, and is "functionally interchangeable" with lending. The court stressed that this "functional interchangeability" was the touchstone of its decision. Id. at 1383. Similarly, in American Insurance Association v. Clarke, 865 F.2d 278 (D.C. Cir. 1988), the court also considered whether a new activity was "functionally equivalent" to a recognized banking power. There, the court affirmed the Comptroller's opinion that the use of standby credits to insure municipal bonds was functionally equivalent to the issuance of a standby letter of credit, a device long recognized as within the business of banking. The Bank's proposal to reinsure loans through its Subsidiary is clearly consistent with this line of analysis and represents an alternative way for the Bank to extend mortgage loans.

The Bank's proposal is also consistent with other bank activities related to banks' lending powers. Under 12 C.F.R. § 7.1013 a national bank may offer debt cancellation contracts for the death or disability of a borrower.[11] The Bank's credit position, as reinsurer of mortgage loans through its Subsidiary, would resemble the position assumed by lenders in issuing debt cancellation contracts. In both of these activities, the initial credit decision also provides the basis for assuming the additional role involving the loan. Moreover, in both cases the risk assumed is closely related to the risk of default that is inherent in banks' lending functions.[12] The fact that the Subsidiary's reinsurance activities will include reinsuring mortgage insurance on certain mortgage loans that are not originated or purchased by the Bank, i.e., mortgage loans that are originated or purchased by the Bank's mortgage lending affiliates, does not affect the permissibility of the Bank's proposal. Under the Bank's proposed reinsurance arrangement, a portion of the risk of default associated with a loan held by a mortgage lending affiliate would simply be transferred to the Subsidiary. According to the Bank, the Subsidiary will only reinsure those loans that meet the Bank's credit standards. In

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[11] See also Interpretive Letter No. 277, December 21, 1983, reprinted in [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,441 (permitting national banks to underwrite credit life insurance); Interpretive Ruling 7.1016 (permitting national banks to issue and honor independent undertakings).

[12] Debt cancellation contracts provide for the cancellation of specified loan amounts upon the occurrence of a specific event (e.g., the borrower's death), whereas private mortgage insurance covers mortgage loan defaults for any reason where there is insufficient mortgage loan collateral. Thus, the risks assumed when a bank reinsures mortgage loans is more analogous to a bank's lending than the risks assumed when a bank issues debt cancellation contracts.

any case, the Bank has represented that its affiliates use comparable underwriting standards for their mortgage loans.[13] As a result, the Bank will be reinsuring essentially homogenous mortgage loans originated under the oversight and subject to the credit guidelines of the same overall banking company. The fact that the banking company may choose for business reasons to originate some portion of these mortgage loans from the Bank's affiliates, or to purchase some portion of these mortgage loans, does not in this instance limit the Bank's authority to engage in the proposed reinsurance activity.[14]

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

The Bank's proposal potentially benefits the Bank and its customers. The Bank and its mortgage lending affiliates usually require a down payment of at least 20 percent of the appraised value of a home. However, the Bank and its mortgage lending affiliates will accept smaller down payments if repayment of a mortgage is backed by mortgage insurance. Thus, customers benefit from mortgage insurance because it enables them to make small down payments on the purchases of their homes. They have the option of paying the higher monthly costs associated with low down payments, or paying a larger down payment. The Bank's involvement in mortgage reinsurance should not diminish customers' ability to obtain optional mortgage insurance, and may even increase competition and promote the availability of mortgage insurance at competitive rates.

The Bank's proposal also benefits the Bank because it provides the Bank flexibility in structuring its activities to obtain new sources of credit-related income. Mortgage insurers assume some of the credit risks on the Bank's low down payment loans that would otherwise be borne by the Bank. Through the proposed reinsurance activities, the Bank may acquire additional mortgage credit business that can be managed as part of the Bank's overall mortgage credit risk management program. This additional business provides the Bank an alternative vehicle for achieving risk objectives. One alternative approach by which the Bank could expand its mortgage credit-related business would be to buy interests in loans originated by unrelated lenders. However, this approach has the drawback that the initial underwriting of the mortgage-related risk would not have been done by the Bank's own (or an affiliate's) personnel, using the Bank's underwriting standards. Thus, the Bank would need to review the underwriting standards and credit information for the loans, or obtain appropriate

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[13] See footnote 9, supra.

[14] In many respects, the Subsidiary's reinsurance on a portion of the Bank's affiliates' mortgage loans is equivalent to purchasing participations in those mortgage loans, an express power. In general, a mortgage insurance reinsurer relies on the same credit standards as a bank would in determining whether to purchase a loan participation. A mortgage insurance reinsurer and the purchaser of a loan participation also receive income for assuming credit risks and incur loss when the borrower defaults for any reason.

credit enhancements and guarantees, since it would not have the same familiarity with the borrowers as with its own (or its affiliate's) loans. Mortgage reinsurance thus may provide the Bank a means to manage its mortgage-related risk exposure that could be preferable due to cost or safety and soundness considerations.

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

As discussed, the risks a national bank confronts in reinsuring mortgage insurance in the manner proposed by the Bank are essentially the same type as the risks associated with the permissible activities of underwriting mortgage loans. Through the proposed reinsurance activities, the Subsidiary will assume additional risks transferred by the Bank to a mortgage insurer. However, these Subsidiary risks are similar to risks that would be incurred by the Bank or its mortgage lending affiliates on a loan with a high loan-to-value ratio not covered by mortgage insurance or through purchases of participations in the Bank's loans. Under the reinsurance agreement, this credit-like risk is simply transferred from the Bank or its mortgage lending affiliates to the primary mortgage insurer, and then to the Subsidiary.[15] The Subsidiary receives compensation for the risk of default through its share of premiums paid under the reinsurance contract. Moreover, because the underwriting standards for mortgage insurance are the same as those for the mortgage loans themselves, the Subsidiary's likelihood of liability on a claim is no different than that of the Bank (or the Bank's mortgage lending affiliate) upon default if the loan were not covered by mortgage insurance.[16]

B. Incidental To the Business of Banking Analysis

The OCC also determined in IL 743 that even if the Bank's proposal were not viewed as part of the business of banking, reinsuring a portion of the mortgage insurance on loans originated or purchased by the parent bank of an operating subsidiary, or originated or purchased by the

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[15] The credit-like risk transferred to the Subsidiary is also similar to the risk assumed by a bank in repurchasing an interest in a loan that the bank has previously sold, or in retaining an interest in a pool of loans that the bank has securitized.

[16] We note that as a result of the Subsidiary reinsuring mortgage insurance on the loans of the Bank and its affiliates, the Subsidiary would have the added advantage of commencing the activity with a clear understanding of the mortgage insurance reinsurance operation, the geographic distribution of the mortgage loan portfolio, and historic default rate experience. The Bank and its mortgage lending affiliates maintain risk management procedures designed to control geographic distribution of the mortgage loan portfolio and other concentration risks. The Bank represents that these risk management procedures enable the Bank and its mortgage lending affiliates to avoid undue concentrations in their loan portfolios. The Bank represents that these same risk management procedures will also enable the Bank to avoid undue concentrations in connection with the Subsidiary's mortgage reinsurance operations.

parent bank's lending affiliates, is generally permissible because this activity is incidental to the business of banking. The OCC concluded in IL 743 that this reinsurance activity is incidental to a national bank's express power to make loans.

Based on the particular facts of the Bank's case, the Bank's proposal clearly is incidental to the business of banking. In VALIC, 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. VALIC at 814, n.2. The VALIC decision further established that banks may engage in activities that are incidental to the enumerated powers as well as the broader "business of banking."

Prior to VALIC, the standard that was 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, 472 F.2d 427 (1st Cir. 1972) ("Arnold Tours"). The Arnold Tours standard defined an incidental power as one that is "convenient or useful in connection with the performance of one of the bank's established activities pursuant to its ***express*** powers under the National Bank Act." Arnold Tours at 432 (emphasis added). Even prior to VALIC, the Arnold Tours formula represented the narrow interpretation of the "incidental powers" provision of the National Bank Act. Interpretive Letter 494 (December 20, 1989). The VALIC decision, however, has established that the Arnold Tours formula provides that an incidental power includes one that is convenient and useful to the "business of banking," as well as a power incidental to the express powers specifically enumerated in 12 U.S.C. § 24(Seventh).

The activity the Bank proposes is incidental to the business of banking under the Arnold Tours standard. Reinsuring mortgage insurance in the manner proposed by the Bank is incidental to its express power to make loans. The proposed activity is "convenient" and "useful" to the Bank's power to make loans because it will enable the Bank to structure mortgage loans in a more flexible way. Arnold Tours.[17] Specifically, the proposed activity will provide the Bank an alternative structure for making loans that could otherwise be made with a higher rate of interest to cover the increased risk of nonpayment associated with a low down payment. The proposed activities also provide the Bank an alternative to participating in loans to expand its credit activities. This flexibility is convenient and useful to the Bank in determining how to structure its mortgage lending activities in the most efficient and profitable manner and in offering a competitive array of mortgage lending products to its customers. The proposed activities also are incidental to lending activities because they enable the Bank to optimize the use of its existing credit staff and credit expertise to generate

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[17] See also, Franklin National Bank of Franklin Square v. New York, 347 U.S. 373 (1954) (power to advertise bank services); and Auten v. United States Nat'l Bank, 174 U.S. 125 (1899) (power to borrow money). In these cases the courts' holdings relied on whether the activity was "useful".

additional revenues through activities that support and enhance the Bank's lending business. The activities also enable the Bank to better manage its credit portfolio.

CONCLUSION

Based upon the foregoing facts and analysis, and the commitments made by the Bank in connection with the Bank's request, the Subsidiary may reinsure mortgage insurance for loans made or purchased by the Bank or the Bank's mortgage lending affiliates, in the manner described in this letter.

Sincerely,

/s/

Julie L. Williams
Chief Counsel