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Richard J. Weaver
Commissioner of Finance

October 17, 2013

Re: Interpretive Letter 2-2013: Request under Section 362.106(4), RSMo.
Activity requested – Investment by Banks to purchase interests in publicly traded mutual funds for the purpose of hedging the Bank's obligations under deferred compensation plans maintained by the Bank for its employees

In a letter dated July 24, 2013, you requested a determination from this office that would permit Missouri state-chartered banks to purchase interests in publicly traded mutual funds for the purpose of hedging the Bank's obligations under deferred compensation plans maintained by the Bank for its employees.

Under §362.106(4) RSMo, Missouri's "Super Wildcard Law," state-chartered banks may exercise specific powers that are requested in a notice and writing submitted to the director of finance if within the notice period the director determines that the proposed activity is not unsafe or unsound and that the bank meets the prescribed federal standards for national banks. The director may either take no action or issue an interpretive letter that specifically describes the activity permitted and any limitations on the activity.

National Authority

In support of the request, you rely on Office of the Comptroller of the Currency Interpretive Letter No. 878. The OCC determined that "holding various insurance company products and investment funds in order to hedge, on a dollar-for-dollar basis, obligations to make payments to employees under nonqualified deferred compensation plans" was an acceptable activity for a national bank.

The situation examined by the OCC involved a participating employee deferring a portion of his or her income from a bonus for a period of time and selecting a benchmark fund from a list of options. The employee did not own an interest in the benchmark funds. Instead, the employees owned an unsecured contractual obligation of the bank to pay the deferred amount at the distribution date. Some of the available fund choices involved investments that were not permissible for the bank.

The OCC determined that banks have the express power to employ officers and directors 12 U.S.C. §24(Fifth). Therefore, the power to reasonably compensate those individuals is incidental to banking under 12 U.S.C. §24(Seventh). The form of compensation is not expressly provided for in federal law but it must be consistent with safety and soundness considerations.

In examining the bank's ability to make investments, the OCC recognized that 12 U.S.C. §24(Seventh) prohibits banks from investing and underwriting for speculative purposes in most circumstances. However, the bank was not asking for investment authority to act on its own behalf. Instead, the requested activity would actually benefit the employee whose deferred compensation would be better protected.

The OCC also lists several situations where national banks have been allowed to hedge risk without violating the prohibition on speculative activities. Examples provided include allowing rabbi trusts, equity derivative swaps, offering non-transferable time deposit accounts paying interest based in part on movements in the S&P 500 Index and hedge its interest obligations by purchasing or selling futures contracts on the same index. In each case, the ability to hedge is premised on the fact that the hedge avoids risk on a permissible activity.

The OCC then concludes that a national bank may hold interest in investment funds in order to hedge, on a dollar-for-dollar basis, the bank's deferred compensation obligations to employees. The OCC includes other investment type products in their approval but those investment products are not at issue in this request.

Missouri Authority

Investment powers for a bank to invest for its own account fall within the "powers incidental to the business of banking" found in §362.106(1) RSMo. Limitations on that power are found in §362.170 RSMo. That provision limits investments to a bank's legal lending limit unless the investment falls within one of the enumerated exceptions. Investments to hedge against obligations on a deferred compensation plan are not one of the enumerated exceptions.

Summary and Findings

Section 362.106 permits the director to allow a requested activity, subject to the same limitations as those imposed on national banks, with any additional limitations necessary to find that such request is a safe and sound bank practice. In this case, the director has determined that permitting Missouri state-chartered banks to purchase interests in publicly traded mutual funds for the purpose of hedging the bank's obligations under deferred compensation plans maintained by the bank for its employees is a safe and sound practice.

Under the arrangement requested by the Bank, the employee will direct the investment which will be held with a principle in the Bank's name. The funds used for investment can come from one of three sources: (1) employee contribution; (2) executives with discrimination issues with deferrals to their 401K plan could move returned money to the deferred compensation plan or (3) direct contributions by the Bank subject to vesting. Because the employee will be directing the investment, there are no issues with trust powers as might exist if the Bank were directing the investments.

The director agrees with the rationale employed by the OCC in determining that the requested activity does not constitute an unsafe or unsound practice. The requested investment is not for speculative purposes on the bank's behalf. Instead, the requested investment activity would actually be on behalf of an employee compensated under a deferred compensation plan and would be for the benefit of that employee. Therefore, the director concludes that a Missouri state-chartered bank may hedge its obligation under a deferred compensation plan.

This letter will be filed today with the Office of the Missouri Secretary of State and posted on the public internet website of the Division of Finance. It will become effective ten (10) days after filing with the Secretary of State. If you have any questions regarding this matter, please contact Christie Kincannon, Chief Counsel for the Division.

Very truly yours,

Richard J. Weaver
Commissioner of Finance

RJW:pn