



Office of Thrift Supervision  
Department of the Treasury

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June 23, 2006

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Re: Authority of a Federal Savings Association to Make a Pass-Through Investment In a Title Insurance Agency

Dear [ ]:

This responds to your inquiry, submitted on behalf of [ ], [ ] (Association), a federal savings association, and [ ], seeking confirmation that the Association may make a pass-through investment in a title insurance agency. For the reasons discussed below, we conclude that federal savings associations have incidental authority to sell title insurance on an agency basis and, therefore, the Association may make a pass-through investment in a title insurance agency.

**I. Background**

You have provided the following information. The Association desires to make a pass-through investment, pursuant to Office of Thrift Supervision (OTS) regulation section 560.32,<sup>1</sup> in the Title Center of Greater Kentucky, LLC, a title insurance agency (Title Agency). Title Agency was organized under provisions of the Kentucky Limited Liability Company Act for the purpose of acting as a title insurance agency and other lawful purposes. Title Agency has two categories of membership interests, Class A and Class B. The Class A Member interests represent 15% of the ownership interests of Title Agency and are held by Investors Title Insurance Company (Insurance Company) and KBA Services, Inc.<sup>2</sup> The Class B Member interests represent the remaining 85% of the ownership interest of Title Agency and consist of financial institutions in Kentucky and Southern Indiana.<sup>3</sup> Title Agency is a joint venture formed for the common interests of the members.

<sup>1</sup> 12 C.F.R. § 560.32 (2006) (Pass-through investments).

<sup>2</sup> KBA Services, Inc., a Kentucky corporation, is a wholly-owned, for-profit subsidiary of the Kentucky Bankers Association.

<sup>3</sup> The Class B Members are entitled to one vote for each unit held and may withdraw from Title Agency with sixty days written notice. The ownership interests of Class B Members are subject to dilution upon the admission of additional members.

Title Agency has a manager, who has full and exclusive discretion to manage and control the business of Title Agency, subject to oversight by a board of managers (Board). The Board consists of a minimum of three members of the Title Agency, or their designees. Title Agency members have no fiduciary or partnership relationship between or amongst themselves solely by reason of their status as members of Title Agency. An Operating Agreement between Title Agency, KBA Services, Inc., and the members (Operating Agreement) provides that no member of the Title Agency shall have any liability to Title Agency or to other members for any monetary damages resulting from a single transaction, occurrence, or course of conduct that does not constitute willful wrongdoing or intentional disregard of the terms of the Operating Agreement.

You represent that pursuant to an agreement between Title Agency and Insurance Company (Agency Agreement), Title Agency is designated as an "agent" of Insurance Company and is required to receive and process applications for title insurance in a prudent and ethical manner; not make errors or omissions in abstracting or examining title; issue title insurance commitments, policies, insured closing letters, and other documents granting title insurance coverage for and on behalf of Insurance Company; ensure that any commitment or policy issued correctly describes the property, reflects the condition of the title, and appropriately reflects any liens, claims, encumbrances, or defects; and comply with confidentiality provisions in the Gramm-Leach-Bliley Act (GLBA)<sup>4</sup> and regulations promulgated thereunder. You further represent that under the Agency Agreement, Title Agency is required to maintain a Title Insurance Agent's Errors and Omissions Policy with opinion of title coverage of not less than \$[ ] with a deductible provision of no more than \$[ ] per loss; a Fidelity Bond of \$[ ] covering officers and employees of Title Agency; and a Surety Bond of \$[ ] on each employee licensed in Tennessee. The Agency Agreement also spells out the responsibilities of Insurance Company with respect to Title Agency. The Agency Agreement is for a term of [ ] years, subject to termination provisions.

To become a member of Title Agency, Association proposes to purchase [ ] units of Class B Member interests for the aggregate purchase price of \$[ ]. You represent that the amount of the Association's proposed investment in Title Agency will be not more than 15% of the Association's total capital, and that the book value of the Association's aggregate pass-through investments, after taking into account the Association's proposed investment in Title Agency, will not exceed 50% of the Association's total capital.<sup>5</sup> The Association would be merely one of several Class B Members.

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<sup>4</sup> Pub. L. 106-102, 113 Stat. 1338 (Nov. 12, 1999)

<sup>5</sup> You indicate that the Association's proposed investment of \$[ ] in Title Agency represents approximately [ ]% of the Association's total capital, and that the Association's aggregate pass-through investments after making the proposed investment will be approximately [ ]% of its total capital. The Association's proposed investment would represent ownership of approximately [ ]% of the outstanding ownership units of Title Agency.

## II. Discussion

### A. Authority of A Federal Savings Association to Sell Title Insurance as Agent

The Home Owners' Loan Act (HOLA)<sup>6</sup> and OTS's implementing regulations permit federal savings associations to make certain investments, either directly or through subsidiaries. Section 560.32 of OTS's regulations authorizes federal savings associations to make, under certain conditions, "pass-through" investments, *i.e.*, an investment in an entity that engages only in activities that a federal savings association may itself conduct directly.<sup>7</sup> The regulation provides three possible avenues for a federal savings association to make a pass-through investment. First, if the federal savings association satisfies five specified conditions, it may make a pass-through investment without giving prior notice to OTS.<sup>8</sup> Second, if the five conditions are not met, an association must give OTS 30 days' advance notice of the association's intent to make a pass-through investment, and if OTS does not raise any supervisory, legal, or safety and soundness concerns within the 30 days, the association may proceed to make the investment.<sup>9</sup> Third, if OTS raises concerns in response to the advance notice, then the association must apply for and receive OTS's prior written approval before making the investment.<sup>10</sup>

The pending request thus requires an initial determination whether the activities of Title Agency are permissible for federal savings associations to conduct directly. If the activities are permissible, we must then ascertain whether the five conditions are present and if not, whether there are legal, supervisory, or safety and soundness concerns with the proposed investment.

Neither the HOLA nor OTS regulations specifically authorize federal savings associations to sell title insurance as agent, and to date, OTS has not otherwise specifically addressed the permissibility of such activity.<sup>11</sup> The authority of federal savings associations to engage in other

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<sup>6</sup> 12 U.S.C.A. §1461 *et seq.* (West 2001 & Supp. 2005).

<sup>7</sup> 12 C.F.R. § 560.32 (2006).

<sup>8</sup> The conditions are: (1) an association does not invest more than 15% of its total capital in one company; (2) the book value of the association's aggregate pass-through investments does not exceed 50% of the association's total capital; (3) the investment would not give the association direct or indirect control of the company; (4) the association's liability is limited to the amount of its investment; and (5) the company is a limited partnership, an open-end mutual fund, a closed-end investment fund, a limited liability company, or an entity in which the association is investing to use the company's services. 12 C.F.R. § 560.32(b) (2006).

<sup>9</sup> 12 C.F.R. § 560.30(c) (2006).

<sup>10</sup> *Id.*

<sup>11</sup> OTS regulations do, however, specifically permit service corporations of federal savings associations to conduct activities on behalf of a customer on an other than "as principal" basis. 12 C.F.R. § 559.4(i) (2006). This includes performing insurance brokerage or agency for liability, casualty, automobile, life, health, accident and title insurance. *See* 69 Fed. Reg. 68239, 68243 n.28 (November 24, 2004) (interim final rule preamble discussion explaining that insurance brokerage or agency activities referenced in former OTS service corporation regulation § 559.4(f)(3) are subsumed within the category of conducting activities on an other than as principal basis).

types of insurance and insurance-related activities has been addressed, however, on numerous occasions in response to specific inquiries. OTS has determined that the authority to make loans granted by sections 5(c)(1)(B) and 5(c)(2)(D) of the HOLA<sup>12</sup> includes the authority to underwrite or reinsure credit insurance for loans made by a federal savings association or its subsidiaries.<sup>13</sup> OTS also has concluded that federal savings associations possess incidental power to (1) sell, on an agency basis, credit insurance, including credit life, disability, unemployment, and single interest property insurance, for loans made by a federal savings association, its operating subsidiary, or its affiliate;<sup>14</sup> (2) sell fixed-rate annuities on an agency basis;<sup>15</sup> and (3) participate in group mortgage guaranty reinsurance programs.<sup>16</sup>

OTS considers four factors when determining whether authority for an activity exists pursuant to the incidental powers doctrine: (1) is the activity consistent with the purpose and function Congress envisioned for federal savings associations; (2) is the activity similar to, or does it facilitate the conduct of an expressly authorized activity; (3) does the activity relate to the financial intermediary role federal savings associations were intended to play; and (4) is the activity necessary to enable federal savings associations to remain competitive in the modern economy?<sup>17</sup> An analysis of insurance sales as agent under these four factors leads us to conclude that federal savings associations have incidental authority to sell, as agent or broker, title insurance as well as other insurance products.

*1. Is the activity consistent with the purpose and function Congress envisioned for federal savings associations?*

In section 5(a) of the HOLA, one of the statutory missions Congress gave federal savings associations is to extend credit.<sup>18</sup> We have observed that underwriting and reinsuring credit insurance furthers the statutory mission Congress assigned to federal savings associations to extend credit, and that credit insurance protects both the borrower and the lender.<sup>19</sup> In a

<sup>12</sup> 12 U.S.C.A. §§ 1464(c)(1)(B) and (c)(2)(D) (West 2001).

<sup>13</sup> OTS Op. Chief Counsel (January 10, 1995). The incidental powers doctrine provided an alternative basis for the conclusion that federal savings associations have authority to underwrite or reinsure credit insurance. For safety and soundness reasons, OTS deemed it advisable that such activities be conducted in the thrift's operating subsidiary.

<sup>14</sup> See OTS Op. Chief Counsel (October 17, 1994) (credit life and disability insurance) and OTS Op. Chief Counsel (February 12, 1996) (credit-related unemployment and single interest property insurance).

<sup>15</sup> OTS Op. Chief Counsel (October 17, 1994).

<sup>16</sup> See OTS Op. Chief Counsel (May 13, 2004) and OTS Op. Chief Counsel (March 11, 1999).

<sup>17</sup> For a fuller discussion of the incidental powers doctrine, see OTS Op. Chief Counsel (March 25, 1994).

<sup>18</sup> 12 U.S.C.A. § 1464(a) authorizes the OTS Director, "[i]n order to provide thrift institutions for the deposit of funds and for the extension of credit for homes and other goods and services," to provide for the organization, incorporation, examination, operation, and regulation of federal savings associations.

<sup>19</sup> OTS Op. Chief Counsel (January 10, 1995) at 6.

mortgage loan transaction, title insurance provides a means of protecting the lender, the borrower, and the collateral, thereby furthering the statutory lending mission.

Furthermore, Congress has consistently expanded the powers of federal savings associations over the years to include activities and services that the public has come to expect to be offered by financial service providers.<sup>20</sup> In so doing, Congress has endorsed the notion, and has demonstrated its intent, that modern thrifts should serve as consumer oriented financial intermediaries that can meet all of the financial needs of consumers.<sup>21</sup> Selling title insurance on an agency basis is entirely consistent with this purpose.

Title insurance is an important aspect of what may be one of the most significant financial transactions for a consumer – obtaining a loan to purchase a home or real property and providing protection for the collateral securing the loan. The ability of borrowers to apply for title insurance at the time they apply for a mortgage loan or as part of the loan application or approval process, and with the same entity that is making the loan, would also strengthen the role of federal savings associations. Insurance frequently is integral to a loan transaction. This is true not only of credit insurance, but also of other insurance that often may be required as a condition of a loan, *e.g.*, title insurance, private mortgage insurance, and property or homeowners insurance for a mortgage loan, or automobile insurance for a motor vehicle loan.

The fact that Congress directed the Federal banking agencies to issue insurance consumer protection regulations for retail sales of insurance products by depository institutions is further evidence of the intended purpose of federal savings associations.<sup>22</sup> In response to the congressional mandate, OTS promulgated such regulations.<sup>23</sup> Selling, as agent or broker, insurance products generally, and title insurance in particular, is thus consistent with and complementary to the purpose and function Congress envisioned for federal savings associations.

*2. Is the activity similar to, or does it facilitate the conduct of, an activity expressly authorized by Congress?*

Engaging in title insurance sales facilitates lending activities that Congress expressly authorized in the HOLA<sup>24</sup> by increasing the availability of such insurance to borrowers.

<sup>20</sup> See discussion of amendments to the HOLA in OTS Op. Acting Chief Counsel (March 25, 1994) and OTS Op. Acting Chief Counsel (October 17, 1994).

<sup>21</sup> See *e.g.*, S. Rep. No. 96-368, 96<sup>th</sup> Cong., 1<sup>st</sup> Sess. 13 (1979), reprinted in U.S. Code Congressional and Administrative News 236, 248 (new powers granted to thrifts to enable them to become “one-stop family financial centers”).

<sup>22</sup> GLBA § 305, 12 U.S.C.A. § 1831x (West 2001).

<sup>23</sup> See 12 C.F.R. Part 536 (2006) (Consumer Protection in Sales of Insurance).

<sup>24</sup> See generally, HOLA § 5(c), 12 U.S.C.A. § 1464(c) (West 2001 & Supp. 2005). In particular, § 5(c)(1)(B) authorizes federal savings associations to “invest in, sell or otherwise deal in . . . loans on the security of liens upon residential real property,” § 5(c)(1)(J) authorizes federal savings associations to make loans “to repair, equip, alter, or improve any residential real property,” and §5(c)(2)(B) authorizes nonresidential real property loans.

Insurance mitigates potential risks associated with lending. When evaluating whether to originate a loan, a lender considers a variety of risks that can affect repayment, including the risk that a borrower may die or become disabled, the costs and complexities of repossessing and reselling property, the costs of pursuing a deficiency claim against a borrower's estate, and the costs of protecting collateral. Title insurance and other insurance products such as property insurance and auto insurance advance expressly authorized lending by mitigating risks and protecting loan collateral. Credit insurance can mitigate repayment risks. Private mortgage insurance can mitigate similar risks, while enhancing the attractiveness of low down payment mortgages to lenders, borrowers, and investors. When selling insurance as agent or broker, a federal savings association generally would not be taking a risk with respect to the insurance policy, and there would be little or no change to an association's risk profile.

An adverse claim on the title to collateral securing a loan may impair the value of the collateral and affect a borrower's willingness to repay a loan, as well as the transferability of the collateral. OTS has observed that "[t]itle insurance is a product that seeks to eliminate the risk of loss before the transaction by identifying any liens or judgments that would prohibit the transfer of a clear title. This differs from other types of insurance that reimburse for incurring a loss."<sup>25</sup> Title insurance protects against the risk of degradation and impairment to the value of the collateral by, for example, prior encumbrances on the property, and thereby increases the lender's level of security. The sale of title insurance therefore facilitates expressly authorized mortgage lending.

3. *Does the activity relate to the financial intermediary role that all federal savings associations were intended to play?*

OTS has previously addressed the funds intermediation role that the sale of credit insurance serves.<sup>26</sup> Like credit insurance, the sale of title insurance involves funds intermediation; in exchange for use of the purchaser's funds, the issuer of a title insurance policy promises to pay the purchaser upon the occurrence of certain contingencies. The transaction involves the movement of funds from one point to another.<sup>27</sup> Engaging in title insurance sales is another way savings associations can act as financial intermediaries for consumers and help them execute basic financial transactions. This is consistent with Congress's intention that savings associations be family financial centers.

4. *Is the activity necessary to enable federal savings associations to remain relevant and competitive in the modern economy?*

When assessing whether an activity falls within the scope of incidental powers, OTS considers whether federal savings associations need to be able to engage in the activity to keep

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<sup>25</sup> OTS Holding Companies Handbook, § 930A.5 (January 2003).

<sup>26</sup> OTS Op. Chief Counsel (October 17, 1994) at 8-10.

<sup>27</sup> *Id.* See also, OTS Op. Chief Counsel (January 10, 1995).

pace with changes in the modern economy and to compete with other financial service providers. In other words, is the activity one that consumers have come to expect financial institutions to perform as a matter of convenience?

The modern consumer expects to be able to effectuate a wide variety of financial transactions at depository and other financial institutions. To remain competitive, federal savings associations therefore need to be able to offer a range of financial products, including insurance products, in addition to traditional deposit and lending products. That ability is not only a matter of customer convenience, but it is also critical to ensuring that federal savings associations remain relevant in a modern economy where other financial service providers can serve the needs of customers who expect “one stop” shopping. Several years ago, a news report noted that more than half of the banks in this country were selling some type of insurance.<sup>28</sup> With respect to title insurance, you indicate that the law of Kentucky, the state where the Association has its home office, permits Kentucky-chartered banks and their subsidiaries to sell insurance.<sup>29</sup> Thus, if federal savings associations are not permitted to sell title insurance, they will be at a competitive disadvantage in relation to Kentucky-chartered banks.

You also indicate that members of Title Agency include national banks. Section 303 of GLBA generally prohibits national banks from underwriting or selling title insurance, with two exceptions.<sup>30</sup> First, in a state where state-chartered banks are authorized to sell title insurance as agent, a national bank may sell title insurance as agent in such state in the same manner, to the same extent, and under the same restrictions as such state banks.<sup>31</sup> Second, subject to certain exceptions, a national bank may conduct title insurance activities that it was actively and lawfully conducting before GLBA was enacted.<sup>32</sup> Since it appears that Kentucky-chartered banks can sell title insurance, national banks also would be able to sell title insurance in Kentucky. Thus, both Kentucky-chartered banks and national banks may sell title insurance as agent in Kentucky, the state where the Association’s home office is located, and the Association would be at an even greater disadvantage if it cannot sell title insurance. To avoid losing competitive position to Kentucky-chartered banks and national banks doing business in Kentucky, federal savings associations need to be able to engage in the sale of title insurance as agent.<sup>33</sup>

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<sup>28</sup> See David Reich-Hale, *It’s a Majority: 52% of Banks are Selling Insurance*, American Banker.Online, April 30, 2003.

<sup>29</sup> We note that the provision of Kentucky law you cite, Section 287.030, Kentucky Revised Statutes, does not explicitly refer to title insurance; rather, it contains broad authorizing language that “Kentucky chartered banks, or their subsidiaries, are specifically authorized to engage in the sale of insurance.” § 287.030(4).

<sup>30</sup> 15 U.S.C.A. § 6713(a) (West Supp. 2005).

<sup>31</sup> 15 U.S.C.A. § 6713(b) (West Supp. 2005).

<sup>32</sup> 15 U.S.C.A. § 6713(c) (West Supp. 2005).

<sup>33</sup> We note that GLBA § 303(e) provides that if a state law that was in effect before GLBA’s enactment wholly prohibits title insurance from being offered, provided, or sold in the state by any person or entity, or from being underwritten with respect to real property in the state, then such state law would control. 15 U.S.C.A. § 6713(e).

Accordingly, we conclude that federal savings associations possess incidental authority to engage, as agent, in the sale of title insurance.<sup>34</sup> Other federal savings associations that intend to sell title insurance on an agency basis should first consult with their regional office to address any safety and soundness concerns that may be associated with the particular institution in conducting the activity.

### **B. Authority to Make a Pass-Through Investment in Title Agency**

The next question is whether the Association's proposed pass-through investment in Title Agency meets the five conditions in OTS regulation § 560.32(b) for making a pass-through investment without prior notice to the OTS, and if not, whether there are any supervisory, legal, or safety and soundness concerns with the proposed investment. Based on the information you have provided, it appears that Association meets each of the five conditions. First, the amount of the Association's proposed investment in Title Agency is less than 15% of the Association's total capital. Second, the book value of the Association's aggregate pass-through investments after making the investment in Title Agency will not exceed 50% of the Association's total capital. Third, the Association's investment in Title Agency would not give the Association direct or indirect control of Title Agency because the amount of Association's proposed investment will represent less than a 10% interest in Title Agency,<sup>35</sup> and the Association would be merely one of several Class B Members. Fourth and fifth, the Association's liability would be limited to the amount of its investment in Title Agency, which is a limited liability company.<sup>36</sup>

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<sup>34</sup> This conclusion is consistent with the positions we have taken previously with respect to federal savings associations selling, as agent, specific types of insurance products. See page 4 and footnotes 12 – 15, *infra*. Moreover, for many of the same reasons discussed herein, we believe that incidental authority exists for federal savings associations to sell, as agent, an even broader range of insurance products than we have specifically been asked to address to date.

Because the Association in this matter is seeking merely to make an investment in a title insurance agency, we need not address the requirements that would apply to insurance sales directly by the Association, such as compliance with state insurance laws. See GLBA, §§ 104 and 301. We do note that OTS has consistently indicated that federal savings associations engaging in insurance activities must comply with applicable state insurance laws, including state licensing laws. See *e.g.*, OTS Op. Chief Counsel (January 10, 1995); OTS Op. Chief Counsel (February 12, 1996); and OTS Mem. Dep. Chief Counsel (October 17, 1994).

<sup>35</sup> In other contexts, such as acquisition of control of a savings association, OTS deems control as ranging from owning or holding more than 25% of any class of voting stock (conclusive control) to owning or holding more than 10% of any class of voting stock (rebuttable control). See 12 C.F.R. § 574.4 (2006). See also, 12 C.F.R. § 561.14 (controlling person of a savings association owns or holds 10% or more of the voting shares); § 563e.12(a) (OTS community reinvestment regulations adopt definition of control in 12 U.S.C. 1841(a)(2) for bank holding companies, which references ownership or control of 25% or more of any class of voting shares); and § 583.7 (under OTS holding company regulations, control means owning or holding more than 25% of the voting shares).

<sup>36</sup> You indicate that under the Kentucky Limited Liability Act, K.S.R. 275.150(1), no member of a limited liability company is personally liable by reason of being a member, for a debt, obligation, or liability of the company, or for any act or omission of any other member, manager, or employee of the company.



We conclude, therefore, that because federal savings associations have incidental authority to sell title insurance as agent, the Association may make the proposed pass-through investment in Title Agency. Before making such investment, the Association should satisfy itself that Title Agency is in compliance with all applicable state insurance and other laws, including state insurance licensing laws. In addition, in the event Title Agency begins to engage in activities that are not permissible for a federal savings association to conduct directly, the Association may be required to terminate its investment in Title Agency within a reasonable period of time, as determined by the OTS Southeast Regional office.

In reaching the foregoing conclusions, we have relied upon the factual information, representations, and documentation you have provided to us. Our conclusions depend upon the accuracy and completeness of such information, representations, and documentation, and any material differences may result in different conclusions. If you have questions regarding this matter, please contact Vicki Hawkins-Jones, Special Counsel, at (202) 906-7034.

Sincerely,

/s/

John E. Bowman  
Chief Counsel

cc: Regional Directors  
Regional Counsel