

INTERPRETIVE LETTER 94-023 (OCTOBER 19, 1994)

State bank may not purchase and hold a vacation home for the use of senior executive officers in a non-qualified employee benefit trust.

This is in response to your letters asking the Commissioner of Banks and Trust Companies ("Commissioner" or "Agency") whether your client the* ("Bank"), an Illinois state bank, may adopt a Senior Executive Officer Benefit Plan ("Plan") that provides the use of a vacation home located in * for certain senior officers of the Bank. For the reasons set forth in this letter, we conclude that ownership of a vacation home is not permitted by the Illinois Banking Act ("Act").

The Plan

On *, the Bank purchased a single family dwelling in * ("Vacation Home") for \$* and has spent, or intends to spend, approximately \$* for repairs and decorating.

Afterwards, the Bank sought permission from the Federal Deposit Insurance Corporation ("FDIC") to use the Vacation Home as part of a senior executive officer benefit plan so that the four members of the executive committee of the Bank and their families would be given the use of the Vacation Home as additional compensation or a bonus. The use of the Vacation Home by each executive would be deemed additional taxable compensation for the time they used the home based on an estimated fair rental value of approximately \$5,000 per month and would be reported on a Form 1099 filed with the IRS. Legal title to the Vacation Home would be held in a land trust in the trust department of the Bank and a non-qualified employee benefit trust ("Trust") would administer the use of the Vacation Home and pay for maintenance. None of the expenses attributed to maintaining the Vacation Home would be tax deductible to the Bank and the Trust would not be a "qualified" employee benefit trust under the federal Employee Retirement Income Security Act ("ERISA") because use of the Vacation Home would only be for these top four executives. The Trust's provisions permit the Bank to terminate the Trust at any time and upon termination, the Trustee would sell Vacation Home and remit the proceeds back to the Bank. The Bank's interest in the Vacation Home would be listed on its books as an "other asset."

After the Bank submitted its question to the FDIC, the FDIC contacted the Agency to determine whether Illinois law permits the Bank to own a Vacation Home. After the FDIC inquiry, the Bank then submitted its own inquiry to the Agency with the details of the Plan.

Bank Owned Real Property

State banks in Illinois, under the Illinois Banking Act ("Act"), are generally not permitted to own and develop real property except for bank facilities (Section 5(8) of the Act), or

real property obtained in collecting a debt (Section 5(9) of the Act). Section 5(8) permits a state bank:

To own, possess, and carry as assets all or part of the real estate necessary in or with which to do its banking business....

205 ILCS 5/5(8) (1992) (emphasis added).

The highlighted language of Section 5(8) has been interpreted to permit a state bank to own the real estate for a bank's main banking premises and branches as well as real estate used for back office functions and customer and employee parking. In each instance, the state bank is conducting its banking business in the premises of the real estate or, in the case of parking, conducts its banking business with the use of the real estate. The Bank does not intend to conduct banking business in the Vacation Home. It will be used solely for recreational purposes by the top four officers.

The Commissioner has permitted a state bank that is owned by a foreign [non-United States] corporation to purchase a residence located in the community or metropolitan area where the bank conducts its banking business to provide housing for officers of the bank who have rotating assignments to the state bank from the foreign corporation's home country. Interpretive Letter 91-33 (December 11, 1991). Similarly, the Office of the Comptroller of the Currency ("OCC") determined that national banks may purchase residences for foreign branch officers living abroad. Letter No. 263, October 13, 1983, reprinted in [1982-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) &85,427.

We have been informed that the FDIC contacted the OCC and determined that a similarly situated national bank would not be permitted to conduct the proposed activity of owning the Vacation Home. Therefore, the FDIC has required the Bank to file an application pursuant to 12 C.F.R. Part 362 for permission to own the property. Under Part 362 the FDIC reviews such applications to determine whether the activity or investment constitutes a material threat to the deposit insurance fund. However, regardless what the FDIC determines on this question, they have not and will not determine whether, as a matter of Illinois law, the Bank is permitted to hold the property.

The Bank argues that it is authorized to own the Vacation Home by the provisions of Section 5(4) of the Act, which authorizes Bank "to...appoint...officers...and fix their compensation," 205 ILCS 5/5(4) (1992), and Section 5(5) of the Act, which authorizes Bank "to adopt and operate reasonable bonus plans,...and similar incentive plans for its directors, officers and employees." Neither Section 5(4) nor Section 5(5), however, explicitly authorizes owning real estate to compensate or provide a bonus plan for bank officers. The Bank argues that ownership of the real estate is "necessary...with which to conduct its banking business..." and that it uses the real estate in performing its permitted activity of appropriately compensating its officers and providing reasonable bonus plans for them. However, the Bank has admitted that it could rent a comparable residence for a fraction of the amount that it will invest pursuant to the Plan, not including annual maintenance.

The Commissioner has permitted a state bank, pursuant to Section 5(5), to provide various bonus and incentive plans and to purchase life insurance policies to fund a deferred compensation plan even though the state bank would not have been permitted to "invest" in those policies. Interpretive Letter 90-13, (August 8, 1990). A life insurance contract is a common means to fund such plans. Ownership of a Vacation Home by a state bank, however, is so unusual that the Agency concludes that it should only be permitted if the authority to do so is clear.

The Issue and Discussion

The issue raised is whether Bank is permitted to own the Vacation Home pursuant to Section 5(8) of the Act. There is no question that the Bank is not authorized to engage in real estate investment or development other than that necessary "in or with which to do its banking business." The fact that the Bank holds the property in a trust and does not have direct legal title is not relevant and does not excuse the Bank from complying with Section 5(8).

Bank's argument that Section 5(4) and 5(5) authorizes ownership of the Vacation Home is not persuasive because the language in these Sections does not clearly permit a real estate investment in performing the activity. Further, Section 5(8) only authorizes the Bank to own real estate "in which" or "with which" to conduct its banking business. The Vacation Home is not used in conduct of the bank's business. Finally, we conclude that significant policy considerations argue that, in the absence of explicit statutory authority, the Bank should not invest in such a vacation property including: 1) the appearance of impropriety presented by an insured depository institution buying a Vacation Home thereby entwining the personal activities of the officers with real estate holdings of the Bank; 2) the potential for abuse if other banks seek permission to own vacation properties, even out of the United States; and 3) the difficulty that the Agency would have effectively supervising the Bank's ownership and appropriate use of real property in *.

Conclusion

Therefore, for the reasons set forth, the Agency concludes that the Bank may not establish the Trust to administer the senior executive officers' benefit plan and thereby purchase and hold the Vacation Home.