Comptroller of the Currency
Administrator of National Banks

Washington D.C. 20219

Interpretive Letter #852
March 1999
12 USC 24(7)

December 11, 1998

Dear [ ]:

This is in response to your letter dated November 24, 1998, requesting confirmation that [ ] ("Bank"), may permissibly invest directly in a one-half, non-controlling interest in [ ] ("*CS*"). [*CS*] will be a limited liability company that will engage in servicing credit card accounts and servicing receivables to be generated by certain "private label" programs by the Bank, the co-owners of [*CS*] and their affiliates. For the reasons set forth below, it is our opinion that this transaction is legally permissible in the manner and as described herein.

I. Background

The Bank proposes to acquire a non-controlling 50 percent equity interest [*CS*]. The remaining 50 percent equity interest in [*CS*] will be held by [ ] ("*CC*") (which will hold a 1 percent interest in [*CS*]) and [ ] ("*MR*") (which will hold a 49 percent interest in [*CS*]). Initially, the Bank will form a wholly-owned limited liability company (" ") and contribute to [ ] the Bank's private label merchant agreements and approximately 95 percent of its private label receivables. Immediately upon the establishment of [ ], the Bank will contribute all of its ownership interest in [ ] to [*CS*]. At this point, [ ] will cease to exist and the Bank will own directly a 50 percent equity interest in [*CS*].

[*CC*] will contribute to [*CS*] participation interests in a pool of private label credit card accounts under a designated private label program and 95 percent of all new receivables generated under such program during the term of the joint venture with Bank. Each party will contribute employees, office equipment, leases and other assets to [*CS*]. [*CC*] will be the manager of [*CS*] pursuant to the terms of a management and servicing agreement to be entered into by [*CS*] and [*CC*]. Under this agreement, [*CC*] will be responsible for [*CS*]'s daily operations, including management of employees, accounting and bookkeeping. [*CS*]'s

activities will include collection, account servicing, customer service, accounting and cash settlement services.

II. Discussion

A. National Bank Express and Incidental Powers (12 U.S.C. § 24(Seventh))

The Bank's plan to purchase and hold a 50 percent interest in [*CS*] raises the issue of the authority of a national bank to make a non-controlling investment in an entity. A number of recent OCC Interpretive Letters have analyzed the authority of national banks, either directly or through their subsidiaries, to own a non-controlling interest in an enterprise. These letters each concluded that the ownership of such an interest is permissible provided four standards, drawn from OCC precedents, are satisfied.[1] They are:

1. The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking;

2. The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment;

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise; and

4. The investment must be convenient and useful to the bank in carrying out its business and not a mere passive investment unrelated to *that bank's* banking business.

Based upon the facts presented, the Bank's proposal satisfies these four standards.

1. The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking.

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[1] *See, e.g.*, Interpretive Letter No. 697, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-013 (November 15, 1995); Interpretive Letter No. 732, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996). *See also* 12 C.F.R. § 5.36(b). National banks are permitted to make various types of equity investments pursuant to 12 U.S.C. § 24(Seventh) and other statutes.

Our precedents on non-controlling ownership have recognized that the enterprise in which the bank holds an interest must confine its activities to those that are part of, or incidental to, the conduct of the banking business.[2]

As discussed above, Bank has represented that [*CS*] will engage in credit card servicing. National banks have long engaged in servicing their credit card portfolios. Section 5.34(e)(2)(ii)(L) of the OCC's regulations specifically permits national banks to engage in making, purchasing, selling, servicing, or warehousing loans or other extensions of credit, or interests therein, for the subsidiary's account, or for the account of others, including credit card loans. 12 C.F.R. § 5.34(e)(2)(ii)(L) In addition, the OCC has specifically permitted national banks to hold noncontrolling equity investments in companies engaged in servicing credit card accounts as proposed here.[3] Thus, we conclude that the activities to be conducted by [*CS*] are activities that are part of, or incidental to, the business of banking.

2. The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.

The activities of the enterprise in which a national bank may invest must be part of, or incidental to, the business of banking not only at the time the bank first acquires its ownership, but for as long as the bank has an ownership interest. This standard may be met if the bank is able to exercise a veto power over the activities of the enterprise, or is able to dispose of its interest. This ensures that the bank will not become involved in impermissible activities.[4]

Bank has represented to the OCC that the Bank will divest its interest in [*CS*] should [*CS*] engage in any activities that are not permitted for national banks or entities in which national banks may invest.[5]

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[2] *See, e.g.*, Interpretive Letter No. 380, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (December 29, 1986) (since a national bank can provide options clearing services to customers it can purchase stock in a corporation providing options clearing services); Letter from Robert B. Serino, Deputy Chief Counsel (November 9, 1992) (since the operation of an ATM network is "a fundamental part of the basic business of banking," an equity investment in a corporation operating such a network is permissible).

[3] *See, e.g.*, Conditional Approval No. 269, (January 13, 1998).

[4] *See, e.g.*, Interpretive Letter No. 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 3, 1996); Interpretive Letter No. 625, *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (July 1, 1993).

[5] In addition, the agreement establishing[*CS*] requires the approval of a majority of the Board of Directors, or the unanimous consent of all members, including the Bank, in order for [*CS*] to make any significant changes to the management, structure, or activities of [*CS*]. Since one-half of the seats on the Board of Directors will be occupied by the designees of Bank, Bank will be able to prevent [*CS*] from making any significant changes to the management, structure, or activities of [*CS*].

Therefore, the second standard is satisfied.

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

a. Loss exposure from a legal standpoint

A primary concern of the OCC is that national banks should not be subjected to undue risk. Where an investing bank will not control the operations of the entity in which the bank holds an interest, it is important that the national bank's investment not expose it to unlimited liability. As a legal matter, investors in a Delaware limited liability company do not incur liability with respect to the liabilities or obligations of the limited liability company solely by reason of being a member or manager of the limited liability company. Del. Code Ann. Tit. 6, § 18-303 (Michie Cum. Supp. 1996).[6] Thus, the Bank's loss exposure for the liabilities of [*CS*] will be limited by statute and by the agreement establishing [*CS*].

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's 20-50 percent investment in a company is to report it as an unconsolidated entity under the equity method of accounting. Under this method, unless the bank has guaranteed any of the liabilities of the entity or has other financial obligations to the entity, losses are generally limited to the amount of the investment, including loans and other advances shown on the investor's books.

As proposed, Bank will have an ownership interest in [*CS*] of 50 percent. Bank will account for its investment in [*CS*] under the equity method of accounting. Thus, Bank's loss from an accounting perspective would be limited to the amount invested in [*CS*] and Bank will not have any open-ended liability for the obligations of [*CS*].

Therefore, for both legal and accounting purposes, Bank's potential loss exposure relative to [*CS*] should be limited to the amount of its investment in those entities. Since that exposure will be quantifiable and controllable, the third standard is satisfied.

4. The investment must be convenient and useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

Twelve U.S.C. § 24(Seventh) gives national banks incidental powers that are "necessary" to carry on the business of banking. "Necessary" has been judicially construed to mean "convenient or

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[6] Section 10.1 of the agreement establishing [*CS*] specifically provides that none of the members shall be personally liable for any debts, obligations or liabilities of [*CS*].

useful." *See Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972). Our precedents on bank non-controlling investments have indicated that the investment must be convenient or useful to the bank in conducting *that bank's* business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.[7]

You have represented that the formation of [*CS*] is a more efficient way for the Bank to manage certain of its "private label" credit card receivables. The issuance of credit cards is one of the Bank's core lines of business. [*CC*] is one of the largest issuer of private label credit cards in the world. By appointing [*CC*] to manage certain of its private label programs, the Bank will benefit from [*CS*]'s economies of scale and investment in systems, technology and infrastructure. The Bank's investment in [*CS*] will be convenient and useful to Bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied.

III. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, it is our opinion that Bank is legally permitted to acquire and hold a non-controlling interest in [*CS*] in the manner and as described herein, subject to the following conditions:

1. [*CS*] will engage only in activities that are part of, or incidental to, the business of banking;

2. Bank will have effective veto power over any activities and major decisions of [*CS*] that are inconsistent with condition number one, or will withdraw from [*CS*] in the event they engage in an activity that is inconsistent with condition number one;

3. Bank will account for its investment in [*CS*] under the equity method of accounting; and

4. [*CS*] will be subject to OCC supervision, regulation, and examination.

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[7] *See, e.g.*, Interpretive Letter No. 697, *supra*; Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991); Interpretive Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988); Interpretive Letter No. 380, *supra.*

These conditions are conditions imposed in writing by the OCC in connection with its action on the request for a legal opinion confirming that Bank's investment is permissible under 12 U.S.C. § 24 (Seventh) and, as such, may be enforced in proceedings under applicable law.

If you have any questions, please contact John Soboeiro, Senior Attorney, at (202) 874-5300.

Sincerely,

/s/

Julie L. Williams
Chief Counsel