Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #871
November 1999
12 USC 24(7)

October 14, 1999

Re: **[ ]**, LLC

Dear **[ ]**:

This is in response to your letter seeking confirmation that it would be lawful for **[ ]** ("Bank") to acquire a direct non-controlling investment in **[ ]** ("LLC"), a **[State]** limited liability company. Based on the information and representations provided and for the reasons set forth below, I conclude that the proposed investment is legally permissible.

Proposal

The LLC is a commercial finance company engaged in the business of making secured and unsecured loans to owners, operators and third-party landlords of franchised, licensed or branded retail businesses. The LLC is not currently engaged, but intends to engage either directly or indirectly through one or more subsidiaries (not yet established), in the activities of (a) advising its customers regarding acquisitions and dispositions of businesses, (b) assisting customers in private placements of debt and equity, and (c) acting as an investment advisor to private investment funds. (These funds would be closely held and none would be investment companies as defined in the Investment Company Act of 1940, 15 U.S.C. § 80a-1 *et seq*.)

The Bank proposes to make its investment in the LLC in four stages, as follows:

1. The Bank has an existing credit facility to the LLC. If and when the OCC confirms the permissibility of the Bank's investments in the LLC as described in your letter, the LLC will issue to the Bank, without additional consideration, membership interests in the LLC ("Interests") equal to 20 percent of the total outstanding Interests, whereupon the Bank will have the right to designate three

members of the LLC's seven-member Board of Managers. If the OCC does not confirm the permissibility of the Bank's investment in the LLC, the latter will be obligated to prepay the credit facility.

2. If the OCC confirms the permissibility the Bank's investment in the LLC, the Bank will decide on or before March 31, 2000 whether to increase the amount of its credit facility to the LLC. If the Bank decides to do so, the LLC will issue to the Bank, again without additional consideration, an additional 10 percent of the total outstanding Interests. If the Bank decides not to do so, the LLC will have the right to prepay the credit facility and repurchase the Interests previously issued to the Bank.

3. The Bank will have the option, exercisable in 2001, to purchase from the LLC an additional 20.1 percent of the total outstanding Interests ("Option"). If the Bank exercises the Option, it will then own 50.1 percent of the total outstanding Interests and will have the right to designate four members of the LLC's Board of Managers, which will then be increased to eight members.

4. The Bank's exercise of the Option will also obligate it to purchase from the other members of the LLC all of the remaining outstanding Interests, in two stages:

a. A further 29.9 percent of the total outstanding Interests in 2005, at which time the Bank will have the right to designate six members of the LLC's eight-member Board of Managers; and

b. The final 20 percent of the total outstanding Interests in 2008, at which time the Bank will designate all eight members of the Board of Managers.

Under the facts as described, the Bank will not have a controlling interest in the LLC unless and until it exercises the Option in stage 3. At the two earlier stages, the Bank will have only a minority interest. In your letter, you request only the OCC's concurrence that the acquisitions of non-controlling minority membership Interests in the LLC described in stages 1 and 2 above are legally permissible. If in the future the Bank decides that it wishes to exercise the Option to acquire a majority of the Interests in the LLC in stage 3, it will be obligated to submit an application to the OCC and obtain prior approval for such exercise under our operating subsidiary regulation at 12 C.F.R. Part 5.

Analysis

In a variety of circumstances, the OCC has permitted national banks to own, either directly, or indirectly through an operating subsidiary, a non-controlling interest in an enterprise. The

enterprise might be a limited partnership, a corporation, or a limited liability company.[1] In several interpretive letters, the OCC has concluded that national banks are legally permitted to make a non-controlling investment in a limited liability company provided that four criteria are met.[2] These standards, which have been distilled from our previous decisions in the area of permissible non-controlling investments for national banks and their subsidiaries, are:

(1) the activities of the 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 or useful to the bank in carrying out its business and not merely a passive investment unrelated to that bank's banking business.

Based upon the facts presented, the Bank's proposal to make the minority investments described in stages 1 and 2 above satisfies these four standards.

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

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 business of banking.[3]

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[1] *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.

[2] *See, e.g.*, Interpretive Letter No. 842, *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-297 (September 28, 1998); Interpretive Letter No. 737, *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-101 (August 19, 1996); Interpretive Letter No. 694, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009 (December 13, 1995); Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995). In other recent letters, the OCC has permitted national banks to make a non-controlling investment in an enterprise other than a limited liability company, provided the investment satisfies these four standards. *See, e.g.*, Interpretive Letter No. 705, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,020 (October 25, 1995); Interpretive Letter No. 697, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,012) (November 15, 1995).

[3] *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).

As described above and in your letter, the LLC's existing and proposed activities consist of (a) making loans, (b) providing financial advice to business customers regarding acquisitions or dispositions of businesses, (c) assisting customers in private placements of debt and equity, and (d) acting as an investment adviser to private investment funds. Certain of these activities may require the LLC (or its subsidiary, if one or more should subsequently be established) to register as a broker-dealer and/or investment advisor.

The LLC's existing and proposed activities are permissible ones for national banks.

(a) Lending

Lending is clearly an authorized activity under 12 U.S.C. § 24 (Seventh).

(b) Financial advice to businesses

It is well established that national banks have the power to provide financial advice and counseling to their customers as part of or incidental to the business of banking pursuant to 12 U.S.C. § 24 (Seventh). *See, e.g.*, Interpretive Letter No. 137, *reprinted in* [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,218 (December 27, 1979); Letter from Judy Walter, Senior Deputy Comptroller for National Operations (July 17, 1986) (unpublished). Such advice may include "consulting services in connection with merger and acquisition transactions." Letter from J. Michael Shepherd, Senior Deputy Comptroller for Corporate and Economic Programs (March 9, 1988) (unpublished).[4]

(c) Private placement of debt and equity

The OCC has confirmed in a number of letters that national banks are authorized to arrange private placements of debt and equity securities for their customers on an agency basis and that this activity does not constitute securities dealing or underwriting in violation of the Glass-Steagall Act, 12 U.S.C. §§ 24(Seventh), 377, 78 and 378. *See, e.g.*, Interpretive Letter No. 463, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,687 (December 27, 1988); Interpretive Letter No. 212, *reprinted in* [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,293 (July 2, 1981); Interpretive Letter No. 32, *reprinted in* [1978-1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,107 (December 9, 1977).

[4]While not discussed in your letter, it is noted that to the extent that the proposed counseling services involve bringing together potential buyers and sellers of businesses, they would also be permissible activities under Interpretive Ruling 7.1002, 12 C.F.R. § 7.1002, which allows a national bank to act as a finder. The permissibility of a national bank acting as a finder to bring together buyers and sellers of various types of products and services has been confirmed in several interpretive letters. *See, e.g.*, Interpretive Letter No. 653, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601 (December 22, 1994); Walter Letter, *supra;* Shepherd Letter, *supra*.

Further, to the extent that the activities of the LLC or any subsequently established subsidiary may involve securities brokerage services, the authority of national banks to perform such services for their customers has been confirmed both by the OCC and the federal courts. *See, e.g.*, Interpretive Letter No. 403, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,627 (December 9, 1987); Interpretive Letter No. 380, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 (December 29, 1986); *Securities Industry Association v. Comptroller of the Currency*, 577 F. Supp. 252 (D.D.C.. 1983), *aff'd.*, 758 F. 2d 739 (D.C. Cir. 1985), *cert. denied*, 474 U.S. 1054 (1986) (brokerage issue); Securities *Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 207 (1984). Moreover, the combination of investment advisory and discount brokerage services in the same national bank subsidiary has also been approved. *See, e.g.*, Interpretive Letter No. 403, *supra*.

(d) Investment advice

It is well established that national banks and their subsidiaries are authorized to provide investment advice as part of or incidental to the business of banking. *See, e.g.*, Interpretive Letter No. 622, *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,504 (April 9, 1993); Interpretive Letter No. 367, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,537 (August 19, 1986).

Accordingly, the first standard is met.

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.

Subject to the OCC's authorization of the Bank's investment in the LLC, the latter's operating agreement will be amended to add the Bank as a member of the LLC and to limit the LLC's activities to those that are part of, or incidental to, the business of banking and that are permissible activities for a national bank. In addition, the operating agreement and any other relevant documentation governing the LLC's operations will provide that the LLC will not engage in any new business activity disapproved by the managers designated by the Bank. Therefore, the Bank, while holding only a non-controlling interest in the LLC, will be able to prevent the latter from engaging in any activity that is not permissible for a national bank.

Accordingly, 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 bank's investment not expose it to unlimited liability.

As a legal matter, investors in a Delaware limited liability company will 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 company.[5] Moreover, the LLC's operating agreement will not contain any clauses making the Bank liable for any obligations of the LLC.[6] The Bank's loss exposure for the liabilities of the LLC will be limited to the amount of its investment, which will be minimal in stages 1 and 2, and the existing credit facility.

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 ownership share of investment in a limited liability company is to report it on an unconsolidated basis. Under the equity method of accounting, unless the bank has extended a loan to the entity, guaranteed any of its liabilities or has other financial obligations to the entity, losses are generally limited to the amount of the investment shown on the investor's books.[7] In this instance, as described above, the Bank has extended a credit facility to the LLC as part of its normal banking business.

During the period in which the Bank owns only a non-controlling interest in the LLC, *i.e.*, during stages 1 and 2 as described above, the Bank will account for its investment in the LLC under the equity method of accounting. The Bank's loss exposure from an accounting perspective will be limited to the amount of its investment and the credit facility. The Bank will not have any open-ended exposure to the liabilities of the LLC.

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure relative to the LLC should be limited to the total amount of its investment (expected to be minimal in stages 1 and 2) and the credit facility, which of course is subject to the regular legal lending limits of 12 U.S.C. § 84. Because the Bank will not have open-ended liability for the liabilities of the LLC and its potential exposure is 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 the bank's banking business.

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[5]*See* Del. Code Ann. Title 6, Section 18-303 (West 1996).

[6]Telephone conversation with Mr. Robert F. Darling, Vice President and Senior Counsel, Wells Fargo Law Department (September 23, at 2:00 p.m.)

[7]*See generally,* Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock). Interpretive Letter No. 692, *supra*.

A national bank's investment in an enterprise or entity that is not an operating subsidiary of the bank must also satisfy the requirement that the investment have a beneficial connection to the bank's business, *i.e.*, be convenient or useful to the investing bank's business activities, and not constitute 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 useful."[8] 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.[9]

As noted above, the Bank views its investment in the LLC as a means of entering the franchise finance and related businesses conducted by the LLC. Moreover, as part of the transaction, the LLC will agree to use the Bank's services for all of its banking needs (subject to applicable law). In addition, the LLC will give the Bank a right of first refusal to provide financing to the LLC to enable the LLC to fund loans to the latter's customers. As a result, the Bank expects to generate substantial new lending opportunities.

For these reasons, the investment is convenient and useful to the Bank in carrying out its business and is not a mere passive investment.

Accordingly, the fourth standard is satisfied.

Conclusion

Based upon the information and representations you have provided, and for the reasons discussed in this letter, I conclude that the Bank's acquisition of non-controlling minority membership Interests in the LLC as described in stages 1 and 2 above is legally permissible, subject to the following conditions:

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[8] *See Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972).

[9] *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*.

(1) the LLC will engage only in activities that are part of, or incidental to, the business of banking;

(2) the Bank will have veto power over any activities and major decisions of the LLC that are inconsistent with condition (1) above, or will withdraw from the LLC in the event it engages in an activity that is inconsistent with condition (1);

(3) the Bank will account for its investment in the LLC under the equity method of accounting; and

(4) the LLC will be subject to OCC supervision, regulation, and examination.

This letter applies only to the Bank's acquisition of non-controlling minority Interests in the LLC as described in stages 1 and 2. If in the future the Bank decides that it wishes to exercise the Option to acquire a majority of the Interests in the LLC in stage 3, it will be obligated to submit an application to the OCC and obtain prior approval for such exercise under our operating subsidiary regulation at 12 C.F.R. Part 5.

Please be advised that the conditions of this approval are deemed to be "conditions imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818, and, as such, may be enforced in proceedings under applicable law.

Sincerely,

/s/

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel