Comptroller of the Currency
Administrator of National Banks

Washington D.C. 20219

Interpretive Letter #898
December 2000
12 USC 24(7)
12 USC 24(10)

July 14, 1998

Dear **[ ]**:

This is in response to your letter dated May 7, 1998, requesting confirmation that **[ ]** ("Bank"), may lawfully acquire and hold a ten to twenty percent non-controlling equity interest in **[ ]** (" "), a holding company engaged in the origination, purchase and securitization of prime auto leases. 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 equity interest **[ ]** in exchange for providing warehouse financing for **[ ]** and thereby reducing the cost of funds for **[ ]**'s wholly-owned operating leasing subsidiary, **[ ]** ("***OpSub***"). **[ ]** conducts its origination, purchase and securitization of prime auto leases as authorized for national banks under 12 C.F.R. § 5.34(e)(2)(ii)(M). Bank will acquire an equity interest in **[ ]** in connection with a financing strategy designed to reduce **[*OpSub*]**'s cost of funds. On the closing date of the proposed warehouse financing with Bank, and as additional consideration for such financing, **[ ]** will issue to Bank a warrant to purchase preferred or common stock entitling Bank to 10 percent of **[ ]**'s common stock.[1] As long as the warehouse financing remains in place, Bank will receive additional warrants to purchase preferred or common stock entitling Bank to a maximum of an additional 10 percent of **[ ]**'s common stock, thereby raising Bank's equity interest in **[ ]** to as much as 20 percent of **[ ]**'s common stock.

[1] The **[ ]** preferred stock is immediately convertible into common stock.

Bank will lend funds on a revolving basis to a subsidiary of **[*OpSub*]** that will hold the beneficial interest in the lease assets. As payments are collected on the automobile leases, they will either be passed on to Bank to reduce outstanding balances under the revolving loans or invested in the acquisition of new leases. In addition, **[ ]** and **[*OpSub*]** will establish a titling trust in order to fasciliate the securitization of automobile lease assets. The leases in the titling trust will be securitized by identifying a discrete pool of leases and subsequently transferred to a securitization trust as collateral for a securitization. The proceeds from the issuance of trust certificates by the securitization trust will be used to repay the funds advanced by Bank.[2]

II. Discussion

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

The Bank's plan to purchase and hold up to a 20 percent interest in **[ ]** raises the issue of the authority of a national bank to make a non-controlling investment in an entity.[3] 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.[4] 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;

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[2] Bank anticipates that **[ ]**, Inc. (formerly **[ ]** Corp.), a securities subsidiary affiliate of Bank, will serve as placement agent or underwriter in the issuance of the trust certificates to institutional investors.

[3] The OCC recently amended its operating subsidiary rule, 12 C.F.R. § 5.34, as part of a general revision of Part 5 under the OCC's Regulation Review Program. Operating subsidiaries in which a national bank may invest include corporations, limited liability companies, or similar entities if the parent owns (1) more than 50 percent of the voting (or similar type of controlling) interest, or (2) less than 50% so long as the bank "controls" the subsidiary and no other party controls more than 50 percent. 12 C.F.R. § 5.34(d)(2). Here, **[ ]** will not be considered an operating subsidiary since the Bank will not "control" **[ ]**.

[4] *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.

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.

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.[5]

As discussed above, Bank has represented that **[ ]** and its subsidiaries will engage in the organization, purchase and securitization of prime auto leases as authorized for national banks by 12 C.F.R. § 5.34(e)(2)(ii)(M). See also, 12 U.S.C. §§ 24(Seventh) (lending and leasing activities) and 24(Tenth)((leasing activities); and 12 C.F.R. Part 23 (personal property leasing). The sale of such assets to a third party for the purposes of securitization is permissible for national banks under a long line of OCC precedents recognizing the authority of national banks to sell loan assets and further recognizing that the Glass Steagall Act does not restrict the means by which national banks may sell such assets.[6] Thus, we conclude that the activities to be conducted by **[ ]** 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.

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[5] *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).

[6] *See, e.g.*, OCC Interpretive Letter No. 585, *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83-406 (June 8, 1992) (automobile loan receivables); Interpretive Letter No. 416, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85-640 (February 16, 1988) (leases and motor vehicle installment sales contracts).

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.[7]

Bank will have the ability to prevent **[ ]** and its subsidiaries from engaging in impermissible activities consistent with prior OCC interpretive letters. The bylaws of **[ ]** will be amended to provide that **[ ]** and its subsidiaries shall only engage in activities that are permissible for national banks and that Bank shall have the right to veto any proposed activities that are not permissible for national banks. In addition, the bylaws of **[ ]** also will be amended to provide that the business and operations of **[ ]** and its subsidiaries will be subject to the regulation, supervision and examination of the OCC.

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, Bank's losses will be limited by statute. Under Delaware law, the corporate structure of **[ ]** will protect Bank from potentially unlimited exposure. Del. Code Ann. tit. 8, §§ 101 to 398. Thus, the Bank's loss exposure for the liabilities of **[ ]** and its subsidiaries will be limited by statute.

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 minority 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

[7] *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).

are generally limited to the amount of the investment, including loans and other advances shown on the investor's books.[8]

As proposed, Bank will have an ownership interest in **[ ]** from between 10 and 20 percent. Bank will account for its investment in **[ ]** under the equity method of accounting. Thus, Bank's loss from an accounting perspective would be limited to the amount invested in **[ ]** and Bank will not have any open-ended liability for the obligations of **[ ]** or its subsidiaries.

Therefore, for both legal and accounting purposes, Bank's potential loss exposure relative to **[ ]** and its subsidiaries 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 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.[9]

[ ] is an established automobile lending and leasing company. By expanding its role in the automobile lending and leasing industry Bank will be able to gain valuable experience and expertise through **[ ]**, and leverage that experience and expertise for Bank's own benefit and that of its customers. For these reasons, Bank's investment in the LLC is convenient and useful to Bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied.

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[8] *See generally*, Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock). Interpretive Letter No. 692 (November 1, 1995), reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-007.

[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.*

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 **[ ]** in the manner and as described herein, subject to the following conditions:

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

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

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

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

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,

-signed-

Raymond Natter
Acting Chief Counsel