



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #578

February 27, 2003

March 2003

Phillip A. Wertz, Esq.
Assistant General Counsel
Bank of America, N.A.
101 South Tryon Street
Charlotte, NC 28255

Re: Application by Bank of America, N.A., Charlotte, North Carolina, for its wholly-owned operating subsidiary to hold special equity interests in connection with investment management activities
Application Control Number: 2002-ML-08-0029

Dear Mr. Wertz:

This responds to the application filed by Bank of America, National Association, Charlotte, North Carolina (the "Bank"), requesting approval for its wholly-owned operating subsidiary, Banc of America Capital Management, LLC ("BACAP"), to hold for limited periods of time limited interests in certain private investment funds for which it serves as investment manager. The Bank indicates that holding such limited interests is convenient and useful in order for BACAP to conduct its investment management business. Based upon the representations and commitments made by the Bank, the application is approved subject to the conditions described herein.

A. Background

The Bank is a national bank. BACAP is registered as an investment advisor under the Investment Advisers Act of 1940.¹ BACAP serves as an investment manager and advisor for a number of investment funds organized in the United States (the "Funds").² The Funds invest in a

¹ 15 U.S.C. §§ 80b-1 - 80b-21.

² BACAP also serves as investment manager for a number of private investment funds organized outside the United States. This letter does not address the permissibility of the Bank's activities with respect to the foreign funds.

variety of financial instruments, including stocks and bonds, currencies, other private investment funds and commodities. The Funds invest in cash instruments and engage in over-the-counter and exchange-traded derivatives. The Funds also take both short and long positions in securities. The Funds may invest in securities and other financial assets in which a national bank ordinarily is not permitted directly to invest.³ Certain of the Funds are organized as limited partnerships and others are organized as limited liability companies. All of the Funds are taxed as partnerships. Consistent with this tax treatment, all the losses, gains, fees, and expenses are passed through from the Funds to their respective investors.

The Funds' investors are primarily high net worth individuals. The Funds are marketed primarily by broker-dealers that are affiliates of the Bank and through the private banking unit of the Bank. These affiliated broker-dealers are registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934.⁴ As investment manager, BACAP may receive both a management fee and a fee for performance for each of the Funds. The management fee is a percentage of the assets of each Fund. The fee for performance is a percentage of the profits of each Fund above a certain hurdle rate.

The Bank represents that it would be to the advantage of U.S. investors in the Funds if BACAP's compensation for performance were paid as a share of profits, rather than as a fee. To receive a share of the profits, BACAP would need to hold an interest in the Funds. In the case of Funds organized as limited partnerships, BACAP would become a special limited partner. As a special limited partner, BACAP would not participate in all of the gains and losses of the partnership, but only in the gains equal to the performance fee to which BACAP is entitled as investment manager. In the case of Funds organized as limited liability companies, BACAP would be a special member of those companies, with the same types of rights it would have in the limited partnerships. We refer to BACAP's special limited partner and special member interests in the Funds as "Special Interests."

Performance compensation can be a substantial percentage of the Funds' respective returns. The Bank represents that individual investors, trusts, and investors taxed as partnerships that in turn have individual or trust investors, prefer that investment funds structure performance compensation as an allocation to the investment manager's equity account rather than as a fee. Under U.S. tax law, individual investors must report as income their proportionate share of the gross amount of an investment fund's income and gains *before* deducting investment-related fees and expenses paid by the investment fund. The limit placed by the U.S. tax laws on the deductibility of these fees and expenses may preclude high-income individuals from deducting their full proportionate share of the fees and expenses of the investment funds. The Bank represents that if the investment manager is paid in the form of a profit allocation, rather than through a performance fee, the amount so paid is not treated as income to investors who are not recipients of the allocation.

³ BACAP plans to invest only in funds that invest primarily in securities. Any non-securities investments will be limited to financial investments, and will not include real estate or tangible personal property.

⁴ 15 U.S.C. § 78b, *et seq.*

For these reasons, the Bank represents that it is an industry practice for investment advisors and managers of certain types of investment funds to receive performance-related compensation as a profit allocation. The OCC has previously recognized this industry practice with respect to similar private investment funds.⁵ The similar funds are structured to provide payments for advisory services as fund allocations rather than as fees to maximize tax efficiency for investors. Because other investment managers follow industry practice in structuring performance compensation as an equity interest, the Bank has found that the limitation on deductibility of the Funds' performance fees as currently structured (rather than the proposed performance-based equity allocation to BACAP as investment manager) is having a significant adverse effect on BACAP's ability to compete for this type of advisory business.⁶ The Bank represents that if BACAP is not able to structure its performance-based compensation using an allocation of income and gains to its equity account, the Funds would be significantly disadvantaged in competing for investors' business.

BACAP's ownership interest in the Funds would be limited. BACAP does not propose to make any out-of-pocket investments in the Funds and will hold a Special Interest in certain Funds only to enable it to receive its performance-based compensation in the form of a profit allocation as described above. The Bank has represented that under the terms of the instruments governing the Funds and creating the Special Interests, BACAP will not participate in any losses suffered by the Funds. BACAP will account for its Special Interest in the Funds under the equity method of accounting. BACAP's loss exposure from an accounting perspective will be limited to the amount of profit allocation it expects to receive as compensation. The Special Interest would not entitle BACAP to voting rights. The Bank represents that BACAP will receive a Special Interest in a Fund only while BACAP provides investment management services to the Fund. BACAP will withdraw all profit allocations immediately.⁷

BACAP will receive a Special Interest in a Fund for which it serves as investment manager only to the extent it is necessary to attract investors into the Fund. BACAP will hold Special Interests only in investment funds that hold securities and financial instruments, and will not invest in any fund that includes real estate or tangible personal property. BACAP will hold a Special Interest in a Fund containing bank-ineligible investments only while it serves as an investment manager to the Fund, and only if the terms of the instruments governing the Fund allow BACAP to sell, redeem or otherwise dispose of its equity allocation if it no longer services the Fund.

⁵ See Interpretive Letter No. 940 (May 24, 2002), *reprinted in* [2001-2002 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,465 ("Interpretive Letter 940").

⁶ The Bank has furnished information showing registered funds offered by major competitors follow this industry practice in structuring performance compensation as an equity interest.

⁷ The Bank has indicated that BACAP will have a standing request for redemption of all equity allocations from each Fund. BACAP will receive the redemption proceeds on the same business day that a Fund determines the final amount of each allocation. Because BACAP will in effect withdraw all profit allocations immediately, the amount of BACAP's interest in any Fund as a practical matter would, consistent with Interpretive Letter No. 897, *supra*, never exceed 24.99 percent of the total equity of any fund.

B. Analysis

Section 5.34(e) of the OCC's operating subsidiary regulation provides that "a national may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking, as determined by the OCC, or otherwise under other statutory authority."⁸ The OCC has long held that a national bank may provide investment management services as part of the business of banking authorized under 12 U.S.C. § 24(Seventh) and pursuant to their fiduciary powers under 12 U.S.C. § 92a.⁹ BACAP currently engages in the authorized activities of acting as an investment advisor to investment companies and receiving compensation for such services. Holding the Special Interests is an alternative means to receive payment of incentive compensation for advisory services, and is therefore incidental to permissible investment advisory activities.

The authority of a national bank to hold Special Interests in advised funds, subject to certain conditions, was recently confirmed by the OCC in Interpretive Letter No. 940. In that letter, the OCC permitted a national bank to own similar special interests in investment funds the bank managed, reasoning that such ownership is directly related to, and an integral part of, the bank's activity of providing bank-permissible investment management and administrative services to certain private investment funds.¹⁰ The purpose of holding the Special Interests was to enable the bank to act as an investment manager to the types of investment funds in which this form of ownership by the investment manager is convenient and useful—indeed necessary. The Special Interests in the investment funds were not to be passive or speculative investments on the bank's part. The investments were made solely to enable the bank to provide investment management services as conducted by its competitors in the investment management industry. The OCC found that, as a practical matter, in order to offer the funds it manages, the bank must structure its compensation to hold the investments in this limited manner. Among other conditions, the OCC required that the Special Interests may be held under these circumstances only when, and for so long as, the bank is providing investment management services.

In the instant proposal, consistent with the OCC's determination in Interpretive Letter No. 940, BACAP's ownership of the Special Interests in the Funds it advises will be restricted to a context where the holding is integral to facilitating a recognized bank-permissible activity and therefore such holdings are permissible as an incident to the bank-permissible investment management

⁸ 12 C.F.R. § 5.34(e)(1).

⁹ See, e.g., Interpretive Letter No. 897 (October 23, 2000) *reprinted in* [2000-2001 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-416; Interpretive Letter No. 851 (December 8, 1999) *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,308; Interpretive Letter No. 871 (October 14, 1999) *reprinted in* [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,365; Conditional Approval Letter No. 164 (December 9, 1994); Interpretive Letter No. 648 (May 4, 1994) *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557; Interpretive Letter No. 647 (April 15, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,558; Interpretive Letter No. 622 (April 9, 1993) *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557; and Interpretive Letter No. 403 (December 9, 1987), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,627.

¹⁰ The OCC also concluded that holding the Special Interests is not prohibited by 12 U.S.C. § 24(Seventh).

activities. BACAP's receiving the Special Interests enables it to engage in permissible banking activities and act as investment manager for investment funds that, in practice, require the manager to take an equity interest. Institutional and sophisticated individual investors in these funds require the manager to structure the payment of performance fees in this fashion. In this connection, these investments permit BACAP to offer funds that provide investors with a tax treatment comparable to that of investors in other, similar funds. BACAP would be unable to offer these funds on a competitive basis unless it makes these investments. Based on these circumstances, the proposed investments are an integral component of investment management services provided by BACAP to the investment funds.

C. Conclusion

Based upon a review of the information you provided, including the representations and commitments made in your letter, and for the reasons discussed above, we conclude that BACAP may receive the Special Interests in the Funds, subject to the following conditions:

- (1) The Funds shall constitute "affiliates" of BACAP and the Bank for purposes of Sections 23A and 23B of the Federal Reserve Act.
- (2) Prior to BACAP receiving the Special Interest in the Funds, the Bank shall adopt and implement an appropriate risk management process, acceptable to the OCC Examiner-in-Charge, to monitor these interests. The risk management process shall be comprehensive and shall include:
 - (i) Adoption and implementation of a conflict of interest policy addressing all inherent conflicts associated with BACAP's holding of the Special Interests in the Funds; and
 - (ii) Adoption and implementation of risk management policies and procedures for monitoring the Special Interests in the Funds and the risks associated with those interests, taking into account relevant factors noted in OCC guidance (e.g., OCC Banking Circular 277 (BC-277 - October 1993), Supplemental Guidance 1 to BC-277 (January 1999) and the Handbook for National Bank Examiners, Risk Management of Financial Derivatives (January 1997)).

The Bank shall provide the OCC with copies of the policies and procedures described in (i) and (ii) prior to BACAP receiving a Special Interest in the Funds.

- (3) The Bank, through BACAP, shall not receive Special Interests in the Funds other than Funds that invest in securities and financial instruments, and shall not invest in any Fund that holds real estate or tangible personal property.
- (4) The Bank shall make reports and other information readily available to OCC supervisory staff as necessary for the OCC to determine compliance with these conditions.

(5) The Bank shall account for BACAP's Special Interests in the Funds under the equity method of accounting.

(6) The Bank, through BACAP, shall hold Special Interests in a Fund only when, and only for so long as, BACAP is providing investment management services to the Fund.

Please be advised that the above conditions of this approval shall be 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(b)(1).

This approval, and the activities and communications by OCC employees in connection with the filing, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, United States, any agency or entity of the United States, or any officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory and examination authorities under applicable laws and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

Sincerely,

/s/ Julie L. Williams

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel